DEPOSITORY TRUST COMPANY AND THE OMNIBUS PROXY: SHAREHOLDER VOTING IN THE ERA OF SHARE IMMOBILIZATION

I. INTRODUCTION

Both corporate law and securities law have long wrangled over the ownership interests and rights associated with equity interests in corporations, otherwise known as stock. While people typically think of a shareholder as the investor who actually pays to purchase stock, that is—legally speaking—a false impression. This problem stems from the fact that stock ownership carries with it numerous intangible interests of different natures; natures which may conflict with each other in different policy contexts. These various interests are simultaneously governed by corporate law—which regulates the management of corporations and the relationships between a corporation and its shareholders—and securities law—which regulates the clearance and settlement of securities transactions in the marketplace. Because stocks are traded as securities, they are governed by both sets of laws. However, corporate law and securities law are concerned with fundamentally different property interests inherent in shares, which have historically been inseparable.[1]

1. *See infra* Part III.

As capital markets evolved, the corporate structure itself evolved along with them. However, laws governing corporations and securities consistently struggled to keep up.[2] When the law tried to adapt, the attempts frequently resulted in the mistaken application of concepts that no longer fit the realities of the marketplace.[3] All too frequently these changes were piecemeal, focused on only one aspect of the law with no regard to the implications such changes would have on the rest of the legal structure.[4] These changes inevitably resulted in unintended consequences that required their own solutions.[5] In response to evolutions in the market, securities laws generally changed to encourage the further growth of securities trading.[6] However, such changes sometimes came at the expense of important corporate law concerns.[7]

That is exactly what happened following a paperwork crisis that struck New York in the last century.[8] By the late 1960s, the growth in trading volume on stock exchanges had made the transfer of physical certificates, and the required accompanying paperwork, unworkable.[9] Banks and brokerage firms failed en masse, as they were unable to clear the growing volume of transactions.[10] In an attempt to process all of the paperwork, the New York Stock Exchange (NYSE) was forced to close early every day, and eventually forced to close an extra day every week.[11]

Congress responded by working out a shortcut to immobilize shares in depositories and cut the substantial paperwork out of transactions with book-entry transfers.[12] However, state corporate laws failed to adapt to this new reality.[13] Consequently, the immobilization of shares severed the relationship between a corporation and its shareholders and created a

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2. *See infra* Part II.A.

3. *See, e.g.*, Jeanne L. Schroeder, *Is Article 8 Finally Ready This Time? The Radical Reform of Secured Lending on Wall Street*, 1994 COLUM. BUS. L. REV. 291, 303–08 (1994) (discussing how problematic it has been applying the physical metaphor of holding property to securities trading in modern practice).

4. *See id.* at 311–12 ("[T]he drafters [of the 1977 Amendments] thought they could change the conveyancing regime merely by changing the form of the evidentiary token. They did not stop and reexamine the other presumptions underlying the statutory schema.").

5. David C. Donald, *Heart of Darkness: The Problem at the Core of the U.S. Proxy System and its Solution*, 6 VA. L. & BUS. REV. 41, 62 (2011).

6. *See, e.g.*, Bryn R. Vaaler, *Revised Article 8 of the Mississippi UCC: Dealing Directly with Indirect Holding*, 66 MISS. L.J. 249, 254–60 (1996).

7. *See* Donald, *supra* note 5, at 59.

8. *See id.* at 50.

9. *See id.* at 50–54.

10. *Id.* at 53.

11. *Id.* at 52.

12. *Id.* at 54.

13. *See infra* Part III.A.

fundamental gap between federal and state corporate laws regarding who actually owns stock.[14]

In the modern indirect holding system, there are two types of shareholders: beneficial owners and record owners. Beneficial owners are the actual investors who purchase shares and have a financial stake in a corporation, while record owners are the parties that are actually legally recognized as shareholders.[15] Share transfers today occur through book-entry transactions at a central depository that do not require registering transfers with issuing corporations, and the depository is registered on the issuing corporation's books for all the shares held in the depository.[16] Federal law recognizes this modern indirect holding system, and the Securities and Exchange Commission (SEC) has promulgated rules to encourage the involvement of beneficial owners.[17] However, these rules are inefficient, confusing, and often serve to compound the problems they attempt to solve.[18]

State law has failed to adapt to the modern indirect holding system and the realities of the securities industry.[19] Unlike federal corporate law, which recognizes beneficial owners and attempts to reconnect them with the corporations they own, state corporate law only recognizes parties registered with an issuing corporation as its shareholders, which today is typically the central depository that holds most of the publicly traded shares in America.[20] There is a legal gap between the issuing corporation and its beneficial owners. This gap significantly impacts the exercise of shareholder rights—most importantly voting rights—and threatens to disenfranchise shareholders and destroy the integrity of the corporate voting process.[21] Until now, this gap has been solved with an improvised bridge known as the omnibus proxy, which allows the depository to pass on voting authority through the indirect holding system to the ultimate beneficial owners.[22]

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14. *See* Donald, *supra* note 5, at 62.

15. *See id.*

16. *See infra* Part II.A.

17. *See, e.g.*, ALAN L. BELLER & JANET L. FISHER, COUNCIL OF INSTITUTIONAL INVESTORS, THE OBO/NOBO DISTINCTION IN BENEFICIAL OWNERSHIP: IMPLICATIONS FOR SHAREOWNER COMMUNICATIONS AND VOTING 9–10 (2010) (discussing the SEC's attempt to include beneficial owners via changes to communication rules).

18. *See, e.g.*, *id.* at 11.

19. *See* Donald, *supra* note 5, at 61–62 (noting that both state corporate law and state commercial law continue to treat the party registered with the issuer as the shareholder).

20. *See infra* Part II.B.

21. *See infra* Part IV.B.

22. *See infra* Part IV.A.

Remarkably, there are no federal or state laws or regulations governing the issuance of the omnibus proxy, and there is significant confusion regarding how it operates.[23] Yet, the entire shareholder voting system designed for publicly traded corporations depends on the issuance of the omnibus proxy.[24] When this improvised bridge fails, its failure may destroy the rights of beneficial owners of stock and threaten the very integrity of the corporate form.[25] It has failed before and is likely to fail again.[26] This Comment will analyze the importance of the omnibus proxy and, with a look to the historical reasons supporting applicable law, demonstrate why the omnibus proxy should not be required for shareholders to vote.

Part II of this Comment begins by discussing the evolution of the modern indirect holding system. It analyzes how the modern indirect holding system operates and discusses the policy concerns supporting share immobilization. It will then explain how this immobilization resulted in the discrepancy between state and federal law's treatment of beneficial owners.

Part III turns to the rights inherent in stock ownership, distinguishing between the rights derived from treatment of stock as a membership interest in a corporation and those derived from treatment of stock as a transferable security. Part III will begin with an analysis of the historical foundations of these rights. It will then focus on how the evolution of both corporate law and securities law, while attempting to evolve along with changing market realities, has separated corporations from their shareholders by severing the beneficial owners from the rights incident to share ownership.

Part IV will return to today's conflict regarding ownership and discuss the complicated proxy system that the SEC has implemented in its attempt to reconcile the conflict and reconnect corporations with their shareholders. This Comment will analyze *Kurz v. Holbrook*[27] to demonstrate how the omnibus proxy can fail and the ramifications of that failure. The chancellor in *Kurz* found an ingeniously simple workaround; however, his ruling was eventually overturned on other grounds.[28] Nevertheless, the case illustrates the dangers posed by the failure to obtain the omnibus proxy and helps explain why the omnibus proxy is an unnecessary formality.

Finally, in Part V—drawing on analysis and discussion from above—this Comment will argue why the omnibus proxy should be seen as legally

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23. *See* Kurz v. Holbrook, 989 A.2d 140, 148 (Del. Ch. 2010), *aff'd in part, rev'd in part sub nom.* Crown EMAK Partners, LLC v. Kurz, 992 A.2d 377 (Del. 2010).

24. *See infra* Part IV.A.

25. *See Kurz*, 989 A.2d at 161.

26. *See infra* Part IV.A.

27. 989 A.2d 140, (Del. Ch. 2010), *aff'd in part, rev'd in part sub nom.* Crown EMAK Partners, LLC v. Kurz, 992 A.2d 377 (Del. 2010).

28. *See* discussion *infra* Part IV.B.

irrelevant. It will explore two different arguments that reach this conclusion: one that advances our understanding of record ownership to enable the rule to serve, rather than inhibit, the goal it is meant to serve; and one that recognizes an inherent agency relationship between the depository and its participants that does not require the execution of a written proxy.

II. THE MODERN INDIRECT HOLDING SYSTEM

A. Evolution of Indirect Holding

Traditionally, stock ownership was demonstrated by possession of a physical certificate, and delivery of that certificate was required to evidence a change in ownership.[29] From the time of the first corporations up through the 1960s, physical delivery of certificates remained a requirement to transfer ownership.[30] Securities firms processed transfers through the manual work of clerks, using as many as "thirty-three different forms for a single security transfer,"[31] and messengers were required to run around New York City carrying checks and stock certificates back and forth between brokers.[32] As trading volume surged, brokers lagged behind at settling transactions, resulting in "enormous backups in deliveries."[33] In 1968, the NYSE was forced to close every Wednesday, in addition to closing early on other trading days, to allow traders to "reconcile their paperwork."[34] During this period, over 100 brokerage firms went bankrupt or were bought out.[35]

In response, Congress amended the Securities Exchange Act of 1934 (Exchange Act) to adopt a policy immobilizing share certificates,[36] which was deemed necessary to facilitate the clearing and settlement of the ever-

29. Vaaler, *supra* note 6, at 254.

30. Schroeder, *supra* note 3, at 310.

31. Donald, *supra* note 5, at 50.

32. Teresa Carnell & James J. Hanks, Jr., *Shareholder Voting and Proxy Solicitation: The Fundamentals*, 37 MD. B.J., Feb. 2004, at 23, 26. In addition, registered shares had to be surrendered to the issuing corporation or its transfer agent for registration. Marcel Kahan & Edward Rock, *The Hanging Chads of Corporate Voting*, 96 GEO. L.J. 1227, 1237 n.48 (2008) (quoting U.C.C. art. 8, prefatory note I.A. (2005)).

33. Donald, *supra* note 5, at 50. The paperwork crisis had reached the point that "[s]tock certificates and related documents were piled 'halfway to the ceiling' in some offices." Suellen M. Wolfe, *Escheat and the Concept of Apportionment: A Bright Line Test to Slice a Shadow*, 27 ARIZ. ST. L.J. 173, 181 n.49 (1995) (quoting SEC. & EXCH. COMM'N, STUDY OF UNSAFE AND UNSOUND PRACTICES OF BROKERS AND DEALERS, H.R. DOC. NO. 92-231, at 219 n.1 (1971)).

34. Emily I. Osiecki, Comment, Alabama By-Products Corp. v. Cede & Co.: *Shareholder Protection Through Strict Statutory Construction*, 22 DEL. J. CORP. L. 221, 224 n.24 (1997).

35. Donald, *supra* note 5, at 51.

36. *Id.* at 54.

growing volume of securities trading.[37] Today, shares of publicly owned corporations are typically held in "street name" through custodians such as banks or brokers.[38] These banks and brokers, in turn, hold the shares in accounts at the Depository Trust Company (DTC),[39] "the world's largest securities depository."[40]

Since DTC physically possesses the certificates, shares of publicly traded companies are generally registered with a corporation in the name of "Cede & Co.," the nominee name used by DTC.[41] Transfers between depository participants are accomplished via book entry.[42] Participants that "engage[] in multiple transactions in the same securities in a trading day will report only the net change in their ownership to . . . DTC."[43] This process is known as netting and is considered a major advantage of the custodial system, as banks and brokers that engage in multiple transactions in the same securities need only report their net change in ownership to DTC at the end of the day.[44]

However, due to the netting of transactions, a share held by DTC is not traceable to a particular beneficial owner.[45] DTC holds all of a bank's or broker's shares "in fungible bulk,"[46] and only the bank's or broker's records indicate who owns which shares.[47] When an investor buys or sells shares through a participant bank or broker, DTC simply "shift[s] shares by book entry from the selling custodian bank's account to the acquiring custodian's account."[48] This means that an unlimited number of trades of an issuer's

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37. Kahan & Rock, *supra* note 32, at 1237; *see also* 15 U.S.C. § 78q-1 (1976) ("The prompt and accurate clearance and settlement of securities transactions . . . are necessary for the protection of investors and persons facilitating transactions by and acting on behalf of investors.") (current version at 15 U.S.C. § 78q-1 (2012)).

38. Kahan & Rock, *supra* note 32, at 1237. "Street name" ownership refers to the use of a nominee to hold legal title to shares on behalf of the beneficial owners. J. Robert Brown, Jr., *The Shareholder Communication Rules and the Securities and Exchange Commission: An Exercise in Regulatory Utility or Futility?*, 13 J. CORP. L. 683, 687–88 (1988).

39. Kahan & Rock, *supra* note 32, at 1237.

40. Charles W. Mooney, Jr., *Beyond Negotiability: A New Model for Transfer and Pledge of Interests in Securities Controlled by Intermediaries*, 12 CARDOZO L. REV. 305, 317 n.23 (1990).

41. *Id.* at 319 n.34. "Cede" is short for "certificate depository." Donald, *supra* note 5, at 46 (emphasis omitted).

42. Brown, *supra* note 38, at 722.

43. Apache Corp. v. Chevedden, 696 F. Supp. 2d 723, 726 (S.D. Tex. 2010).

44. *Id.*

45. Vaaler, *supra* note 6, at 297; *see also* Russell A. Hakes, *UCC Article 8: Will the Indirect Holding of Securities Survive the Light of Day?*, 35 LOY. L.A. L. REV. 661, 711 (2002) (explaining the netting process and noting that tracing specific assets through the netting process "is extremely difficult, if not impossible").

46. Kahan & Rock, *supra* note 32, at 1239–40.

47. *Id.*

48. *Id.* at 1239.

shares can be made between DTC participants without changing the party registered with the issuer; Cede & Co. will remain registered on the issuer's stockholder list as long as DTC still stores the certificates.[49]

DTC is a subsidiary of the Depository Trust and Clearing Corporation (DTCC).[50] In 2009, DTCC and its subsidiaries held almost $34 trillion in securities and processed an average of over 90 million transactions a day.[51] Though there used to be as many as four depositories, DTC is the only depository in the United States today.[52] As a whole, the DTCC system is estimated to hold more than 99% of depository-eligible securities traded on United States capital markets.[53] It is now "wholly possible that a listed company will have only one registered shareholder, 'Cede & Co.'"[54]

Without the immobilization of shares, the volume of trading we see today would be impossible.[55] However, the depository system that was adopted creates a "discrepancy between ownership of the share itself (economic or beneficial ownership) and the legal status as shareholder (registered stockholder)."[56] This is problematic because it is the beneficial owners who have the appropriate incentives to make corporate decisions.[57] Because shareholders are the residual claimants, they are the ones who "receive most of the marginal gains and incur most of the marginal costs" from the success or failure of the corporation.[58] Non-beneficial holders lack the optimal incentives to exercise discretionary authority.[59]

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49. Donald, *supra* note 5, at 61.

50. *Id.* at 59.

51. *Id.* at 60–61.

52. Kurz v. Holbrook, 989 A.2d 140, 166 (Del. Ch. 2010), *aff'd in part, rev'd in part sub nom.* Crown EMAK Partners, LLC v. Kurz, 992 A.2d 377 (Del. 2010). "While major, regional exchanges had previously maintained their own depositories, in the 1990s DTC and its affiliate, the National Securities Clearing Corporation, assumed the activities of the depositories for the regional exchanges." Carnell & Hanks, *supra* note 32, at 26.

53. Donald, *supra* note 5, at 60.

54. *Id.* at 62. Today, more than eighty percent of all shares of public companies are held in street name. Notice of Filing of Proposed Rule Change Amending NYSE Rules 451 and 465, and the Related Provisions of Section 402.10 of the NYSE Listed Company Manual, Exchange Act Release No. 34-68936, 2013 WL 603321 (Feb. 15, 2013).

55. Kahan & Rock, *supra* note 32, at 1238. DTCC processed, on average, 92.3 million transactions every business day and settled over $1.48 *quadrillion* in transactions in 2009. Donald, *supra* note 5, at 60–61.

56. Donald, *supra* note 5, at 62.

57. *See* FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 68 (paperback ed. 1996). While Judge Easterbrook and Professor Fischel do not differentiate between beneficial owners and record owners when discussing shareholders, their focus is clearly on beneficial owners as it is they who have a financial stake in the success or failure of a company. *See id.*

58. *Id.*

59. *See id.* at 67–70.

B. *Conflict Between State and Federal Law*

Following the implementation of the custodial system, federal regulations were issued that defined a "record holder" of shares as "any broker, dealer, voting trustee, bank, association or other entity that exercises fiduciary powers which holds securities of record in nominee name or otherwise or as a participant in a clearing agency registered pursuant to § 17A of the [Exchange] Act."[60] These regulations defined "entity that exercises fiduciary powers" to specifically exclude clearing agencies registered pursuant to § 17A of the Exchange Act.[61] DTC is a clearing agency registered with the SEC pursuant to § 17A,[62] so it cannot be considered a record holder under federal law. It is the banks and brokers whose shares are held in their accounts at DTC and who are considered the record holders under federal law.[63]

However, corporations are formed and their internal operations are governed pursuant to state law.[64] Like federal law, the rights incident to share ownership belong to the record holder under state law as well.[65] However, unlike federal law, which recognizes intermediary banks and brokers as record holders, state law recognizes the party registered with the corporation on its stockholder list as the record holder.[66] Since DTC is listed on a company's stockholder list (through its nominee Cede & Co.) for any shares held in its depository, state law recognizes DTC as the record owner.[67] As the record owner under state law, DTC is the legally recognized shareholder,[68] but DTC is merely a custodian and lacks discretionary authority to exercise any shareholder rights.[69]

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60. 17 C.F.R. § 240.14a-1(i) (2013).

61. *Id.* § 240.14a-1(c).

62. MMI Invs., L.L.C. v. E. Co., 701 A.2d 50, 61 (Conn. Super. Ct. 1996).

63. *See* Brown, *supra* note 38, at 753 (noting that the definition of record holder includes depository participants).

64. Donald, *supra* note 5, at 61.

65. *See id.* ("Under state corporation law, a shareholder is defined as someone who is registered on the stockholders list, not a person who has title to shares." (footnote omitted)).

66. *Id.*; *see also* DEL. CODE ANN. tit. 8, § 219(c) (West 1974 & Supp. 2011) (providing that the stock ledger shall be the only evidence of stockholders entitled to vote).

67. *See* Donald, *supra* note 5, at 61.

68. *Id.*

69. *See* Kurz v. Holbrook, 989 A.2d 140, 161 (Del. Ch. 2010), *aff'd in part, rev'd in part sub nom.* Crown EMAK Partners, LLC v. Kurz, 992 A.2d 377 (Del. 2010) ("Because DTC lacks discretionary voting authority over the shares it holds, DTC inevitably passes on its voting authority . . . ."); *see also Rules, By-laws and Organization Certificate of the Depository Trade Company*, DEPOSITORY TRUST CO. 45–49 (June 2013), http://www.dtcc.com/~/media/Files/Downloads/legal/rules/dtc_rules.pdf (providing a mechanism to pass on shareholder rights to participants).

In an effort to adapt to modern securities practices, share immobilization separated beneficial owners of shares from their rights as shareholders. The SEC adopted regulations to facilitate shareholder communications and allow shareholders to vote,[70] but it did not fully satisfy this goal. The SEC did not address how or when DTC would be required to transfer voting rights to the beneficial owners. There remained a gap that would prevent shareholders from voting, which both federal and state laws and regulations failed to address.[71] As a result, the DTC omnibus proxy was created.[72] However, the DTC omnibus proxy remains an improvised and unstable bridge linking federal securities law and state corporate law.

III. SHAREHOLDER RIGHTS

Before progressing further, it is necessary to address an important question: What exactly does a shareholder own? The implications of the conflict between state and federal law will not be clear without a better understanding of the rights inherent in stock ownership. Corporate law and securities law are difficult to disentangle when applied to stock ownership; however, the rights incident to stock ownership can generally be divided into two categories: rights as members of the corporation, and rights as holders of negotiable securities.

A. Rights as Corporate Members

Historically, an equity ownership interest in a corporation was a non-negotiable membership right.[73] An early understanding of this membership right viewed it as "a fraction of all the rights and duties of the stockholders composing the corporation."[74] This fractional interest can be viewed to comprise all the rights that shareholders hold arising from their relationship with the corporation.[75] These include the rights to vote, to inspect corporate

70. *See infra* Part IV.A.

71. *See Kurz*, 989 A.2d at 170 ("There does not appear to be any federal statute or regulation, any listing standard, or any state statute or decision calling for the issuance of the DTC omnibus proxy.").

72. *Id.* The circumstances surrounding the creation of the omnibus proxy are unclear. The chancellor in *Kurz* speculated that "someone must have recognized that a mechanism was needed to ensure the transfer of DTC's voting authority to the participant members." *Id.*

73. Egon Guttman, *Transfer of Securities: State and Federal Interaction*, 12 CARDOZO L. REV. 437, 443 (1990).

74. Samuel Williston, *History of the Law of Business Corporations Before 1800* (pt. 2), 2 HARV. L. REV. 149, 149 (1888).

75. *See id.* at 149–50.

books and records, and to demand an appraisal;[76] the right to receive dividends;[77] the right to issue shareholder proposals;[78] and the right to bring a derivative action.[79] Although the separation of beneficial and legal ownership implicates the exercise of all of these rights, this Comment focuses on voting rights.

The right to vote is "a shareholder's main legal channel to exercise control" over a corporation and is thus "essential to corporate law."[80] The Delaware Court of Chancery has recognized that "[t]he shareholder franchise is the ideological underpinning upon which the legitimacy of directorial power rests."[81] This is because the shareholder vote "legiti[mize]s the exercise of power" by directors and managers over property that they do not own themselves.[82] The shareholder franchise protects the corporation and gives it value.[83] While shareholders can also influence management by selling their stock,[84] that is not an action of internal corporate governance and thus is less vital for the protection of shareholders' interests.[85]

In the original English corporations, each shareholder of a corporation was entitled to one vote.[86] However, it soon became customary for corporate charters to provide votes in proportion to the number of shares held[87]—what is frequently known today as the "one share, one vote" standard.[88] This standard is "based on the principle of apportioning voting power commensurate with the investment risk taken by the common stockholders as residual owners."[89] Only shareholders with voting power proportionate to their investment risk have the proper incentives to make

76. *See* Henry T. C. Hu & Bernard Black, *Equity and Debt Decoupling and Empty Voting II: Importance and Extensions*, 156 U. PA. L. REV. 625, 722 (2008).

77. Donald, *supra* note 5, at 86.

78. *See* 17 C.F.R. § 240.14a-8 (2013).

79. *See* Ala. By-Products Corp. v. Cede & Co., 657 A.2d 254, 265 (Del. 1995) (noting that the authority of a shareholder to bring derivative suits stems from the financial interest in the corporation and the resulting "incentive to obtain legal redress for the benefit of the corporation").

80. Donald, *supra* note 5, at 43–44.

81. Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651, 659 (Del. Ch. 1988).

82. *Id.*

83. Lord v. Equitable Life Assur. Soc'y of U.S., 87 N.E. 443, 448 (N.Y. 1909).

84. *See Blasius Indus., Inc.*, 564 A.2d at 658–59.

85. *See id.* at 660.

86. Williston, *supra* note 74, at 156.

87. *Id.* at 156–57.

88. Manning Gilbert Warren III, *One Share, One Vote: A Perception of Legitimacy*, 14 J. CORP. L. 89, 91 (1988).

89. *Id.*

corporate decisions,[90] so the shareholder vote is crucial to ensuring that managers act in the best interests of the corporation.[91]

The common law did not permit voting by proxy absent an express authorization by a corporate charter or bylaw.[92] Shareholders had a duty to attend shareholder meetings and vote in person.[93] This requirement was based on the theory that every stockholder was "entitled to have the benefit of the judgment of every other stockholder."[94] However, as the size of corporations increased, this requirement became impractical, and proxies became an acceptable substitute for attendance.[95] This was not a legal rejection of the purposes underlying the shareholder meeting, but a recognition that modern practices made the common-law prohibition unworkable.[96] The use of proxies became necessary for corporations to meet quorum requirements,[97] and eventually the proxy process became the primary method for shareholders to vote, "often rendering the annual meeting a formality."[98]

Dating back to some of the earliest corporations, it was customary to include in the corporate charter a requirement that transfers of stock must be entered into the corporate books before title could pass.[99] Under the original concept of stock ownership as a membership right,[100] the registration of stock on an issuer's books did not merely provide evidence of a shareholder's rights—it established those rights.[101] A corporation was viewed as "the custodian of its shares, a responsibility that it held in trust for the protection" of its shareholders, and could be held liable for mistakenly transferring a shareholder's shares to another.[102]

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90. *See* EASTERBROOK & FISCHEL, *supra* note 57, at 68.

91. *See id.*

92. *See* Taylor v. Griswold, 14 N.J.L. 222, 231 (N.J. 1834).

93. *Id.* at 232.

94. Mackin v. Nicollet Hotel, Inc., 25 F.2d 783, 786 (8th Cir. 1928).

95. Brown, *supra* note 38, at 695–96.

96. *See Mackin*, 25 F.2d at 786 ("The old theory . . . has necessarily been rendered obsolete because of our modern business being conducted by large corporations with thousands of stockholders located in all parts of the country.").

97. Jill E. Fisch, *From Legitimacy to Logic: Reconstructing Proxy Regulation*, 46 VAND. L. REV. 1129, 1135 (1993).

98. Brown, *supra* note 38, at 696.

99. *See* Williston, *supra* note 74, at 155.

100. *See* discussion *supra* Part III.A.

101. Kenneth B. Davis, Jr., *Pledged Stock and the Mystique of Record Ownership*, 1992 WIS. L. REV. 997, 998–99 (1992).

102. *Id.* at 999.

This rule fell out of fashion, and courts in America adopted the rule that title to stock passed upon transfer to the assignee.[103] Common law considered voting rights to be incident to ownership, and the right to vote was understood to follow the title when title was passed.[104] However, this rule only applied as between the assignor and assignee.[105] Even when an assignee had gained title to shares, the issuing corporation was not required to regard the assignee as the owner of those shares until the assignee registered the transfer with the corporation.[106] Thus, a beneficial owner could gain the right to vote by purchasing shares without gaining the actual power to vote until registering the transfer with the issuing corporation.[107] The requirement that a transfer be registered with the corporation functioned as a recording system.[108]

There were both legal and practical justifications for this rule. It has been argued that a corporation is analogous to a set of contracts.[109] There is no privity of contract between an unrecorded assignee and a corporation.[110] If the basis of shareholder rights rests in contract, even if it is a type of contract unique to the corporate relationship, it stands to reason that someone who is not in privity with the corporation and its other shareholders has no legal right to exercise the rights derived from the underlying corporate contract.[111] A contract between an unrecorded assignee and a corporation would only arise upon registration with the corporation, and only then would the rights that stem from the contract arise.[112]

As a practical matter, the registration requirement provided a necessary evidentiary rule that allowed a corporation to determine whom it would regard as shareholders without undue difficulty.[113] This is important because corporations must know who their shareholders are for the purposes of distributing dividends as well as providing notice of, and

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103. *See, e.g.*, State *ex rel.* Cooke v. N.Y.-Mexican Oil Co., 122 A. 55, 58 (Del. Super. Ct. 1923).

104. Dennistoun v. Davis, 229 N.W. 353, 355 (Minn. 1930).

105. *In re* Giant Portland Cement Co., 21 A.2d 697, 701 (Del. Ch. 1941).

106. *Id.* This common-law rule was eventually codified into state corporate statutes. *See, e.g.*, *id.*

107. Davis, *supra* note 101, at 1024.

108. James Steven Rogers, *Negotiability as a System of Title Recognition*, 48 OHIO ST. L.J. 197, 214–15 (1987).

109. EASTERBROOK & FISCHEL, *supra* note 57, at 14.

110. *In re Giant Portland Cement Co.*, 21 A.2d at 701.

111. *See id.*

112. *Id.*

113. *Id.* at 701–02.

allowing votes at, meetings.[114] State laws require corporations to provide shareholders with notice of any meetings in which shareholders are required or permitted to vote,[115] and permit corporations to "fix a record date" for determining the shareholders who are entitled to receive notice and vote.[116] The reliance on record ownership gave issuers a safe harbor that protected them from liability for failing to either provide notice of meetings to unknown shareholders or recognize their votes.[117]

The original Model Business Corporation Act focused on identifying who is entitled to vote in corporate elections.[118] As the Uniform Commercial Code (UCC) was revised to reflect reality more accurately,[119] the Revised Model Business Corporation Act (Revised Act) was adopted, which resulted in an unmistakable parallelism between them.[120] Instead of focusing on who is entitled to cast a vote, the focus shifted to "identifying whose vote the corporation is entitled to accept."[121] The Revised Act also added provisions allowing companies to "adopt procedures designed to permit beneficial owners to vote."[122] However, these provisions do not grant beneficial owners any new voting powers; rather, they provide issuing corporations with greater defenses against legal challenges by expanding a corporation's flexibility in determining whose votes they are entitled to accept.[123]

B. Rights as Security Holders

Recall that shareholder rights were historically considered non-negotiable membership rights.[124] In cases of lost or stolen certificates, courts in the United States allowed owners to assert their title against a subsequent holder, even if the subsequent holder was a bona fide

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114. Donald, *supra* note 5, at 62. State law requires that corporations provide shareholders with written notice in advance of any meeting where shareholders "are required or permitted to take any action." *See, e.g.*, DEL. CODE ANN. tit. 8, § 222(a) (West 1974 & Supp. 2011).

115. *See, e.g.*, DEL. CODE ANN. tit. 8, § 222(a).

116. *See id.* § 213(a).

117. *See* Davis, *supra* note 101, at 999–1000.

118. *Id.* at 1053.

119. *See* discussion *infra* Part III.B.

120. Davis, *supra* note 101, at 1053.

121. *Id.* at 1053–54.

122. J. ROBERT BROWN, JR., THE REGULATION OF CORPORATE DISCLOSURE § 15.03[2] (3d ed. 2014).

123. *See* Davis, *supra* note 101, at 1053–54, 1059.

124. Guttman, *supra* note 73, at 443. The concept of negotiability allows a purchaser to take what they purchase "free from any [potential] adverse claims." James S. Rogers, *An Essay on Horseless Carriages and Paperless Negotiable Instruments: Some Lessons from the Article 8 Revision*, 31 IDAHO L. REV. 689, 695 (1995).

purchaser.[125] As trading expanded, market participants pushed to make shares negotiable, and the Uniform Stock Transfer Act was passed in 1910.[126] As a result, shareholder rights were reified into stock certificates, integrating the intangible rights inherent in stock into the physical paper itself.[127] The primary benefit of negotiable certificates was increased liquidity, which made stock more valuable and desirable as an investment.[128] This was the result of two perks of negotiability: purchasers evaluating stock did not need to inquire into potential adverse claims, nor did they need to investigate title.[129] Instead, they were able to rely on the stock certificate itself and the information contained on it.[130]

The rise in the volume of trading that led to the paper crisis and the subsequent immobilization of shares posed problems for the application of the negotiability doctrine to the transfer of stock.[131] Negotiability rests on the physical delivery of a stock certificate.[132] The original version of the UCC's Article 8 (Original Article 8) was based on this system of physical delivery.[133] It did not address how property interests were transferred to purchasers who acquired through intermediaries that held securities in fungible bulk.[134]

Following the immobilization of shares, Article 8 was amended (Amended Article 8) in 1978 to provide for the transfer of paperless uncertificated securities.[135] However, like Original Article 8, Amended Article 8 was based on the presumption that the "paradigm of property interests" was the actual physical possession of an object.[136] The drafters of Amended Article 8 established an elaborate structure analogous to physical delivery in which "uncertificated securities [were] fictively delivered

125. *See* Knox v. Eden Musee Americain Co., 42 N.E. 988, 992–93 (N.Y. 1896); *see also* James Steven Rogers, *Negotiability, Property, and Identity*, 12 CARDOZO L. REV. 471, 477–78 (1990) ("In some respects, stock certificates were treated no differently than ordinary goods, as, for example, in the rule that the owner of property who has not entrusted possession to the wrongdoer can recover it even from a bona fide purchaser.").

126. Guttman, *supra* note 73, at 443 & n.35.

127. *Id.* at 443. Reification refers to the merger of the obligations of the instrument's issuer into the instrument itself. Mooney, *supra* note 40, at 398 n.332.

128. Ronald J. Mann, *Searching for Negotiability in Payment and Credit Systems*, 44 UCLA L. REV. 951, 957–58 (1997) (noting that negotiability decreases transaction costs). "At least in commercial contexts, an asset that is easy to sell normally is more valuable than an otherwise similar asset that is hard to sell." *Id.* at 957.

129. *See id.* at 959–60.

130. *Id.* at 960.

131. *See* Rogers, *supra* note 125, at 480.

132. *Id.*

133. U.C.C. art. 8, prefatory note I.A. (2005).

134. Mooney, *supra* note 40, at 331.

135. Rogers, *supra* note 124, at 690.

136. Schroeder, *supra* note 3, at 303.

through acts designed to parallel, and be directly analogous to, the physical delivery of security certificates."[137] This required expanding "two simple traditional modes of transfer . . . into sixteen alternate" legal methods.[138]

However, once the practice of physical delivery is abandoned, the entire concept of delivery "becomes a metaphysical absurdity."[139] The drafters of Amended Article 8, believing that individual shares could remain identifiable and traceable through multiple tiers of intermediaries, mistakenly "analyze[d] the relationship[s] among financial intermediaries" and investors in the context of "agency and bailment principles."[140] They were fixated on analogizing the new reality to possession of a physical certificate and lost sight of the property interests a physical certificate was meant to embody: "They conflated the property right in the *res* with the *res* itself; conflated the intangible *res* . . . with the tangible token evidencing the *res* . . . ; and conflated physical custody of the token with both beneficial and record ownership of the underlying *res*."[141]

This is somewhat understandable since agency and bailment principles had traditionally worked in dealing with the relationship between shareholders and intermediaries. When a beneficial owner purchased stock through an intermediary, the intermediary held the stock for the owner in street name, but the stock was considered to be owned by the beneficial owner.[142] The broker was considered the owner's agent and owed the owner duties to carry out the customer's instructions and to act in the customer's best interests.[143] While a beneficial owner who owned in nominee name through an intermediary assumed the risk of not being the record owner as

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137. *Id.* at 313; *see also* U.C.C. art. 8, prefatory note I.B. (2005) ("[A]mendments primarily took the form of adding parallel provisions dealing with uncertificated securities . . . .").

138. Schroeder, *supra* note 3, at 314. See U.C.C. art. 8, prefatory note IV.B.3 for a detailed analysis of the complexity in Amended Article 8's treatment of uncertificated securities.

139. Rogers, *supra* note 125, at 480.

140. Schroeder, *supra* note 3, at 328–29; *see also* Hakes, *supra* note 45, at 679 ("The rules in [Amended Article 8] governing transfers and pledges were unduly complex because they tried to cover the relationships existing in the indirect holding system using direct holding concepts." (footnote omitted)).

141. Schroeder, *supra* note 3, at 311.

142. *See, e.g.*, Weiss v. Dempsey-Tegeler & Co., 443 S.W.2d 934, 935 (Tex. Civ. App.—Amarillo 1969, writ ref'd n.r.e.); *see also In re* Ellis' Estate, 6 A.2d 602, 612 (Del. Super. Ct. & Orphans' Ct. 1939) (noting that the relationship between the securities broker and customer is one of agency, bailment, or trust, and that when holding securities for a customer a broker has no right to use the securities as his own).

143. *See* Restatement of Agency § 1 cmt. d (1933) ("An agent may be one who, to distinguish him from a servant in determining the liability of the principal, is called an independent contractor. Thus, the attorney at law, the broker, the factor, the auctioneer, and other similar persons employed either for a single transaction or for a series of transactions are agents, although, as to their physical activities, they are independent contractors.").

against the corporation,[144] the intermediary record owner was typically considered a trustee or fiduciary of the beneficial owner.[145] The unrecorded beneficial owner's right against the corporation was inchoate until her ownership was recorded with the corporation,[146] but the intermediary could be held liable to the beneficial owner for failure to vote according to the owner's instructions, or for voting against the owner's interests.[147] Thus, the law treated stock held by a bank or broker intermediary on a customer's behalf as constructively owned by the customer.[148]

This system preserved a beneficial owner's property interest in shares that were represented by identifiable certificates. However, with the immobilization of stock certificates, the concepts of agency and bailment could not easily be applied to "the complex set of relationships which [had] developed between the participants [and intermediaries] in the various tiers of the securities industry."[149] Amended Article 8's treatment of securities as analogous to physical property was "inadequate and unworkable."[150]

As a result, Article 8 was amended a third time (Revised Article 8), making it "the first article of the [UCC] to reach the third generation."[151] The goal of Revised Article 8 was to "better reflect the commercial reality of how the market . . . operates and to provide . . . sufficient flexibility" to adapt to market developments.[152] Under Revised Article 8, investors who purchase shares held in street name merely own a "securities entitlement" in a "pro rata interest in all like securities" held by their intermediary.[153] This is a fundamentally different interest than the traditional property interests the old laws reflected.[154] Under Revised Article 8, a beneficial owner who holds shares through an intermediary can become an entitlement holder the moment the bank or broker indicates on its books that the customer has bought shares, even if the bank or broker has not actually acquired the shares yet.[155] This security entitlement will give the beneficial owner a

144. *See* Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651, 668 (Del. Ch. 1988).

145. *See* Salt Dome Oil Corp. v. Schenck, 41 A.2d 583, 585 (Del. 1945).

146. *Id.*

147. *See, e.g.*, Witham v. Cohen, 28 S.E. 505, 506 (Ga. 1897). Early judicial opinions considered such acts to be an invasion of the beneficial owner's legal rights, amounting to a tort affecting the owner's property right in the shares. *E.g.*, *id.*

148. Schroeder, *supra* note 3, at 306. Amended Article 8 explicitly stated that a person who purchased a security through an intermediary was the owner of that security. *Id.* at 329.

149. *Id.* at 329–30.

150. Mooney, *supra* note 40, at 313.

151. Rogers, *supra* note 124, at 690.

152. Vaaler, *supra* note 6, at 271 (footnote omitted).

153. Kahan & Rock, *supra* note 32, at 1242.

154. *See* Hakes, *supra* note 45, at 692 n.162 (noting that the rights included in a securities entitlement are merely rights against the securities intermediary to enforce its obligations).

155. Kahan & Rock, *supra* note 32, at 1242.

superior claim against the broker's general creditors.[156] However, it is not an ownership interest in specific shares as the old laws envisioned; it is "best characterized as a bundle of rights against the intermediary."[157] It is not even an interest in "the fungible bulk of securities" held at DTC, but merely an interest in the beneficial owner's account with the intermediary.[158]

Thus, Revised Article 8 now recognizes that securities today are generally held in fungible bulk; however, "it loses determinacy with respect to the key shareholder rights in corporate law."[159] Under Revised Article 8, beneficial owners that hold shares through intermediaries no longer have an actual property interest in specific shares.[160] Their interest is more comparable to a creditor's interest against a debtor, except a securities entitlement is given higher priority than the typical unsecured claim.[161] But if beneficial owners no longer have a legal interest in distinguishable shares, how can they exercise the right to vote, which has traditionally been tied to distinguishable shares, and which remains necessary to support the corporate form?

IV. RECONCILING THE CONFLICT

A. The SEC Proxy System and the Omnibus Proxy

In today's custodial ownership system, the actual investors who purchase shares of corporations and have the financial interest in the shares are no longer legally considered shareholders.[162] As a result, "[i]ssuers no longer know who owns [the shares]" and corporations have been cut off from their investors.[163] With the effective destruction of the stockholder list, issuers do not know where to send information and "invitations to annual meetings," nor can they determine who is entitled to vote and receive dividends, and shareholders are cut off from each other such that they cannot effectively organize to exercise their rights.[164]

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156. *Id.*

157. *See* Mooney, *supra* note 40, at 310.

158. *Id.* at 310–11 (noting that a securities entitlement is an interest in the customer's account, not in the securities that underlie the account).

159. Kahan & Rock, *supra* note 32, at 1242–43. This can lead to problems such as overvoting and empty voting; however, discussions of these problems are beyond the scope of this Comment.

160. Schroeder, *supra* note 3, at 373.

161. *See id.* (comparing checking accounts, which are unsecured debt obligations banks owe to their depositors, to the new concept of a securities entitlement).

162. Donald, *supra* note 5, at 46.

163. *Id.*

164. *Id.* at 62.

When Congress amended the Exchange Act to immobilize shares, it was well aware of the problems it would cause and directed the SEC to study what steps could be taken to facilitate shareholder communications.[165] A number of problems arose. In 1975, banks held nearly 80% of the shares that were held in street name, and the SEC "had no regulatory authority over banks."[166] The SEC considered rules that required intermediary brokers to disclose shareholder information to issuers so that issuers could communicate directly with beneficial owners,[167] but that posed problems for brokers.[168] Allowing direct communication also raised concerns about state law.[169] Since only record holders can vote under state law, only record holders can execute proxies.[170] "Allowing issuers to mail proxy cards directly to street name owners would be of little value if the recipient had no authority to vote the shares."[171]

The SEC settled on a complex and inefficient "pass-it-along" approach that did not satisfy anyone.[172] Today's voting process for street name holders is a complex web of federal, state, and stock exchange requirements.[173] Before the process actually begins, federal regulations require any issuer whose shares are held at DTC to contact the depository and request a list of participant banks and brokers who hold its shares.[174]

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165. Brown, *supra* note 38, at 721.

166. *Id.* at 725.

167. *See* Donald, *supra* note 5, at 63.

168. *See* Brown, *supra* note 38, at 725.

> [W]hile everyone might agree that beneficial owners ought to be brought into the proxy process, less unanimity existed on the best method of doing so. It might seem intuitively obvious that brokers should be required to identify beneficial owners and disclose a list of names to issuers, thereby allowing issuers to communicate with beneficial owners directly. Brokers, however, had little sympathy for such a system. The system not only imposed additional paperwork, but also raised the possibility of competitive harm, particularly if issuers circulated the lists to other brokers. Providing lists also threatened to deprive brokers of a source of income. Under exchange rules, brokers received reimbursement from issuers for the cost of forwarding materials, reimbursement that could amount to a significant source of income. Last, direct communication arguably enhanced enforcement risks by making a broker's obligations and, concomitantly, violations, more readily apparent.

Id.

169. *Id.*

170. *Id.*

171. *Id.* Ironically, the system adopted still provides for passing information to the beneficial holders without expressly providing them with proxy authority as well. *See infra* note 192 and accompanying text.

172. *See* Donald, *supra* note 5, at 47.

173. Brown, *supra* note 38, at 745.

174. *See* 17 C.F.R. § 240.14a-13 n.1 (2013) ("If the registrant's list of security holders indicates that some of its securities are registered in the name of a clearing agency registered pursuant to Section 17A of the Act (e.g., 'Cede & Co.,' nominee for the Depository Trust Company), the registrant shall make appropriate inquiry of the clearing agency and thereafter of

Issuers are then required to send search cards to these banks and brokers to ascertain the number of beneficial owners who hold through them, as well as the "number of proxies, proxy statements, and annual reports to be printed."[175] "[S]earch card[s] must be sent whether an issuer is soliciting proxies, seeking consents in lieu of a meeting, or mailing information statements."[176] Once an issuer's inquiry has been received, federal rules require DTC to "promptly identify the participants and indicate the number of shares owned by each."[177] The securities position list that DTC provides in response to an inquiry is frequently referred to as a "Cede breakdown."[178]

Once DTC provides this Cede breakdown, the issuer must send search cards to the participants identified on the breakdown.[179] The next steps in the process differ depending on whether the issuer is communicating with a bank or a broker. If the issuer is communicating with a bank, it must ask the bank to identify how many of its customers are beneficial owners of the issuer's stock,[180] as well as whether the bank is holding the issuer's shares for any respondent banks.[181] If the bank is holding for respondent banks, the bank then has one business day to respond to the issuer and identify those respondent banks.[182] The issuer then has one business day to send search cards to identified respondent banks.[183] It is possible that respondent banks hold for other respondent banks as well.[184] This further complicates the process, as the same requirements will apply concerning the respondent bank: it must provide to the issuer the identities of the respondent banks that hold through it within one day, issue an omnibus proxy to the respondent banks holding through it, and the issuer must send search cards to the lower-tier respondent banks as well.[185]

If an issuer is communicating with a broker, the process is simpler. Upon contact from an issuer, a broker has seven business days to inform the issuer how many of its customers hold the issuer's stock beneficially

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the participants in such clearing agency who may hold on behalf of a beneficial owner or respondent bank, and shall comply with the above paragraph with respect to any such participant."). This request must be made "at least twenty business days prior to the record date" of a shareholder meeting. Donald, *supra* note 5, at 68.

175. Brown, *supra* note 38, at 746.

176. *Id.* (footnote omitted).

177. *Id.* at 748–49; *see also* § 240.17Ad-8(b) (requiring a registered clearing agency to promptly furnish a securities position listing upon request).

178. Donald, *supra* note 5, at 68.

179. Brown, *supra* note 38, at 749.

180. § 240.14b-2(b)(1)(ii)(A).

181. Brown, *supra* note 38, at 749.

182. *Id.*

183. *Id.* at 750.

184. *See id.*

185. *See id.*

through the broker.[186] Once this process has been completed, "the issuer *should* know the *approximate number* of beneficial owners owning shares through each . . . intermediary."[187] The issuer must then deliver the necessary proxy materials to the intermediary banks and brokers.[188] Those intermediary banks and brokers then "have five business days to forward them to [the] beneficial owners."[189] If an intermediary bank holds shares for a respondent bank, federal regulations require the intermediary bank to issue an omnibus proxy transferring its voting authority down the chain to the respondent banks that hold through the intermediary bank.[190] It should be noted that actual proxy authority is not generally transferred to the ultimate beneficial owners through this process.[191] It is actually the banks and brokers that will vote the shares for their clients; however, they are prohibited from deciding how to vote on important matters.[192] Instead, they will deliver a voting instruction form (VIF) to their clients.[193] The beneficial owners will indicate on the VIF how their shares should be voted and return it to their bank or broker.[194]

Banks and brokers typically outsource these operations to an independent company—Broadridge Financial Solutions, Inc. (Broadridge).[195] First, the "[b]rokers and banks transfer their proxy authority . . . to Broadridge."[196] Broadridge then distributes the proxy materials to the beneficial owners, receives their voting instructions, executes proxies on behalf of its clients "aggregating the instructions it has

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186. *Id.* at 749; 17 C.F.R. § 240.14b-1(b)(1)(i) (2013).

187. Donald, *supra* note 5, at 68.

188. *See* § 240.14a-13(a)(4) (requiring the issuer to supply proxy materials to record holders). Readers should remember that under federal regulations the intermediary banks and brokers are considered the record holders, not DTC. *See supra* Part II.B.

189. Kahan & Rock, *supra* note 32, at 1246.

190. § 240.14b-2(b)(2)(i).

191. *See* Kurz v. Holbrook, 989 A.2d 140, 147–48 (Del. Ch. 2010), *aff'd in part, rev'd in part sub nom.* Crown EMAK Partners, LLC v. Kurz, 992 A.2d 377 (Del. 2010) (quoting John C. Wilcox, John J. Purcell III & Hye-Won Choi, *"Street Name" Registration & the Proxy Solicitation Process*, *in* A PRACTICAL GUIDE TO SEC PROXY AND COMPENSATION RULES 10-1, 10-3 (Amy L. Goodman, John F. Olson & Lisa A. Fontenot eds., 4th ed. 2007 & Supp. 2008)).

192. *See* Richard W. Barrett, Note, *Elephant in the Boardroom?: Counting the Vote in Corporate Elections*, 44 VAL. U. L. REV. 125, 150 (2009) (noting that beneficial owners have an equitable right to direct record holders how to vote). However, banks and brokers are allowed to vote the shares themselves on routine matters when they do not receive instructions from beneficial owners. *Id.* at 151.

193. *See* Concept Release on the U.S. Proxy System, Exchange Act Release No. 34-62495, Investment Advisers Act Release No. 3052, Investment Company Act No. 29340, at 19–20 (July 14, 2010), http://www.sec.gov/rules/concept/2010/34-62495.pdf.

194. *Id.* at 20.

195. Donald, *supra* note 5, at 66; *see* Concept Release on the U.S. Proxy System, *supra* note 193, at 22 n.57 (noting that Broadridge handles over 98% of proxy services).

196. Barrett, *supra* note 192, at 154.

received," and forwards the results to a vote tabulator.[197] Although Broadridge serves as agent for the custodians, federal rules require the issuers—not the bank and broker custodians—to pay the cost of these services.[198] The fees Broadridge may charge both issuers and its custodian clients are limited by NYSE rules.[199] However, while Broadridge typically charges issuers the maximum fees permitted by the NYSE, it sometimes charges its larger broker-dealer clients less than the maximum fees permitted.[200] By charging the issuers more than their broker-dealer clients, Broadridge effectively transfers the difference from issuers to broker-dealers, giving rise to concerns that the broker-dealers are being unjustly enriched by receiving more than what was necessary to cover their reasonable expenses.[201]

This convoluted web of rules makes up the procedure by which banks and brokers pass on voting rights to the beneficial owners who hold through them, but there is a loophole. To recap, the rules require issuers to request a Cede breakdown from DTC, and send a search card to the banks and brokers listed in the Cede breakdown. The banks and brokers are then required to forward proxy cards or requests for voting instructions to the ultimate beneficial owners. But remember, under state law, DTC as the record owner—not the intermediary banks and brokers—has the authority to vote and exercise other shareholder rights.[202] Yet there is nothing in the rules compelling DTC to transfer this authority down the communication chain that was created by the federal proxy rules.[203] One of the primary reasons the more elaborate proxy system was chosen was the concern that a simpler system that provided for direct communication between issuers and beneficial owners would not work because beneficial owners did not have the power to vote.[204] However, no legal mechanism was ever established to transfer that power from the depository down through the ownership chain.[205]

To allow the beneficial owners to vote as the proxy system intended, DTC created an omnibus proxy to transfer its voting authority to the

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197. Kahan & Rock, *supra* note 32, at 1245–47.

198. 17 C.F.R. § 240.14a-13(a)(5) (2013) (requiring issuers to pay "reasonable expenses" for sending proxy materials to the beneficial owners).

199. *See* Concept Release on the U.S. Proxy System, *supra* note 193, at 56.

200. *Id.* at 57.

201. *See id.*

202. *See* Mooney, *supra* note 40, at 319–20 & n.34.

203. *See* Kurz v. Holbrook, 989 A.2d 140, 170 (Del. Ch. 2010), *aff'd in part, rev'd in part sub nom.* Crown EMAK Partners, LLC v. Kurz, 992 A.2d 377 (Del. 2010).

204. *See* Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651, 659 (Del. Ch. 1988); *see also* Lord v. Equitable Life Assur. Soc'y of U.S., 87 N.E. 443, 448–49 (N.Y. 1909).

205. *Kurz*, 989 A.2d at 170.

ultimate beneficial owners.[206] This omnibus proxy "confers voting authority upon bank and broker participants with respect to the shares held in their DTC accounts on the record date."[207] However, there remains no federal or state statute, exchange requirement, or case law governing the issuance of this proxy.[208] No authority whatsoever governs when it is issued, "who should ask for it," or the events compelling its issuance.[209]

Scholars simply discuss the occurrence as expected.[210] DTC's website merely states, "On the day after record date DTC provides the Omnibus Proxy to the issuer along with a Security Position Report."[211] DTC has stated in a letter to the SEC that it has a "longstanding and well established" procedure governing the issuance of the omnibus proxy.[212] However, the document it pointed to as evidence of the procedure simply states, "DTC mails an Omnibus Proxy to the issuer as soon as possible after the record date."[213] This is merely the same thing stated on their website, not evidence of a longstanding and well-established procedure.

There are an estimated 17,000 reporting companies in the U.S., and Broadridge delivers over one billion communications per year.[214] This burden is compounded by the fact that annual meetings tend to be seasonal, with most companies holding them during the second quarter of the year.[215] Given the short time windows available, the concentration of the majority of shareholder votes in the same part of the year, and the complexity of this

206. John C. Wilcox, John J. Purcell III & Hye-Won Choi, *"Street Name" Registration & the Proxy Solicitation Process*, *in* A PRACTICAL GUIDE TO SEC PROXY AND COMPENSATION RULES, at 12-1, 12-7, § 12.3[1] (Amy L. Goodman, John F. Olson & Lisa A. Fontenot eds., 5th ed. Supp. 2012).

207. *Id.*

208. *Kurz*, 989 A.2d at 170.

209. *Id.*

210. *See, e.g.*, Brown, *supra* note 38, at 761 ("The rules contemplate that depositories will execute an omnibus proxy and transfer voting power to participating brokers and banks."); Donald, *supra* note 5, at 69–70 ("Since only shareholders of record can vote . . . it is necessary for Cede & Co. to give its participants an 'omnibus proxy,' which covers all the shares a given participant holds with DTC." (footnote omitted)); Kahan & Rock, *supra* note 32, at 1247 ("At the beginning of the process, DTC executes an omnibus proxy in favor of its participant firms.").

211. *Proxy Services*, DEPOSITORY TRUST & CLEARING CORP., http://www.dtcc.com/asset-services/issuer-services/proxy-services.aspx (last visited Aug. 22, 2014).

212. DTCC Response to SEC Concept Release on the U.S. Proxy System, Exchange Act No. 34-62495, Investment Advisors Act No. 3052, Investment Company Act No. 29340, 2010 WL 4462994 (Oct. 25, 2010).

213. *See Reorganizations Service Guide*, DEPOSITORY TRUST & CLEARING CORP. 26, http://www.dtcc.com/~/media/Files/Downloads/legal/service-guides/Reorganizations.ashx (last visited Aug. 22, 2014).

214. Kahan & Rock, *supra* note 32, at 1249.

215. *Id.*

process, there will be cases where the materials simply do not make it to the owner in time to vote.[216] "It is an accident waiting to happen."[217]

B. *Omnibus Failure and the Breakdown of the System*

That accident happened in *Kurz v. Holbrook*, a Delaware case concerning the validity of a consent solicitation for an election of directors.[218] A group of insurgent stockholders had joined under the name "Take Back EMAK" (TBE) and sought to obtain consents from EMAK shareholders that would allow them to take over the board of directors.[219] On behalf of TBE, Broadridge collected the voting instructions it received from EMAK's beneficial owners of shares held in street name.[220] DTC provided EMAK with the Cede breakdown, which contained all of the substantive information that would have been contained in the omnibus proxy, but never provided the omnibus proxy itself.[221]

Because no legal authority addressed who had the responsibility to obtain the omnibus proxy from DTC, the parties themselves disagreed over who should request it.[222] "TBE's proxy solicitor . . . took the initial steps that ordinarily would result in DTC issuing an omnibus proxy, but then assumed it would happen and failed to follow up."[223] In its contract with the election inspector, EMAK agreed to provide the omnibus proxy but failed to do so.[224] On the final day of the consent solicitation, the inspector informed EMAK that it did not have the DTC omnibus proxy.[225] TBE alleged that EMAK "improperly delayed informing [them] until it was too late."[226] The failure to obtain the omnibus proxy from DTC threatened to swing the election by invalidating TBE's votes and disenfranchising a majority of EMAK's common stockholders[227] because Delaware law

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216. *Id.*
217. *Id.*
218. *See* Kurz v. Holbrook, 989 A.2d 140, 154 (Del. Ch. 2010), *aff'd in part, rev'd in part sub nom.* Crown EMAK Partners, LLC v. Kurz, 992 A.2d 377 (Del. 2010) ("My task is to determine whether either the Crown Consents or the TBE Consents validly effected corporate action."). State laws allow for elections to be held via written consent in lieu of a meeting. *E.g.*, DEL. CODE ANN. tit. 8, § 228(a) (West 1974 & Supp. 2011).
219. *Kurz*, 989 A.2d at 144–45, 147.
220. *Id.* at 148.
221. *Id.* at 161.
222. *Id.* at 148–49.
223. *Id.* at 149.
224. *Id.*
225. *Id.*
226. *Id.*
227. *Id.* at 161.

expressly limits voting rights to those registered on a corporation's stock ledger.[228]

A witness for the defendants testified that obtaining the omnibus proxy was TBE's "responsibility [as] the soliciting stockholder in a consent solicitation, even though it is the responsibility of the issuer . . . in a proxy contest."[229] However, the witness could not provide any legal authority that imposed this responsibility on the soliciting stockholder.[230] Extensive research has revealed no legal authority imposing this duty on either party. There are no apparent public-policy justifications supporting different rules or practices for consent solicitations versus proxy solicitations. The witness also recognized that an issuer has a contractual relationship with DTC that soliciting shareholders do not have, as well as the ability to request and obtain an omnibus proxy from DTC.[231] The witness went so far as to admit that even if a soliciting stockholder requests a proxy from DTC, the proxy will only be delivered to the issuer.[232]

After analyzing the factual record, Vice Chancellor Laster found that whether an issuer holds a meeting or solicits consents, it "does not 'get' the . . . omnibus proxy."[233] Federal securities laws require an issuer to contact DTC in advance of a meeting or consent solicitation, and through this interaction DTC "issues the . . . omnibus proxy as a matter of course."[234] As Vice Chancellor Laster pointed out, "It just happens."[235] Yet it failed to happen in this case.

This left the vice chancellor with a tough decision. Falling back on the statute would have disenfranchised the majority of EMAK's stockowners.[236] But he recognized that Delaware public policy supported the certainty and efficiency provided by the rule allowing corporations to recognize only record holders as shareholders.[237] He could have issued a

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228. DEL. CODE ANN. tit. 8, § 219(c) (West 1974 & Supp. 2011). Different states may use different terms to refer to corporate books. In Delaware, the stock ledger includes all the transactions made by every shareholder, "with each transaction separately posted to separately maintained shareholder accounts"; the stocklist compiles the currently effective entries found in the stock ledger. *Kurz*, 989 A.2d at 163.

229. Plaintiffs' Post-Trial Brief at 26, Kurz v. Holbrook, 989 A.2d 140 (Del. Ch. 2010) (C.A. No. 5019-VCL).

230. *Id.*

231. *Id.*

232. *Id.*

233. *Kurz*, 989 A.2d at 149 ("[T]here is no legal obligation for the company to obtain the DTC omnibus proxy, nor any legal mechanism for the company to compel its issuance.").

234. *Id.* at 149, 170.

235. *Id.* at 149.

236. *Id.* at 161.

237. *See id.* at 164.

ruling on equitable grounds that applied only to these circumstances.[238] There was evidence in the record that EMAK intentionally delayed obtaining the proxy until it was too late.[239] EMAK was not subject to the federal proxy rules, and thus was not required to contact DTC to initiate the search card process.[240] This allowed EMAK to publicly solicit consents without initiating the process that typically results in the issuance of the omnibus proxy.[241] EMAK's contract with the inspector of elections expressly stated that the inspector expected EMAK to provide the omnibus proxy.[242] The inspector informed EMAK before the deadline that it needed the proxy, and the inspector followed up in another e-mail telling EMAK that only it could request the omnibus proxy from DTC.[243] And yet, EMAK not only "failed to request an omnibus proxy" but also waited until it was too late to get one before informing TBE.[244]

The vice chancellor could have equitably estopped EMAK from relying on the absence of the omnibus proxy. Equitable estoppel is the doctrine "intended to prevent a party from taking unconscionable advantage of his own wrong by asserting his strict legal rights."[245] There was certainly enough smoke to indicate that EMAK had acted wrongly. Ruling against them on equitable grounds would have been the easier way to prevent disenfranchising EMAK's shareholders. But the vice chancellor did not take the easy way out in reaching his decision.

Instead of deciding the case on equitable grounds, Vice Chancellor Laster incorporated the Cede breakdown that EMAK obtained from DTC into the stock ledger.[246] The vice chancellor reasoned that the federal policy requiring share immobilization essentially forced corporations to outsource part of their stock ledger to DTC, effectively transforming it into the Cede breakdown, and noted that this approach aligned Delaware law with federal regulations that treat the participant banks and brokers as record holders.[247] The vice chancellor reasoned that the Cede breakdown contained the same substantive information as the omnibus proxy, and that the omnibus proxy

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238. *See* Parfi Holding AB v. Mirror Image Internet, Inc., 954 A.2d 911, 939 (Del. Ch. 2008) (noting that the Delaware Chancery Court is one of equity).

239. *Kurz*, 989 A.2d at 149.

240. *See* Answering Brief of Appellees at 23, Crown EMAK Partners, LLC v. Kurz, 992 A.2d 377 (Del. 2010) (Nos. 64, 2010, 85, 2010).

241. *Id.*

242. *Kurz*, 989 A.2d at 148.

243. Answering Brief of Appellees, *supra* note 240, at 23.

244. *Id.* at 23–24.

245. N. Petrochemical Co. v. U.S. Fire Ins. Co., 277 N.W.2d 408, 410 (Minn. 1979).

246. Kurz v. Holbrook, 989 A.2d 140, 174 (Del. Ch. 2010), *aff'd in part, rev'd in part sub nom.* Crown EMAK Partners, LLC v. Kurz, 992 A.2d 377 (Del. 2010).

247. *Id.* at 171.

"simply reformats the information and appends a computer generated page reciting a boilerplate grant of proxy authority."[248] Acknowledging that even this stamping of boilerplate proxy language was not an affirmative act by DTC—since DTC has no discretionary voting authority over shares in its vault—the vice chancellor concluded that the omnibus proxy was merely a formality.[249]

This would have been a landmark decision with significant positive effects for Delaware corporate law; however, the Supreme Court of Delaware overruled the case on other grounds.[250] With regard to Vice Chancellor Laster's integration of the Cede breakdown into the stock ledger, the court announced that "the Court of Chancery's interpretation of stock ledger in section 219 [was] *obiter dictum* and without precedential effect."[251] Notably, the court believed the failure to obtain the omnibus proxy may have been a "one-time anomaly that may not again occur."[252]

That decision leaves open the possibility that the same reasoning could be reapplied in a later case; however, shareholder rights remain on unstable ground. The shareholder vote is the ideological underpinning that legitimizes the corporate form.[253] The Supreme Court of Delaware is wrong about the likelihood of recurrence. As discussed above, the demands placed upon DTC and Broadridge by the ever-growing corporate voting system make such an occurrence increasingly likely.

V. THE NECESSITY OF THE OMNIBUS PROXY

Anything that threatens to destroy the legitimacy of the voting process endangers the integrity of the corporate form. If the shareholder vote is what legitimizes corporations, then corporate law must promote, not inhibit, shareholder voting. It is certainly a worthwhile endeavor to determine now, before the omnibus proxy fails again, whether it is really legally necessary—and if so, what changes may be made to protect shareholder suffrage.

A. The Policy Supporting Shareholder Suffrage

It has long been theorized that shareholders vote in the "best interest of the corporation . . . to further [their] own self-interest," while individuals

248. *Id.* at 161.
249. *Id.*
250. *Crown EMAK Partners, LLC*, 992 A.2d at 402.
251. *Id.* at 398.
252. *Id.*
253. *See* Warren, *supra* note 88, at 91; Williston, *supra* note 74, at 156.

"with voting power disproportionate to their capital risk 'would be tempted to use that power to further their private interests in opposition to the welfare of the corporation.'"[254] Other capital investors—secured creditors, general creditors, and preferred shareholders—have priority over common shareholders in claims against the corporation.[255] The values of their claims are fixed, so they receive little benefit from maximizing the value of the corporation.[256]

Only the residual owners, i.e., those who bear the marginal risk and enjoy the marginal gains, have the proper incentives to make decisions that are first and foremost in the best interests of the corporation.[257] This is why, even though most states permit corporations to "establish almost any voting practices they please," holders of common shares universally hold voting rights "to the exclusion of creditors, managers, and other employees."[258] It is also why "shareholders lose the controlling votes" when a corporation is insolvent or bankrupt.[259] "When [a] firm is in distress, the shareholders' residual claim goes under water, and they lose the appropriate incentives to maximize on the margin."[260] When this happens, the residual claim flows up the chain to creditors or preferred shareholders, who now have the proper incentives to make decisions for the company in order to maximize their own claims.[261]

The importance of shareholder voting rights is further demonstrated by their value to investors. In cases where "firms have outstanding [classes] of stock with identical rights to share in the profits but significantly different voting rights, the stock with the stronger voting rights trades at a premium."[262] Investors will make tender offers at a substantial premium over market price to gain voting control over a corporation.[263] Non-voting stock is not as attractive to investors because it does not allow them to improve the performance of a corporation.[264] It is no surprise then that firms with no residual claimants perform poorly in relation to firms with residual

254. Warren, *supra* note 88, at 91 (quoting Earl Sneed, *The Stockholder May Vote as He Pleases: Theory and Fact*, 22 U. PITT. L. REV. 23, 27 (1960)).

255. *Id.*

256. *See* EASTERBROOK & FISCHEL, *supra* note 57, at 67–68.

257. *See id.*

258. *Id.* at 63, 67.

259. *Id.* at 69.

260. *Id.*

261. *Id.* This transfer of the residual claim is typically accomplished via contract terms or bankruptcy law. *Id.*

262. *Id.* at 71.

263. *See id.* at 26.

264. *Id.* at 71–72.

claimants.[265] It is clear when you consider the desirability of voting stock in this manner why the voting process increases corporate efficiency.[266]

Corporations are often discussed as a "nexus of contracts," and corporate law is said to provide "the terms people would have negotiated, were the costs of negotiating at arm's length for every contingency sufficiently low."[267] Thus, corporate law supplies rules that will "maximize the value of [the] corporate endeavor as a whole."[268] This is why it has long been considered public policy to refuse to enforce agreements separating voting power from stock ownership, except in carefully-carved-out exceptions.[269]

Where those exceptions have been made, they have not been made without due regard to the potential harm of separating voting rights from beneficial ownership. Thus, the common law recognized that a legal holder with no interest in the stock, called a "naked" or "dry" trustee, was bound to vote at meetings according to the instructions of the beneficial owners.[270]

Voting trusts, in which shares were pooled into a common bloc to be voted as such by a trustee, were illegal at common law.[271] Once the practice of personal attendance at shareholder meetings became impractical, and the majority of corporate votes shifted to proxy contests, the law evolved to accept voting trusts.[272] However, these were subject to "strict statutory limits and regulation,"[273] which recognized that beneficial owners would still be legally protected because they would have claims against a trustee who violated its fiduciary duties.[274] Thus, there was no true severance of the legal and beneficial interests.[275]

When there was real severance of legal and beneficial interests, courts have had no problem denying record owners from voting. Thus, in a case where a corporate director bought a controlling interest in the corporation but took proxies from the sellers instead of registering the transactions with

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265. *Id.* at 72.

266. *See id.*

267. *Id.* at 12, 15.

268. *Id.* at 35.

269. *See* Richard Maidman, *Voting Rights of After-Record-Date Shareholders: A Skeleton in a Wall Street Closet,* 71 YALE L.J. 1205, 1207 (1962).

270. Am. Nat'l Bank v. Oriental Mills, 23 A. 795, 799 (R.I. 1891); *In re* Canal Constr. Co., 182 A. 545, 548 (Del. Ch. 1936).

271. EASTERBROOK & FISCHEL, *supra* note 57, at 65.

272. *See* Mackin v. Nicollet Hotel, Inc., 25 F.2d 783, 786–87 (8th Cir. 1928).

273. A. A. Berle, Jr., *Non-Voting Stock and "Bankers' Control,"* 39 HARV. L. REV. 673, 675 (1926).

274. *See In re* Giant Portland Cement Co., 21 A.2d 697, 702 (Del. Ch. 1941).

275. Carnegie Trust Co. v. Sec. Life Ins. Co. of Am., 68 S.E. 412, 421 (Va. 1910) (noting that in the case of an active trust, as opposed to a dry or naked trust, "there would be no separation . . . of the ownership of the stock from the beneficial interest in it").

the corporation—in an attempt to evade a one-vote-per-shareholder limitation in the corporate charter[276]—the Minnesota Supreme Court invalidated the proxy votes cast because the record owners had no beneficial interest in the shares.[277] In Delaware, courts have long recognized that unrecorded assignees had the right to compel a record owner they purchased from to grant them a proxy or cast votes according to the instructions of the assignee.[278]

Today, the policy supporting corporate suffrage is recognized by the implementation of the SEC proxy framework.[279] However, it is complex and confusing, and drives up agency costs by imposing significant compliance costs on issuers.[280] These costs are borne by the shareholders. In effect, shareholders are forced to pay an extra fee to vote.

Corporate law is intended to supply rules that "maximize the value of [the] corporate endeavor as a whole,"[281] not rules that decrease its value. Securities law works toward similar ends. Its goal is to maximize the value of securities by encouraging liquidity.[282] This Comment has shown how the evolution of securities law and practices had an unquestionably significant benefit for stock as an investment security, but that evolution has also had unintended consequences that have harmed stock as a corporate membership interest under corporate law. By inhibiting efficient shareholder suffrage, this evolution has restrained the ability of corporations to maximize their value. But this does not need to be an either/or choice. Corporate law is meant to be enabling, and is intended to allow for significant "private ordering" for corporations to run themselves largely as they see fit.[283]

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276. Dennistoun v. Davis, 229 N.W. 353, 354 (Minn. 1930).

277. *Id.* at 356. This case also demonstrates the importance of the stock ledger to the corporation. Were a corporation not permitted to rely on the stock ledger to determine its shareholders, it would be much easier for people to gain control of the corporation without the corporation's knowledge. *See id.*

278. *See In re Giant Portland Cement Co.*, 21 A.2d at 701. This may seem at odds with the ruling in *Dennistoun*; however, that case was focused on the relationship between a corporation and an unrecorded assignee, not the relationship between a record-owner seller and beneficial assignee. *Compare Dennistoun*, 229 N.W. at 356 (noting that the purpose of the transfer-registration requirement was for the protection of the corporation against transfers it lacked notice of), *with In re Giant Portland Cement Co.*, 21 A.2d at 702 (noting that a nominal owner owes duties to the beneficial owners it has sold to, and may be answerable in damages to the beneficial owner if the nominal owner votes in a manner that materially affects the rights of the beneficial owner).

279. *See supra* Part IV.

280. Brown, *supra* note 38, at 726 (noting that all of the costs of the communications process, including brokers' costs, are absorbed by the issuers).

281. *See* EASTERBROOK & FISCHEL, *supra* note 57, at 35.

282. *See* Mann, *supra* note 128, at 959–60.

283. *See* Williams v. Geier, 671 A.2d 1368, 1381 (Del. 1996).

The role of corporate law is to provide a framework that prevails unless changed by a corporate charter or bylaws; that framework "should be the one that is either picked by contract expressly or is the operational assumption of successful firms."[284] The absolute cornerstone of the corporate form has always been the voting participation of the residual claimants. Any law that threatens this right should be interpreted very strictly to ensure that it does not violate the policy concerns that underlie the corporate form.

B. The Omnibus Proxy Should Not Be Required

It is clear that a shareholder's right to vote today does not originate from registration with a corporation.[285] Rather, "the right to vote . . . is an incident of the ownership of stock" itself.[286] The right of a corporation to rely on its stock ledger is really an evidentiary rule that functions as a legal defense protecting the corporation.[287] In an era in which shareholders attended meetings in person, and did not have airplanes to take them anywhere in the country in a matter of hours, this rule was vitally necessary. Corporations had to provide sufficient notice to their shareholders before the meeting, which meant they had to know who to send notice to and who would be allowed to vote months before the meeting.[288] Reliance on the stock ledger guaranteed a more certain and efficient process.[289] Allowing shareholders to prove their interests any other way would have crippled the voting process.[290] It would have also been legally impossible, as inspectors of elections had purely ministerial powers.[291] They had no judicial powers and thus were not allowed to exercise discretion in determining whether a voter was a valid shareholder or not.[292]

Today, shareholders rarely attend meetings in person. Record dates remain necessary due to the time needed to provide notice and distribute proxy materials; however, the original purpose of looking to the corporate

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284. EASTERBROOK & FISCHEL, *supra* note 57, at 36.

285. *See In re* Giant Portland Cement Co., 21 A.2d 697, 701 (Del. Ch. 1941).

286. Dennistoun v. Davis, 229 N.W. 353, 355 (Minn. 1930).

287. *See In re Giant Portland Cement Co.*, 21 A.2d at 702.

288. *See id.* at 699–700 (explaining the purpose of record dates to allow for the determination of shareholders "entitled to notice of, and to vote at" a meeting).

289. Kurz v. Holbrook, 989 A.2d 140, 164 & n.6 (Del. Ch. 2010), *aff'd in part, rev'd in part sub nom.* Crown EMAK Partners, LLC v. Kurz, 992 A.2d 377 (Del. 2010).

290. *See* Williams v. Sterling Oil of Okla., Inc., 273 A.2d 264, 265 (Del. 1971) (noting that disenfranchisement was unfortunate but preferable to uncertain election procedure and impractical delay).

291. *Id.*

292. *Id.*

books is no longer served by actually looking to the corporate books.[293] Looking at the stock ledger of most publicly traded companies today simply reveals what anyone involved in the process already knows—that its shares are held at DTC.[294] Before the immobilization of shares, corporate law provided for direct communication between corporations and their shareholders, "and relied on the information in registered shares to do so."[295] But today corporate books no longer record all the transactions of the issuer's stock, nor do they indicate who any of the shareholders are.

As Vice Chancellor Laster observed, these responsibilities have effectively been outsourced to DTC; the stock ledger is now DTC's transfer books, which evidence their netted transactions, and the stocklist has become the Cede breakdown.[296] This is why courts have long incorporated the Cede breakdown into the stock ledger when shareholders have exercised their right to inspect corporate books and records.[297] In this sense, the vice chancellor's reasoning was perfectly on point. Recall that under the original concept of stock ownership, registration on an issuer's books established a shareholder's rights because a corporation was viewed as the custodian of its shares.[298] By incorporating the Cede breakdown into the stock ledger, he may have technically been redefining the stock ledger, but he was simply restoring its definition to include the information it was originally intended to include.

While courts should "accord to clear and definite statutory words their ordinary meaning," interpreting statutes is not merely a "dictionary-driven enterprise."[299] When interpreting statutes, courts should interpret them in a way that promotes the goal the legislature had in mind when passing the statute.[300] The definition of a stock ledger may seem clear and unambiguous to some, but that is a false perception. As the saying goes, the only constant is change. The meanings of words change over time. It is impossible to expect courts not to grant deference to historically understood meanings,

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293. *See generally Kurz*, 989 A.2d at 169 (explaining how the depository system was created and why "DTC is the world's largest securities depository").

294. *See id.* (stating that DTC holds roughly 75% of publicly traded companies' shares (quoting Larry T. Garvin, *The Changed (And Changing?) Uniform Commercial Code*, 26 FLA. ST. U. L. REV. 285, 315 (1999))).

295. Donald, *supra* note 5, at 66.

296. *Kurz*, 989 A.2d at 171.

297. *See, e.g.*, *id.* at 161–62 ("[O]ver three decades ago, when stockholders first sought stocklists after the creation of the depositary system, the Court of Chancery did not hold that the depository was the stockholder of record and the stock ledger stopped there. Our courts instead held that the Cede breakdown was part of the stock ledger . . . .").

298. *See supra* notes 100102.

299. Speiser v. Baker, 525 A.2d 1001, 1008 (Del. Ch. 1987).

300. *Id.* at 1009.

but the idea that words are immutable and thus should always be taken to mean what they were understood to mean at one stationary point in time is flawed. Here, where that idea would serve to inhibit the clear intent of the legislature, it cannot be said to be unambiguous. "When application of [a] statute . . . reveals a latent ambiguity," courts examine the law "in the context of the particular social problems it [sought] to address."[301] When a corporation needs to know who its shareholders are and the statute directs the corporation to use the stock ledger to determine their identities, but an inspection of the stock ledger does not reveal the residual claimants, the statute is clearly ambiguous.

The importance of shareholder suffrage—and its exercise by those with the beneficial interest—is clear; since the days of the first corporations it has been supported by common law, statutory law, public policy, and corporate practices. This is demonstrated by the fact that corporations have universally granted the vote to residual investors at the expense of all others.[302] It is made even clearer by the fact that when corporations are insolvent or bankrupt, shareholders lose the controlling vote because they no longer have the residual interest.[303] And it becomes irrefutable when one recognizes the fact that corporations that vest voting power—and therefore control—in beneficial owners perform better than those that do not.[304] Integrating the Cede breakdown into the stock ledger would prevent the disenfranchisement of shareholders without offending this concern.

Many may be unconvinced by this argument for integrating the Cede breakdown into the stock ledger to satisfy legislative intent. Indeed, the vice chancellor's ruling in *Kurz* was contrary to long-established precedent in every state. Courts believed it necessary to prevent every close proxy fight from leading to "protracted and costly litigation."[305] If the Cede breakdown is not to be integrated into the stock ledger, then the Delaware statute seems to clearly require the omnibus proxy; it specifically states that the ledger "shall be the only evidence as to who are the stockholders,"[306] and it has been common practice to treat DTC as the registered holder. Even for states that follow the Revised Model Business Corporation Act—such as Texas, where the statute states, "[A] corporation *may* consider the person registered as the owner of a share in the share transfer records of the

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301. MMI Invs., L.L.C. v. E. Co., 701 A.2d 50, 63 (Conn. Super. Ct. 1996) (quoting Conway v. Town of Wilton, 680 A.2d 242, 249 (Conn. 1996)).

302. *See* EASTERBROOK & FISCHEL, *supra* note 57, at 67.

303. *Id.* at 69.

304. *See id.* at 72.

305. *E.g.*, Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651, 668 (Del. Ch. 1988).

306. DEL. CODE ANN. tit. 8, § 219(c) (West 1974 & Supp. 2011).

corporation . . . as the owner of that share"[307]—the practice has been the same.

However, there is an alternative argument against the necessity of the omnibus proxy. Recall that the omnibus proxy is said to confer "voting authority upon bank and broker participants with respect to the shares held in their DTC accounts on the record date."[308] While a written instrument typically evidences a proxy, the writing does not establish the proxy authority.[309] Vice Chancellor Laster noted this important point in his opinion in *Kurz*.[310]

A proxy is simply a specific type of agency relationship in which one party authorizes another to act on her behalf.[311] Proxy authority can exist without the piece of paper,[312] and can be implied from the facts and relationships in a case.[313] It stands to reason that because DTC generally transfers the omnibus proxy to its participants as a matter of course, the agency relationship is implied and DTC simply issues the omnibus proxy as a matter of ministerial recordation. This is the approach Vice Chancellor Laster took when he recognized that DTC "inevitably" transferred its voting authority.[314] If an implied agency already exists between DTC and its bank and broker participants—a claim further supported by DTC's contracts with its participants—then the physical omnibus proxy is unnecessary for beneficial owners to vote.

VI. CONCLUSION

While these are practical legal arguments that may work within the existing legal framework, they are inelegant solutions at best. Indeed, the entire concept of requiring a proxy from DTC flips the notion of the traditional agency relationship on its head. When a broker executes a proxy, he is acting as an agent—in accordance with federal rules—for his customer who holds the beneficial interest, not for DTC.[315] The right to vote under

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307. TEX. BUS. ORGS. CODE ANN. § 21.201 (West 2012).

308. Wilcox et al., *supra* note 206, at 12-7.

309. Duffy v. Loft, Inc., 151 A. 223, 227 (Del. Ch.) (noting that the written instrument is merely evidence of an agency relationship), *aff'd*, 152 A. 849 (Del. 1930).

310. Kurz v. Holbrook, 989 A.2d 140, 165 (Del. Ch. 2010), *aff'd in part, rev'd in part sub nom.* Crown EMAK Partners, LLC v. Kurz, 992 A.2d 377 (Del. 2010).

311. *Duffy*, 151 A. at 227.

312. *See id.*

313. *See, e.g.*, Davis, *supra* note 101, at 1066 (analyzing cases in which courts have inferred proxies from agreements between parties, even when the agreement was not originally intended to grant proxy authority).

314. *Kurz*, 989 A.2d at 161.

315. *See* discussion *supra* in Part IV.

corporate law is intended to belong to the residual claimant, i.e., the beneficial owner,[316] and the proxy arose to allow the residual claimant to cast a vote without having to attend a meeting.[317] As markets evolved and investors began purchasing and holding securities in nominee name through intermediaries, courts began implying proxy relationships between the beneficial owners and the brokers they held through to justify the continued reliance on recordation.[318] While courts recognized the intermediary as the record owner, they also clearly recognized that the right to vote derived from the beneficial owner.[319] The beneficial owner was the principal in the relationship, and her bank or broker was the proxy.

Share immobilization has unfortunately inverted the traditional proxy concept. The SEC proxy system, though it had the noble goal of restoring shareholder rights to beneficial owners, has helped to enshrine this inversion in practice and law. Recall that DTC does not have discretionary authority to vote the shares it holds, nor does it have any interest in the shares that it stores.[320] Even if corporations are entitled to recognize its votes under state law, DTC likely does not have the legal power to vote the shares that it holds since it does not have legal title to those shares.[321] Yet under the system as it exists today, DTC is treated as if it is the principal shareholder and the beneficial owners as DTC's proxies. The concepts underlying proxies simply do not apply to DTC, and there is no practical reason to require a proxy from DTC. This requirement is an absurd result of ad hoc modifications to the law. It is a legal artifact of a bygone legal era, stretched beyond recognition to the point that it now inhibits what it was created to empower.

The immobilization of share certificates has proven to be enormously beneficial for capital markets. However, while immobilization solved one problem, it gave rise to another by decoupling shareholder rights from the owners most interested in exercising them. The federal regulations and stock exchange rules that have been implemented to bridge the gap and

316. *See* EASTERBROOK & FISCHEL, *supra* note 57, at 68–69.

317. *See* Mackin v. Nicollet Hotel, Inc., 25 F.2d 783, 786 (8th Cir. 1928).

318. *See* Brown, *supra* note 38, at 694–95 ("Early cases routinely concluded that, by using street name accounts, beneficial owners implicitly transferred their voting rights to brokers.").

319. *See, e.g.*, *In re* Pressed Steel Car Co. of N.J., 16 F. Supp. 329, 336 (W.D. Pa. 1936) ("An equitable owner of shares who permits them to stand in his broker's name impliedly authorizes the broker to vote them; any other rule would lead to hopeless confusion.").

320. *See* Kurz v. Holbrook, 989 A.2d 140, 161 (Del. Ch. 2010), *aff'd in part, rev'd in part sub nom.* Crown EMAK Partners, LLC v. Kurz, 992 A.2d 377 (Del. 2010).

321. *See* Dennistoun v. Davis, 229 N.W. 353, 355 (Minn. 1930) (noting that statutory regulations, corporate bylaws, and common law provide that title to shares passes to purchasers upon assignment for value).

keep shareholders involved have been inadequate, hugely inefficient, and have created numerous problems of their own.

Allowing corporations to limit their recognition of shareholders to those registered on corporate books once served an important public policy. However, this limit now restricts the very purpose it was intended to serve, and technology today has greatly reduced the burden on issuers of keeping track of beneficial owners. Continued reliance on this old tradition harms both shareholders and corporations. The right to vote is important to investors who continue to value voting stock over non-voting stock, and critically necessary to optimize corporate decision-making. Communication between corporations and their owners is also vital for the proper functioning of corporations.

Federal law recognizes these important policy concerns and has evolved to protect them. State corporate law, which was designed to support these interests, has failed to evolve with the marketplace. By blindly adhering to and codifying old common-law principles, corporate law has lost track of its foundational principle that voting rights belong to the residual claimants. This blind adherence has ironically completely subverted those principles and now threatens the integrity of the corporate form.

By continuing to rely on the old rule requiring stockholders to register with the corporation before exercising their rights, corporate law now hinders the same policy goals it originally developed to support. It is time for significant revisions to corporate codes that reconnect corporations with their shareholders. This is necessary to allow corporations to maximize their efficiency and value once again, and to improve the value of stock as an investment by reconnecting stock ownership with the voting rights that investors value so highly. However, until those revisions are made, shareholders remain at risk of being disenfranchised, public trust in corporations will continue to decrease, and the integrity of the corporate form will remain at risk. Courts should not let blind adherence to old applications of statutes threaten the vital policy goals those statutes were originally designed to promote.

David Brooks