"ONE SHARE, ONE VOTE"

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SECURITIES AND EXCHANGE COMMISSION

COPY

PUBLIC HEARING ON :)
)
NEW YORK STOCK EXCHANGE'S PROPOSAL)
AMENDING "ONE SHARE, ONE VOTE" RULE)
)

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BEFORE THE

SECURITIES AND EXCHANGE COMMISSION

In the Matter of:	)	
	)	
NEW YORK STOCK EXCHANGE'S PROPOSAL AMENDING "ONE SHARE, ONE VOTE" RULE	)	File No. H

Room 1C30
Judiciary Plaza Building
450 5th Street, N.W.
Washington, D.C. 20549

Tuesday,
December 16, 1986

The above-entitled matter came on for hearing, pursuant to notice, at 9:06 a.m.

BEFORE: JOHN S. R. SHAD, Chairman
CHARLES C. COX, Commissioner
JOSEPH GRUNDFEST, Commissioner
EDWARD FLEISCHMAN, Commissioner
AULANA PETERS, Commissioner

APPEARANCES:

SEC Staff:

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GREGG JARRELL
Chief Economist

WITNESSES:

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New York Stock Exchange

ARTHUR LEVITT, JR., Chairman
RICHARD SCRIBNER, Senior Vice-President
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MOOM

C O N T E N T S

MOOM 2

C O N T E N T S (Continued)

P R O C E E D I N G S

(9:06 a.m.)

CHAIRMAN SHAD: Ladies and gentlemen, these hearings are to address an issue of great public interest and importance, the New York Stock Exchange's proposal to amend its 60 year old One Share, One Vote listing requirement.

The proposal would also -- would proposal would allow the New York Stock Exchange listed companies to issue classes of stock with any co-voting rights if approved by a majoriety of independent directors and public shareholders.

The proposal is in response to the recent competition for new listings among exchanges in the National Association of Securities Dealers. All companies are subject to state law which requires shareholder approval of such voting provisions.

The New York Stock Exchange is the only marketplace with a one share one vote requirement. The American Stock Exchange's rules impose limited voting restrictions and the NASD does not have such requirements.

When several New York Stock Exchange listed companies changed their corporate structures in 1984 to permit classes of stock with disparate voting rights, the New York Stock Exchange imposed a moratorium on the enforcement of its one share and one vote rule.

After two years of deliberations the New York

Stock Exchange, the American Stock Exchange, and the NASD, have not been able to agree on a uniform standard.

The New York Stock Exchange proposal has generated a great deal of intention and comment from major groups representing public shareholders and companies, broker dealers, institutional investors, the securities buyer, and the self-regulatory organizations, as well as members of Congress.

These hearings are intended to assist the Commission in deciding whether to approve the New York Stock Exchange's proposed rule change.

Questions participants may wish to address include the following: whether shareholder voting rights should be uniform regardless of the market in which the shares are traded; what is the proper role of the Commission, Congress, and the states in this matter; whether the New York Stock Exchange's proposed standards are -- for permitting dual classes of stocks are adequate; and the cost benefit considerations to investors, the exchanges, and the issuers, of a one share, one vote requirement, or of the absence of such a requirement.

There are here today many distinguished individuals from industry, government, and the public -- and various public interest groups. It is an excellent group of hearing participants to discuss the serious and complex issues

supposed.

The following simple ground rules are intended to make these hearings as useful as possible. The participar have been divided into panels based on their affiliations. And each panel has been assigned a specific time period. Each panel participant will be permitted to make a five minute opening statement. The five minute rule must be enforced so that everyone will be able to speak.

After the opening remarks the Commissioners and senior staff will direct questions to the panelists.

I am an exception to the rule in the case of Mr. Phelan who is the first person to address the hearing, if I ever find it, who will -- we're looking forward to his opening remarks and, if the schedule permits, approximately until 10:00 for the full discussion of Mr. Phelan's views.

Mr. Phelan?

MR. PHELAN: Thank you very much, Mr. Chairman. I welcome this opportunity -- is this on? Can you hear all right? Welcome this opportunity to appear before the Commission. I am John J. Phelan, Jr., Chairmand and Chief Executive Officer of the New York Stock Exchange. On my left is Richard Grasso, who is executive vice president of the New York Stock Exchange, and is also available to the Commission to answer any questions they may have, after my testimony, or on any other panel that you might have as well.

In September 1986 the New York Stock Exchange filed a proposal to modify its voting rights policy. We would allow corporations issuing equity securities with different voting rights to list and continue listing provided certain safeguards to protect public shareholders are met.

I welcome this opportunity to testify in support of these modifications. The key element in the proposal is the approval procedure for any variation from the historical one share, one vote policy. We would require the approval of the majority of the independent directors, and the majority of the shares owned by the public shareholders eligible to vote.

Shares owned by corporate officers, directors, members of their immediate families, or their affiliates, or affiliates of the issuers, would be excluded from the approval process.

It should be noted that the proposal will require the approval of majority of the shares owned by public shareholders eligible to vote, not merely a majority of those who actually vote.

Since shares not voted have the same effect as a negative vote, a change cannot be approved as a result of a low participation, or the action of a small quarum.

The approval requirement would not apply if the

stock with a different voting right was outstanding at the time that the company first became a public company, nor would it apply if the stock was created in a spinoff transaction with distribution to the common shareholders.

The modified policy provides that listed companies that have created different voting rights, stock, in recent years, but have not obtained the necessary approvals, would have two years in which to apply.

Existing prohibitions against non-voting stock would not be changed.

With these modifications, the NYSE proposed listing standards will still exceed those of state law, as well as those of any other self-regulatory organization, and we believe will safeguard the rights of shareholders.

In our deliberations we also considered a sunset provision that would require shareholders to confirm the continuation of different voting rights at specific intervals. While this had appealing aspects, there was little support for it among our constituents or the Board of Directors.

Among the difficulties identified, two were prominent. One was that the market price volatility that might occur in advance of each confirmation day, and the other concern, which I think is more fundamental, was that the requiring confirmation in the short and intermediate term might discourage the infusion of permanent equity

capital.

The subject of different voting rights has been under discussion at the Exchange and throughout the corporat community for several years. Our board's decision to revise this listing standard was a particularly difficult one because we support the general concept of one share, one vote, as part of our broad commitment to corporate democracy.

However, corporate America today is experiencing changes for which there are no predecence, for practical as well as philosophical reasons, corporate issuers have told us that they need optimal flexibility in the choice capital structure and the methods for raising new money.

In response to the proliferation of tender offers in recent years, and the use of new types of equity to effect acquisition, shareholders of some of our listed companies have approved the creation of a second class of common stock having multiple votes per share.

Under our current listing standards this makes issuers subject to delisting even though they remain otherwise fully qualified, which raises a number of public policy and shareholder protection issues.

Consequently, this policy places the Exchange in opposition to the will of shareholders in the growing number of our listed companies. In the near time more than 29 companies have already created shares with different voting

rights, and others are now contemplating such measures.

In the long term hundreds of growing companies would eventually be blocked from future eligibility for listing on the NYSE.

In June of 1984 our Board of Directors appointed a subcommittee of shareholder participation and quality listing standards. They made an extensive study that included comments from Exchange constituents.

In May and June of 1985 I testified on this issue before three Congressional committees, emphasizing these points. First one share, one vote has served the investor and the financial community well since it was reintroduced in 1926.

Second, evolutionary changes in the equity markets, regulatory effectiveness, and the role of substitutional investors, have dramatically altered the environment in which these rules operate.

Third, a number of companies have already proposed and received approval from their shareholders for restructuring of their capital into multiple classes of common stock with different voting rights. Two other efforts to resolve this issue were unsuccessful.

In June 1985 the NYSE amex and the NASD met with the SEC Chairman to explore the possibilities of other markets accepting the standard of one share, one vote.

That effort was unsuccessful, as the other markets were either unwilling or unable to adopt the one share, one vote standard.

And on June 18, 1985 legislation was introduced into the House and Congress to mandate standards for all companies publicly listed on the Exchange or traded through an automated quotation system.

Over a year has elapsed since these events, and the issue has not been resovled. However, the world has not stood still. If anything, the need for a resolution of this issue is even more urgent. A level playing field must be adopted for the companies qualified for trading in a national market system. The New York Stock Exchange in today's business environment certainly cannot stand alone in applying this one share, one vote principle.

In recognition of these developments, and the need to maintain investor safeguards, one of the following steps should be taken. Promptly develop and implement rules requiring all issuers of a size to qualify for trading in a national market system to comply with one share, one vote requirements, or approve our proposed modification and current listing standards.

We believe our proposal continues to protect the shareholders, gives them participation in deciding whether a second class of common stock should be created, and also

allows corporations additional flexibility in how they structred themselves and how they may raise capital.

I thank you very much, Mr. Chairman.

CHAIRMAN SHAD: Thank you, Mr. Phelan.

I'll start it off with the questions. You indicated basically, I believe, that you favor, among many things you've indicated, you favor the one share, one vote rule, but competitive pressures have compelled the New York Stock Exchange to propose the revision that you've described.

And I wonder if you would comment on the proper rule of the SEC, the Congress, and the states, in addressing the concept of one share, one vote, and with requiring all markets to come to such a standard.

MR. PHELAN: First I would like to comment that I think -- I would not like to emphasize merely the competitive aspects of it, but I think a good number of our listed companies have said to us that -- to state laws in which they are registered, and other things, that their ability to raise capital and to restructure themselves in some way is something that while in 1926 the Exchange should be involved, and because there weren't too many other people around there to do it then, then that environment has changed, and that, particularly, if, in fact, their shareholders say that we think it's all right, they really don't think that we should have the right to oversee that.

As requires what the role of the SEC is in this matter, I assume that we are today because at least somebody thinks that perhaps you do have some role in that.

I don't know whether the SEC has the authority to mandate this or not. We have a legal advisory committee, and there are a lot of other people that have a variety of views on this subject. But I do think that in all our looking, and in all our research, that there is nothing that we have proposed today that would in any way be in opposition the the 34 Act which we are concerned with.

As far as Congress is concerned, we've testified three times in Congress. There have been a number of bills up on that, and I think Congress has asked for you to take a look, and at least some Congressmen have thought that you have authority in this area.

As far as the states are concerned, there are any number of states that have a variety of rules and regulations. Some of them are very tough and very strict, and others are very loose, and I suppose there is no uniformity of opinion but that most states, at least, would allow multiple classes of common stock with or without shareholder votes and approval.

CHAIRMAN SHAD: Well, as part of this basic question, I'd like to word that, in order to accommodate the many people that we'll be hearing, participating, the

Commission is even trying to hold it to one question per Commissioner. We can always go back around if time permits.

I want to get a little clarification on my basic question, however, and that is that do you have any concerns as to the SEC's authority to impose a standard one share, one vote for all markets?

MR. PHELAN: No, I don't think I have any concerns about that, and all the things that we do, including our changes and our listing requirements, we do file them with the Commission. I think above a certain level of sized corporation, and number of shareholders, that perhaps that standard might become too burdensome, and that it might be impossible for every corporation in the United States, particularly the young fledgling companies that are coming out.

It might be very difficult for them to accept that. But I think once they get to a certain size, and we picked 500 shareholders, it could be anything like that where you become truly a public corporation, then it seems to me that you ought to have the shareholder approval to do that.

CHAIRMAN SHAD: Thank you. Commissioner Cox?

COMMISSIONER COX: Thank you, Mr. Chairman.

MR. Phelan, my question regards part -- the very first part of your statement where you point out the key element in the proposal is the requirement for shareholder

approval, and the way that is in your proposal.

One of the written testimonies that will apply this afternoon in the academic -- or later this morning in the academic panel session, makes a point that despite the shareholder approval part of this proposal, that it won't really work, that it won't express a true reflection of shareholder will, but due to problems in voting in these kinds of situations, that it won't be what shareholders really desire.

Do you -- you may not have seen this kind of argument before, but I would be interested if you would expand on your view of why the shareholder approval would be safeguard for shareholders.

MR. PHELAN: Well, we come at it from two points. One is to take a look at the boards and look at the independent directors, and if they were to be shareholders, to strip them of that voting right. But as independent directors representing the interest of the corporation and its shareholders, and the public at large, you should get a majority of their voting as well and have the management stand aside from that so that at least you get an independent outside look that is representing the shareholder and the shareholder interest.

Secondly, majority of all the shares have to be voted, and I don't know how you get the true intent and will

of the shareholders except for going and asking them. It's much like going and asking the voters what they think on a certain issue. And I think that our proposal says that of all the shares that are outstanding, you must get a majority of them to say, yes, this is fine with us, and that we don't have any problem with it, and it seems to me I don't know how else you assess the intent and desire of shareholders as well.

I would like to speak to another point because I do myself although we couldn't get a consensus on it, have one small problem, and that is that one classification, or one generation of shareholders, forever disenfranchising all shareholders, so that somewhere along the line I think it probably would be optimum if, in fact, you could have this come up for a vote every once in a while.

The problem with the votes, as we stated, are twofold. One is that if you do it for five or ten years you are likely to discourage either the creation of the second class common stock, or a thrust towards debt rather than equity financing, if that's the vehicle you were going to, and secondly, as we pointed out before, that there are some problems as you near that date as to what's going to happen to that issue prior to the shareholder issue, and you may get some volatility into the market for that.

But, otherwise, I think that I'm not sure how else

you would ask the shareholder whether they approve that or not.

CHAIRMAN SHAD: Commissioner Peters?

COMMISSIONER PETERS: Thank you, Mr. Chairman.

Mr. Phelan, I think your prepared testimony and your response to Commissioner Cox's question, underscores what is at the heart of this question of the rule proposal we have before us, and that is that it will result in a disenfranchisement of shareholders of currently -- that currently hold voting rights.

And my question to you is that -- is did the Board of Governors of the New York Stock Exchange, or what did the Board of Governors in the New York Stock Exchange consider in arriving at the majority of the outstanding shares eligible to vote standard for approval of this rule? What, in other words, did you take into account to determine whether that minority that may not wish to give up their voting rights would be adequately protected in the voting process?

MR. PHELAN: Well, first of all, I think the board reiterated its desire to have one share, one vote. I clearly -- if the Lord could create the universe in which we existed they would say that you should have one share, one vote. They say if you have to go to an alternative, then they thought that this perhaps was an acceptable alternative.

What they talked about was public shares only, and just like any other vote that you take on any other thing, the majority of those public shares would have to approve it.

Those people that lost may have been a minority or a significant minority, but at leat they had the right to exercise their voice and their vote, much like they do in any other corporate issue that is submitted to them for a vote.

I don't know that that answers your question or not.

COMMISSIONER PETERS: Did you consider having a super majority like 90 or 80 percent, or 70 percent, to reduce the chance that there might be a significant minority?

MR. PHELAN: Yes, we did consider that, and I think that if we wanted a super majority, which is certainly another alternative to what we proposed today, it puts an extra burden on getting that many people to vote, and was considered that, in effect, it may be very difficult to get that kind of a vote, but that certainly is an alternative.

CHAIRMAN SHAD: Thank you, Commissioner Peters. Commissioner Grundfest?

COMMISSIONER GRUNDFEST: Thank you, Mr. Chairman.

Mr. Phelan, I think you've been quite candid in describing the certain lack of enthusiasm on the part of the New York Stock Exchange for its own proposal.

The Exchange noted that there are 29 companies currently on the Exchange that have dual class capitalization: There are at least seven more companies with dual class capitalization plans currently pending. In your September 16 letter to the Commission you stated, as you repeated today, that the decision by the board was a difficult one, and if the board continues to support the one share, one vote concept, and believes that it should be preferred.

In a sense, what I hear you saying is you're asking us to stop you before you kill it again. Let's put a stop to this spread of dual class capitalizations and see what we can do to keep the one share, one vote standard.

Let me play something of the devil's advocate in this context and ask you to explore the situations in which the one share, one vote rule has historically applied by the New York Stock Exchange might apply to situations that don't involve concerns of disenfranchisement, and might, therefore, lead to situations that would really be overly restrictive.

Three relatively simple examples that come to mind. One, consider a situation where a company goes public by selling non-voting shares. In that context you have a dual class capitalization, but nobody is disenfranchised. No rights are taken from stockholders that expected they would have the right to exercise a vote.

The second situation you have a company that goes public by selling 30 percent of its shares. Now, these stockholders that hold 30 percent of the shares can vote all day and all night and they'll never be able to decide what happens in that corporation because under majority rule the 70 percent stockholder will always determine the future course of the corporation.

And the third situation you can imagine a case where a corporation has outstanding, one share, one vote share, and decides that to raise further capital it wants to issue a new class of non-voting shares.

That could actually be perceived as beneficial by the existing stockholders because it prevents further dilution of their voting rights.

Now, in each of these three cases we have examples of a violation of the one share, one vote principle, but we don't have a situation that involves disenfranchisement.

Does this suggest that there might be some principle or some rule that would be directed at a concern over disenfranchisement of current stockholders that would not be as strict as the current one share, one vote principle followed by the New York Stock Exchange, but by the same token might perhaps not go as far as the proposal currently on the table.

MR. PHELAN: Well, firstly, I think I would have

phrased your introductory remark differently, but I would like to make it plain that the board and the Exchange does not believe in killing in any form.

I think that as far as going public with a different class, we have assumed that there was an initial offering the fact that the public bought those shares, was, in fact, the same as voting for them, and that's how they voted, was with their money.

In the 30 percent problem, I'm not sure how we face up to that. Dick, do you have some idea on that?

COMMISSIONER GRUNDFEST: I think that was meant pretty much as an example of a situation where you can follow the principle of one share, one vote, but one in which the principle is followed far more in form than in substance.

MR. PHELAN: Yes, that might be true, and which is why we raised the issue of not doing those. You still have to get a majority of the public shares outstanding in order to do that, so you do have some vote, and I suppose that once this goes up there are ten other creative proposals that come into play somewhere. That's why I think we always get back to no matter what they do, and no matter what percentage, and no matter how they do it. You have to get a majority of the independent directors, and you have to get a majority of the public shares outstanding to do it, or a simple majority, whatever people would like.

But I think that the fundamental basis is that you must go to those two public sources in your corporation in order to do that, and I think that that's the underlying principle in everything that we've proposed here, not to go off to shareholder approval in some way, and also add the independent directly to it as a safeguard representing the public and the shareholders.

CHAIRMAN SHAD: Thank you, Mr. Grundfest.

Commissioner Fleischman.

COMMISSIONER FLEISCHMAN: Mr. Phelan, your prepared remarks indicate that the essential role remains unchanged; that is to say, the protection of shareholders' interest and their right to participate in corporate affairs.

Aside from the particular section on the company manual that is proposed to be changed, there are other parallel of sections neighboring in the company manual that relate to shareholder approval policies for a variety of transactions.

If the manual were changed in the manner proposed, how would the exchange continue the administration of the shareholder approval policies? Would, for example, groups of shareholders who had given up their vote, or limited their vote, continued to have a say in the particular items that are governed by the shareholder approval policy otherwise applicable?

MR. PHELAN: I think in general we still have the principle of having shareholder participation. We have asked a subcommittee of our legal advisory committee to take a look at the company manual. In working on it they have be at that labor for seven years. They have not yet issued their final reports although they have issued several interim reports, and we would be happy to share those results with you when they do finish, and, of course, then they would have to go through the procedures and processes of the rest of the board.

The company manual discussion, one, is that we try to in the modifications, or at least looking at them, as we looked at all our rules, are trying to keep the basic principles that the change has stood for over the years, and then take a look at whether they need to be updated in some way, made more efficient, and so forth.

So I think we would be better able to answer your question, Commissioner, once we get the recommendation of that group.

CHAIRMAN SHAD: Members of the staff, we have with us here on the right the senior members of the Commission's staff concerned with this issue.

Do any of you have a comment or question that you wish to make at this time?

Start with Mr. Davis.

MR. DAVIS: Mr. Phelan, has Exchange made any exceptions to its one share, one vote rule throughout its 60 year history except in the recent moratorium?

MR. PHELAN: I think the listing of the Ford Motor Company shares in the middle '50's.

MR. DAVIS: I believe you said that the one share, one vote rule has served investors well. I was wondering if you'd noticed there had been any disservice to the shareholders of Fort Motor Company as a result of the exception?

MR. PHELAN: No, but that was put in the trust, and there were so many shares outstanding that at that point in time I must say that I was not in a position of authority then having just entered the business, that it was felt that it was such a broad public issue that both the underwriters, the company, the shareholders, and everybody else thought it should be listed, and so that's why it was done.

MR. DAVIS: One final question. With regard to your statement, one share, one vote has served investors well, now, how do you know that? How can you tell?

MR. PHELAN: It's probably that I was brought up under that philosophy, and I was indoctrinated with it, and like myself, I like my franchise and the right to vote vote as a citizen and as a shareholder. I've never invested

in any company that has two classes of common stock basically because whether I exercise it or not, I like that, and basically because I've heard things even on national and state elections that because people don't vote maybe certain issues shouldn't be brought to them. The fact that people don't vote doesn't mean that they shouldn't be able to and shouldn't be allowed to vote.

So that I think that one of the -- I really do believe in this world that everything should have a checks and balance, and I think that one of the checks and balance in the system, in the corporate structure that we have had in this country, has been a voice and said by shareholders. And I personally myself, and I think I reflect the views of the board on that, think that that check and balance being the shareholders' vote, is an important one, not only serves this country well, but serves the corporations well.

CHAIRMAN SHAD: Director Quinn?

MS. QUINN: Following up on that point, Mr. Phelan, if there was --

CHAIRMAN SHAD: I would ask the staff also to initially limit yourself to one question so that we can cover all of you in the room. Thank you.

MS. QUINN: If there were widespread adoption of AB capitalization, particularly in New York Stock Exchange companies, to whom would the corporate management be

accountable? What is the check and balance that remains as the shareholder vote as essentially non-existent?

MR. PHELAN: Well, that's another issue aside from whether shareholders decide to disenfranchise themselves, and goes beyond this proposal.

But I think that there are several checks and balances in the system itself, and certainly one is the independent directors on that board, and a greater responsibility and burden would be placed on them, and I also think their independent audit committee.

MS. QUINN: The independent directors though would, in essence, then be elected by the vote to have the voting control which one could presume to be largely the insiders.

MR. PHELAN: Yes, don't get me wrong. I don't want to be in a position of defending multiple classes of common stock. I again say that I think that there ought to be shareholder votes on a lot of things, and that I believe in checks and balances in the system. The only thing that we're saying is if, in fact, the world wants to change in some way, and while in 1926 we controlled most of the world today, we don't in a variety of issues, including this one, that the very least you ought to do is go to your shareholders and get permission to disenfranchise in some way.

The issue that you talked about is a much bigger and broader one beyond the one we're talking about here.

CHAIRMAN SHAD: Director Ketchum.

MR. KETCHUM: Mr. Phelan, in the past, certainly in the recent past, the -- your companies that have adopted dual class capitalizations have generally come from companies that enjoyed an insider control perhaps 40 to 50 percent of the company already, and do you believe could suggest that the additional flexibility of being able to move to equity fund offerings as opposed to merely debt, was good news for those shareholders?

Have you had input in -- from your member firms that give you any ability to calculate whether there will be a different group of companies interested in pursuing this then companies with very substantial closely owned situations that exist now?

MR. PHELAN: Our member firm community is a heterogeneous group of people, and it depends on who will ask in the company, and what company you ask, as to what ten different opinions you're going to get.

I think that I've seen some letters here that say that it will help companies in raising capital and giving correct rate of flexibility, and I can also get you people to come up and say, by God, you shouldn't go off that because if you do that it's going to change.

Mr. Whitehead, before he left, at Goldman Sachs, was -- came from a major underwriting company who thought

that one share, one vote was absolutely fundamental to the system.

There are other people who will testify today and have submitted-- think that it gives the company and the shareholder greater flexibility in that, so it would be reasonable unanimity of opinion on that.

MR. KETCHUM: The New York Stock Exchange submitted a number of changes from the recommendations made by the policy committee, you mentioned, as well as some things you initially raised for comment. You mentioned the sunset. You also made a revision moving from a two-thirds voting standard to a majority of public shareholder -- eligible public shareholder standard.

You also eliminated a one to ten limitation with respect to the degree that the voting shares could differ.

Could you possibly comment just for a minute as to the reasons for those changes?

MR. PHELAN: Yes, I think the first one I addressed to Commissioner Peters' response, that I just thought that it was too burdensome to get out that majority, but I don't think that they're hard and fast on that one.

The second one was a ratio, and in all honestly we just couldn't -- once you decided on a different class of voting stock with different voting rights, it didn't seem to us whether you decide whether it was one for five, one for

a hundred, which really made any difference. Once you had agreed to disenfranchise yourself you disenfranchised yourself, and so that we just couldn't --

People had suggested one for ten, but we couldn't really understand really how you arrived better at one for ten rather than one for 50, or one for five. So I think that's why we left that out.

CHAIRMAN SHAD: Associate General Counsel Fienberg, do you have any comments or questions?

MS. FIENBERG: No questions.

CHAIRMAN SHAD: Chief of Commerce Jarrell?

MR. JARRELL: No.

CHAIRMAN SHAD: Let's go back to the Commission then and have another round.

Has the Stock Exchange done any kind of a cost benefit analysis of the alternative methods of shareholder voting, whether it's one share, one vote, or some variation of what you propose?

MR. PHELAN: No. If, in fact, part of the philosophy that drives this, is that we should get out of deciding if shareholders say it's okay to play God in that situation. It also seems to us that we leave to that corporation any shareholders whether they derive any benefits, cost, or otherwise, from issuing a second class of common stocks. And, Mr. Chairman, we have not done any research in that area.

CHAIRMAN SHAD: Commissioner Cox?

COMMISSIONER COX: I find this question of the NYSE's proposal very difficult because it seems to me there are two broad parts to it.

The first is involving investor protection with respect to what investors have the opportunity to purchase on the New York Stock Exchange, should they have the ability to purchase shares with dual voting classes.

The second question involved in this is whether the Commission should indirectly set corporate government standards through its listing standards. And I guess my question in this area is of these two, which do you regard as more important in the decision that's before us, or would you suggest that there is a different question that isn't included in those two branches?

MR. PHELAN: Your first branch -- the corporate government was the second, your first branch was what?

COMMISSIONER COX: The first was a narrower question of whether investor protection requires a decision that shareholders should not have the opportunity to purchase shares with dual voting classes on the New York Stock Exchange. I mean, in one sense that's the very narrow technical question that's before us, but there are implications that go with this proposal that are substantially greater.

MR. PHELAN: I think the broader question for us

is not so much who should be involved in corporate government issues because at one time and another all listed companies said that we should be involved in some times, and other times not, but I think that we have run into a difficulty forgetting about how many companies have decided to do this.

There was one -- if a company doesn't go to its shareholders, and they don't comply within two years, then nothing qualifies for that.

Secondly, there really is a fundamental issue at this point and date in whether the change itself -- what part it plays in the whole corporate government's issue, and how it imposes upon its listed companies for those types of corporate government issues that its listed companies don't think it should have any business doing so? That's number one.

And, number two, probably even more difficult, is that once a corporation for whatever reason decides that he has to go ahead with a proposal. And the shareholders say that this is all right. That doesn't -- the New York Stock Exchange in this day and age, and given what we believe in, which is basic shareholder approval, have a right to override the shareholder and say we don't care what you say, our rule is this, and we think that you don't know what's in your best interest, and we do, and, therefore, we won't allow it.

I think this is highlighted and exaggerated, which is very good, by the Dow Jones experience, which had a majority control by a shareholder block, decided that it would like to issue a second class common stock which would clearly have an impact on the voting rights of the minority shareholders.

Had the majority shareholders stand aside, and agreed to do so, and went to the minority and said would you mind if we went ahead and did this, and got a vast majority of that minority to say it was all right, then they came back to the New York Stock Exchange and now we're faced, and say, well, you've gone not only to your majority, but to your minority shareholders. Both have said okay, and now do we have the right based -- on the basis of that to say that we don't care. We still think it's wrong, and, therefore, we're not allowed to do that.

I think from a philosophical point of view, which is the main point of view that we're dealing with in that area, that we've come to the conclusion we probably do not, and we should allow that to happen even though if I were a shareholder I might not have voted for that.

COMMISSIONER COX: Okay, I guess I find this a little difficult to square with the statements that I've seen associated with the Exchange, where it said that philosophically it supports the one vote per share idea, but yet you've just pointed out that you support the idea

of shareholders determining what the voting classes of their stock should be.

MR. PHELAN: Yes. Well, I don't think there is a dicotomy there because I think we would encourage all shareholders no matter what corporation we're in to hang onto the vote, and we believe they do that, but having voted not to, we've got a problem with coming in and saying we're going to override that, and that no matter what happens, our use prevails.

So I think that that is not inconsistent. If a shareholder of any corporation doing this would come up to me, I'd say, for goodness sake, don't do it. But they said, well, we've heard your arguments, we've heard the company's arguments, we've got to vote in favor of the company, then I as an institution, I think, have a very great problem with saying, okay, you've made up your mind, you voted for it, but we're still going to negate your vote. And that's a very serious problem.

COMMISSIONER COX: Thank you.

CHAIRMAN SHAD: Commissioner Peters?

COMMISSIONER PETERS: Mr. Phelan, I'd like to return to the issue of the sunset provision that you mentioned earlier in your prepared testimony, and this morning in your oral testimony.

Your prepared testimony this morning indicated that

the Exchange considered and rejected attaching such a provision to the proposed rule because commentators felt that such a provision would perhaps create some volatility and uncertainty in the market for these shares, and would also curtail or limit infusion of permanent capital.

I'm not sure I see the logic of those fears or conclusions, but rather than debate that with you and/or the commentators, I'd like to ask you if a sunset in your view -- a sunset provision was designed so that the rule changes expired rather than had to be resubmitted for shareholder approval every five, or ten years or so, would result in the same problems, or possibly result in the same problems as the resubmission of the issue to a shareholder vote of a five or ten years.

I have in mind an analogy of sort of a voting trust where you hand over your voting right for five years and you know -- that you'll get them back in five years, or ten years, or so.

In your view, would that sort of a sunset provision involve the same -- give rise to the same problems that the commentators feared, that proposed by the Board of Governors might?

MR. PHELAN: I would speak for myself now rather than the Exchanges and institution. This is one of those issues like some others where I find myself out in a sandbar

and the tide is coming in around me. I think that there is a -- I'm much more comfortable having given shareholders the right to do that, they don't just have the right to pass that onto succeeding generations.

I think that there are a number of ways that have not been explored fully, and just somewhat you suggesting, which would take the volatility out of that in some way, which that you put it in trust for a while and can get it back.

One of the problems is though that if, in fact, you were to do equity financing in that manner, corporations might be discouraged if it was in such a short period as five years, because they know almost immediately that it's going to come up for revote again, and while they would have raised the capital, they would have to give back the vote. I don't personally see a problem with that, but other people do.

As you get out longer term, you obviously raised the horizon and the need to get that vote is put out a ways. A lot of corporations that we talked to don't like strings like that attached to it. Other people say, well, if you're going to go to that, why don't you just stick with one share vote and forget about it.

I think myself that there probably are things that can be put in place to take away that volatility, and/or to

return that.

But, as I'm saying, if you asked most of the corporations in this country today, and most other people, they're not too fond of the sunset provision.

CHAIRMAN SHAD: Commissioner Grundfest?

COMMISSIONER GRUNDFEST: Thank you, Chairman.

I'd like to explore for a moment the question of our authority to adopt this amendment and potentially to require that all Exchanges and the NASD apply the same one share, one vote standards.

Assuming that we do have that authority, is there a potential that we might be embarked on a rather slippery slope. What then would stop us from using the mechanism of the listing standards to, for example, require accumulative voting for all publicly traded corporations, or to require social responsibility committees, in addition to audit committees, or for example, to set competent standards for independent members, or boards of directors. These would all be types of activities that would not characteristically fall within the jurisdiction of this Commission.

But the suggestion that we might be able to adopt standards to apply across all Exchanges to govern the one share, one vote, the internal government's mechanism, suggest that we might have through the listing standards

such broad range and authority.

MR. PHELAN: I would really like to deal with why I'm here today, aside from your request, and that is that we as an institution felt, number one, that we had to raise the issue, and number two, that after a long process of discussion, including our own internal hearings and Congressional hearings, that we were dying to at least propose making this change, and we are required to present that change to you. And that's as far as we go because we are required to do that.

There's nothing in our filing that says that going beyond that about corporate government's issues, or that you should get involved with other things, and, unfortunately I'm not a lawyer, and I just do not know, and cannot tell you whether you have the right to deal with this, or all corporate government's issues and up. I honestly don't know that question.

CHAIRMAN SHAD: In the moments remaining, Commissioner Fleischman, do you have a further comment or question?

COMMISSIONER FLEISCHMAN: Mr. Phelan, it occurs to me that there is a reference in your prepared remarks to the Stock Exchange subcommittee's conclusion that in the current environment shareholders' rights can be adequately protected by means other than one share, one vote.

If the proposed change were put into place, how would you see accountability checks and balances within the corporation, or in the words of your conclusions, shareholders' rights being protected on an ongoing basis.

MR. PHELAN: Well, we didn't adopt the conclusion of the subcommittee in that area. We only dealt with one piece of that area, was that there was an alternative means of giving shareholders a voice in the company, particularly in the restructuring, and that's the specific piece that we talked about.

I believe that Mr. Sommers will testify later, Perhaps he can give you some insight as to how that committee felt about ongoing accountability. Our proposal only deals with specifically if you're going to restructure the capitalization and voting rights, how do you include the current shareholders in that process and decision-making without disenfranchising, and without asking them. And I think we stopped right there and didn't go any further than that.

It is difficult for at least one Commissioner to stop there with you without considering what follows.

MR. PHELAN: Well, I think that gets back to Commissioner Grundfest's, and others as well, -- as to what -- where and what that puts you in the corporate government's issue, how much authority you should have,

do have, or should have, or don't have, and what are the other checks and balances, and that's a whole other major, major issue that we just have not dealt with in our proposal.

CHAIRMAN SHAD: Thank you, Commissioner Fleischman and Mr. Phelan, Mr. Grasso. The Commission is really appreciative of your excellent presentation this morning. Thank you.

MR. PHELAN: That you, Mr. Chairman. I thank the Commission. I thank the staff as well. And Mr. Grasso will be here later on if you have any other questions.

CHAIRMAN SHAD: Thank you.

We're now going to hear from Arthur Levitt, Jr., shareholder of the American Stock Exchange.

MR. LEVITT: Good morning. My name is Arthur Levitt. I'm Chairman of the American Stock Exchange, and on my left is Dick Scribner, senior executive vice president of the Exchange.

I appear before the Commission today to express my views concerning the proposal of the New York Stock Exchange that it abandoned its longstanding rule requiring that its listed companies provide all common shareholders with one vote for each share owned. I'm opposed to the proposed change.

I believe that it, like the parallel action

of the American Stock Exchange, is a step in the wrong direction. And I think it is dangerous policy not only for shareholders, but ultimately for the securities industry, for corporate management, as well as the economy.

Since our views on this subject were set out fully in the testimony I gave before Congression Dingel's subcommittee on May 22, 1985, I won't restate here the reason and considerations that lead us to those conclusions, but that testimony, a copy of which is attached to AMEX A, is incorporated as part of this statement.

Today I'd rather like to go beyond that earlier statement and focus attention on the chain of interactions in which we are all currently caught up. By chain of interactions, I mean the following.

Many constituent groups and institutions have an important interest in the issues to be considered here, the Exchanges, the NASD, corporate managers, and investors, both institutional and non-institutional, and suggesting that none of us are free to move unilaterally.

The actions of each of us are driven by circumstances and by the acts of the others who are involved. Why is the New York Stock Exchange proposing to scrap a fundamental principle of shareholder protection that it has seen fit to enforce since the mid 1920's. It certainly isn't because the rule has failed to protect shareholders.

And it certainly isn't because the New York Stock Exchange is no longer interested in protecting its shareholders.

As the Chairman of the Exchange says in his letter to Chairman Shad of September of 1986, the decision by our board was a difficult one in that the board continues to support the one share, one vote concept, and believes it should be preserved. Why then propose to change it?

As for the American Stock Exchange, we too have now notified the Commission that we propose to rescind our own existing limitations on dual class issuances by AMEX listed companies, yet in my letter to Chairman Shad informing him of that impending step, I said that I made no effort to conceal our unhappiness with these developments.

We think public shareholder voting is a key element of corporate accountability, and that loss of such accountability conflicts with the traditional role of shareholders as the ultimate owners and controllers of the corporation. Then why have we taken this step?

We all know what drives these steps to be taken albeit reluctantly. To again cite words taken from the same New York Stock Exchange letter quoted earlier, the action of their Board of Directors reflects a recognition that the Exchange can neither dictate corporate government standards for other self-regulatory organizations, nor can it unilaterally maintain such standards not required by

other market centers in today's competitive environment. They're right. The same thought is made in my letter to Chairman Shad.

For the AMEX to stand alone in restricting the structure of voting classes, would place us in a competitively and tenable position. The fact is that today all segments of the securities markets have become increasingly integrated. All segments of the securities market are engaged in vigorous competition. That's healthy. But to be in favor of that competition, as I am, as we all are, I suspect, is not the same thing as to be in favor of competition stripped of quality standards.

The factors of competition should be price and the services. Segments of the securities market should not compete for listings by discarding their shareholder safety standards.

But no single segment of the market is free to move unilaterally, or to stand fast unilaterally. The actions of each of us are driven by circumstances and by the acts of others that are involved.

As I have said before, I don't want to race to the bottom. I don't even want to race downhill as the very sequence of interactions which I feared would occur is now demonstrably in full flag. All of us know why dual shareholder structures have become increasingly popular.

The reason is that swift and powerful new tactics have developed in recent years that go well beyond procedures and contests for corporate control. Takeovers, whether friendly or unfriendly, are in themselves normal, healthy activities of a free market. They should not as an economic matter be stifled, but the process by which corporate combinations and transfers are carried out is quite another matter.

Today, directors and managements often are forced to make hasty decisions in the most highly pressured circumstances. The marketplace reacts spasmotically to rumors, offers, and counter-offers, are thrown together virtually overnight.

Under these conditions it is not surprising that even the most dedicated and respectable corporate managements has sought to erect the strongest possible defenses, and I guess that one of the most effective of those is a two tier voting structure.

Thus, the chain of interactions that brings us to this hearing is now approaching full circle, because of today's takeover environment corporate managements feel compelled to abandon the classical, unitary, common stock structure. In the absence of any shareholder voting protections, and the rules of the NASD, as well as the ten to one standard of our Exchange, the New York Stock

Exchange is understandably pressured by the competition for listings to change its longstanding listing requirments by the demand among its listed companies for the availability for a two tier shareholder structure.

And, finally, the proposed change of listing requirements by the New York Stock Exchange forces our Exchange to further reduce its standard. It's clear that the Exchanges and the NASD will have to operate under substantially the same rules. The only question, the only question, is the level of responsibility set by those rules. Will they be allowed to drift down to the level of the least protective, or will the SRO's work together to establish a full order of shareholder voting rights.

And I believe it would be a mistake for the Commission to allow the sequence of events I have previously described to bottom out. The self-regulatory organization should be setting the highest standards in this area. But under the current competitive circumstances, neither the New York Stock Exchange nor the American Stock Exchange, can stand alone. The problem is that we don't even have the NASD's agreement that a minimum standard is needed.

I guess even at this late hour I believe that we can still accomplish the result of a uniformly high voting rights standard if, but only if, the Commission actively exerts its influence upon all three parties to come to

an agreement, and hope that the Commission will not shrink from pressing from this alternative, both because I believe it is the right result, and because I passionately believe that it will avoid potentially greater and more undesirable governmental intrusion into the governments of America's corporations.

Thank you.

CHAIRMAN SHAD: Thank you, Mr. Levitt.

The American Stock Exchange, as you've indicated, does have a disparate listing requirement permitting a ratio ten to one in the voting rights of different classes.

If the SEC were to deny the New York Stock Exchange's request, and, first of all, you've indicated if we approve the request, why, you will then remove your present limitations, going the other way if the Commission were to deny the New York Stock Exchange's request, would you propose that the American Stock Exchange raise its standards to those that are one share, one vote across-the-board requirement?

MR. LEVITT: If the NASD were willing to join us in raising standards, we most certainly would raise our standards.

As I mentioned before, and as Mr. Phelan commented also, I think some consideration should be given with respect to opposing those standards on every size corporation

involved.

CHAIRMAN SHAD: Thank you.

Commissioner Cox?

COMMISSIONER COX: Mr. Levitt, as things presently stand, the AMEX does have companies listed with disparate classes of common stock. My question is that from your experience with these companies, first of all, approximately how many are there, and second, from your experience with these companies that have disparate voting rights, do you believe that they are run in a way that is less responsive to shareholders than they should be?

MR. LEVITT: I don't believe that that's the case. I really would hark back to an observation that was made at a prior hearing in that connection because that's not grounds upon which I'm appealing to the Commission.

I think that the issue is if, as Mr. Phelan has suggested before, that if this rule change goes through, several hundred of the largest companies in America are allowed to change their corporate structure in a way which would disenfranchise their shareholders, I believe that at this point in time that message to the country, that message to potential investors, that message to the Congress, is a message that suggests that the SRO's have stepped away from, have abdicated their responsibility in this area, and is a message that I don't think we should be sending at this point

in time.

That goes not to the issue of whether these companies are fairly managed. It goes to the issue of perception of corporate America. And I think today more than any other time in recent years, that becomes the critical issue.

We have 91 companies that have dual classes of stock.

COMMISSIONER COX: Thank you.

CHAIRMAN SHAD: Thank you, Commissioner Cox.

Commissioner Peters?

COMMISSIONER PETERS: Mr. Levitt, in February of this year you very kindly provided the Commission, Chairman Shad, with a letter that described a concept that you suggest the Commission adopt with respect to imposing a uniform one share, one vote requirement across all markets.

Assuming that, we could do so, had the authority to do so, and assuming that we pursued your concept of requiring all large companies and, I believe, you identified those as companies with $500 million in assets, or some such, to have a one share, one vote requirement, how would you and, therefore, we justify having a different standard applied to large companies as opposed to a small company, and also having a different standard applied to domestic

issuers in United States companies as opposed to foreign issuers, as I believe your concept would exclude foreign issuers from the one share, one vote requirement.

MR. LEVITT: Well, in terms of size I would say that I don't see anything fundamentally wrong with two classes of stock. It's been used by some smaller companies to raise capital.

The issue, as I stated before, to Commissioner Cox's question, is the issue of what the public perception would be of the largest companies in America suddenly disenfranchising their shareholders.

We're flexible in terms of where the line can be set in terms of size of company, but I think you could clearly demonstrate that there are some sized companies wherein imposing this requirement would be burdensome. A smaller company sometimes has greater difficulty in reaching its shareholders, or giving them the incentive for that matter to create two classes of stock in terms of their treatment of dividends. Smaller companies have greater difficulty in a number of ways which would be harder for them to conform to this standard.

So those are the reasons in general that we favored a difference by size, but that's just one way of approaching it. We're perfectly prepared to approach it in any number of ways which would raise the floor in terms

of the standards, and which would keep with the SRO's this vital regulatory responsibility.

I don't believe there's such a thing as the regulatory vacuum. I think if we step away from this, you allow us to step away from this, and you don't take it on yourselves, somebody else is going to step into it, and that somebody else is the Congress of the United States. And I think we're better able to do the job than the Congress.

COMMISSIONER PETERS: And the difference is the different standard would apply to foreign issuers as well as U.S. issuers -- as opposed to U.S. issuers?

MR. SCRIBNER: If I can, Commissioner Peters, I think that the difficulty with trying to apply the same standard to foreign issuers is that they have -- they come from very different traditions and they have very different concepts of how corporations are organized and governed. I think we're not talking so much about investor protection issue here, as we are talking about a shareholder protection issue, and the concept of how American corporations at least ought to be organized and governed. And I think that's a standard, or a construct that we can't readily impose on other people as a condition of them entering the U.S. securities markets.

Again, the fact of the matter is right now, of course, many companies are in the U.S. market, trading in

the over-the-counter market, without corporate government standards that comport at all with either the New York Stock Exchanges or the American standards.

CHAIRMAN SHAD: Thank you.

Commissioner Grundfest?

COMMISSIONER GRUNDFEST: Thank you, Chairman.

Mr. Levitt, I'd like to explore whether there has been a change of heart in this matter of the American Stock Exchange, and if so, why.

As has been observed, the American has long allowed dual class capitalizations, and there is a list of 91 companies that have A/B capitalization class.

In the past, in fact, the American Stock Exchange has benefitted to a certain degree from competition with the New York Stock Exchange in the market for listing standards. One example would be the listing of Wang Computer was recently listed on the New York Stock Exchange, moved to an A/B capitalization, could not continue its listing on the New York, and migrated to the American Stock Exchange.

To the extent that the American has benefitted in the past from a certain degree of competition in the market for listing standards, why is it that the American Exchange hasn't moved with her to upgrade its listing standards if the setting of the highest standard is an

important function to be achieved by self-regulatory organizations.

We have moved to upgrade our listing standards. The arrival at a ten to one standard is just I guess eight or nine years old now in terms of the Wang listing, and we've upgraded our standards through the years.

The standards we have today for listing are substantially higher than they were at any time before in the history of the Exchange.

I would reiterate once again that this isn't five years ago, or ten years ago, or even six months ago. This is a point in time in the history of the country, and if I felt compellingly about the need for those of us who have an impact on the business community, to establish high standards, I feel it's of critical importance now more than any time before. This is a time to be raising rather than lowering standards, and the American Stock Exchange is prepared to do that, to do it now.

CHAIRMAN SHAD: Thank you, Commissioner Grundfest.

Commissioner Fleischman?

COMMISSIONER FLEISCHMAN: Arthur, I find your testimony most provocative bound by the Chairman's rule only to ask you one question.

And the one question, therefore, must be the point at which you concluded your prepared presentation.

It was, as you put it, with passion that you seek to avoid governmental intrusion into the governments of America's corporations.

Why is not a mandate from the Securities and Exchange Commission on this subject just as serious a governmental intrusion into corporate governments?

MR. LEVITT: I don't think it can compare, frankly, because the relationship between the Commission, and the SRO's through the years, has been one of nudging, of suggesting, of persuading, of cooperation, and of understanding.

In listening to the various proposals that have floated around this issue from the Congress in recent months and years, I would suggest that the Congress very often acts in moments in crisis, and very often over-acts in moments of crisis.

America's business community in recent years has benefitted from a deregulatory trend. I have a feeling that a move toward a re-regulatory environment may already in very subtle ways be underway.

I am suggesting that by allowing the Exchanges to abdicate their responsibility in this regard, we will accelerate that re-regulatory move to go far further and faster than it should go. And I am suggesting that whether it be by rulemaking by the Commission, by jawboning by the

Commission, by being a honest broker, you can prevent this occurrence.

CHAIRMAN SHAD: Thank you.

Would any members of the staff that have any comments or questions please indicate their interest in doing so?

Mr. Davis?

MR. DAVIS: Mr. Levitt, the NASDAC marketplace has grown dramatically in the past several years. In the absence of the Shareholder Safety Standards, such as you advocate, I was wondering if you see that growth as any sort of evidence that shareholders don't believe their safety standards are needed?

MR. LEVITT: No, not necessarily. I think you could look at any of this and say, well, the shareholders want it, let them have it. I think that's kind of a cop-out. It's kind of an easy way to do it.

I think this goes far beyond that. I don't think the shareholders themselves at this point in time understand what can occur in terms of this particular issue. If you combine, for instance, laissez faire government philosophy with an increasingly frustrated Congress that feels that deregulation may have gone to far, and a business scandal, you have the potential of a lot of mischief in term of legislative excess.

It's that excess that I am beseeching the Commission to avoid, to prevent. And the growth of listings in the over-the-counter market are even the fact that our Exchange this year will list more companies than ever before in its history, I think is irrelevant to what will occur when several hundred of the largest companies in America send a message to shareholders, and citizens, a legislators all over the country, that voting rights are no longer a vital principle by which they care to operate.

CHAIRMAN SHAD: Director Quinn?

MS. QUINN: Just to follow-up on your point, Mr. Levitt.

Is it fair to say that the distinction that you draw between big and small is just on this point of the concern that you see Congress having of having major corporations in the United States essentially be unaccountable, and if we look back in the early '70's when there was a great concern and call for federal chartering of corporations, and public interest directors appointed or prescribed by Congress, that it was all out of the concern that the proxy process which at that point was the real way of effecting control if one existed, wasn't working. And that essentially what you're forecasting is a re-introduction of that concern, the unaccountable Board of Directors, essentially unaccountable corporate management in the largest

corporations which would then provoke Congress into saying if they -- if directors and management are not accountable to the public shareholders, we have to come in and prescribe the protection that would, in essence, make them accountable to somebody acting in the public interest?

MR. LEVITT: Yes. I think that was mild compared to what we will be confronted with today. I think that most certainly will occur, but I have said that the critical issue here is establishing a regulatory floor. And I also believe that that floor must be set as high as possible, and again I get back to the abdication of the authority, the self-regulatory authority, that we are allowing ourselves to give up. And, again, there is no regulatory vacuum that will ever exist in this country.

CHAIRMAN SHAD: Director Ketchum.

MR. KETCHUM: Mr. Levitt, in light of your concern about setting the regulatory floor, if the Commission were to approve the New York Stock Exchange proposal, would you either consider voluntarily entering in discussions with the NASD for supporting the Commission mandating the AMEX NASD moving to that standard that the New York Stock Exchange now proposes with respect to voting?

MR. LEVITT: I would certainly enter into discussions with the NASD in that connection, but I believe that floor must raise -- be raised, but again the trigger

event that will bring about the consequences that I fear, consequences that are almost upon us now, is allowing the largest companies in America to change their charters at this time.

MR. SCRIBNER: Again, I think we certainly would be very happy to enter into discussions with the NASD, and hopefully with the NYSE. I think it would be anomylous to leave us in the position where the Commission approves that the New York Stock Exchange's proposal was not prepared to deal with our own situation at essentially the same time; I think would put us in a very untenable, competitive position.

MR. KETCHUM: Why is that? In light of the fact that your present listing standards remain different from the New York Stock Exchange's, what is the need for your present proposal for reducing their present standards? The NASD obviously has not changed theirs. What is the competitive need that requires that?

MR. LEVITT: Well, the NASD obviously has no standards in this connection, and in an increasingly competitive environment, which allows different standards for each of us, it becomes imperative for us to be allowed to compete on an equal basis with the NASD that already has the substantial advantage by being allowed the designation of a national marketplace.

CHAIRMAN SHAD: Any other questions?

MS. FIENBERG: Other than perhaps foreign issuers, what other exemptions that you prescribe from the one share, one vote? In other words, then the size of -- if any?

MR. LEVITT: In terms of an agreement between the SRO's, I don't have any particular other exemptions in mind. I think that size is one that I think suggests to me the maximum area of agreement between the New York Stock Exchange the NASD, and ourselves, and one which we could certainly accommodate as we seek to raise our standards.

I would say that this is not a position that the companies listed on the New York Stock -- on the American Stock Exchange will embrace. This is not testimony that would be endorsed by our listed companies. Quite the contrary, they would like to see the Exchange out of this area. But I feel that there are issues that go far beyond this, and that's why I draw the distinction.

CHAIRMAN SHAD: Your proposal -- if we approve the New York Stock Exchange's proposal, would be to actually drop your listing requirements below theirs?

MR. LEVITT: That's correct.

CHAIRMAN SHAD: Could you amplify that, please?

MR. LEVITT: Yes. If we are going to embark upon this race to the bottom, the competitive imperatives suggests that as we compete against an NASD that has accepted for

themselves, or seized for themselves, the designation as a national marketplace, causes us to do everything possible to compete as aggressively as possible. And hope that you won't allow either the New York Exchange or us to move to the bottom, and that you will motivate us to get together and raise our standards.

CHAIRMAN SHAD: Mr. Levitt, Mr. Scribner, thank you very much. We appreciate your testimony.

And we'll now hear from Gordon Macklin, the Chairman of the National Association of Securities Dealers.

Mr. Macklin?

MR. MACKLIN: Good morning. My name is Gordon Macklin. I'm President of the National Association of Securities Dealers. With me this morning is Daniel Fischel, Professor of Law and Business, Director of the Law and Economics Program at the University of Chicago.

Professor Fischel is the author of a study entitled Organized Exchanges in the Regulation of Dual Class Common Stock, which was prepared for the NASD Board of Governors earlier this year.

We're pleased to participate in this hearing. It is important to know at the outset, however, that while the principal purpose of this hearing is to receive testimony on the rule proposed by the New York Stock Exchange, my statement does not address that proposal.

As we understand it, the New York Stock Exchange was under substantial effort to develop a rule that is appropriate for their market, and we would not presume to second guess their conclusions.

The New York Stock Exchange Board of Directors is much more expert than I on the needs of their market.

The New York Stock Exchange market and the NASDAQ National Market System are similar in many respects, but differences remain. One of the differences is the average size of the companies for securities trading in the two markets. Although some 700 NASDAQ National Market System companies meet or exceed New York Stock Exchange financial listing criteria, the average market capitalization of NASDAQ National Market System companies is $130 million. And the capitalization of -- is even less.

While 25 percent of the 2,600 companies in the NASDAQ National Market System have capitalizations of over 123 million, and over 25 percent below 20 million. There are only 39 NASDAQ National Market System companies where the market capitalization of more than one billion. Those figures compare, of course, with the capitalized value of IBM in the neighborhood of $80 billion.

In view of the differences between the size of companies traded in the NASDAQ National Market System and on the New York Stock Exchange, I do not believe it is

appropriate for me to comment on the NYSE proposal for their companies.

The issue of shareholder voting rights was first considered by the NASD over two years ago. At that time we began a process to enhance the corporate government's protections provided investors in NASDAQ National Market System companies.

There are currently pending before the Commission rules adopted by the NASD in July 1985 which will for the first time create corporate government standards for NASDAQ National Market System companies that are similar to those from the New York and American Stock Exchanges.

These rules will require, for example, the establishment of independent director seats, audit committees minimum quarums for shareholder meetings, the review of conflicts, the distribution of proxies, and quarterly as well as annual reports.

These rules were developed during late 1984 and early 1985 to the joint efforts of the NASD Board of Governors and the NASD Corporate Advisory Board. The body includes Chief Executive Officers of 15 issuing companies.

At its meeting on March 15, 1985 one NASD Board of Governors considered the Corporate Advisory Board's recommendation to gather additional information about shareholder voting rights, and concurred in its conclusion that

the only way to intelligently address the voting rights question was to obtain more detailed facts on the voting structures of NASDAO issuers.

In May of 1985 a survey seeking this information was sent to all NASDAO companies. In excess of 1,000 surveys were completed and returned to the NASD. To assure that we obtained a complete picture of company structures, NASD ecnomists and statisticians undertook an analysis of a statistically valid sampling of the NASDAO NMS population.

The NASDAO qualification staff also began a monthly analysis of new and continuing NASDAQ National Market System companies. The results of these efforts indicate that 95 percent of NASDAQ National Market System companies have a one share, one vote structure. Of the 5 percent companies with unequal voting rights, about one third could properly be called family companies.

This 5 percent figure is an interesting comparison with the over 10 percent found on the American Stock Exchange.

At the time -- to assure that the NASD had the benefit of the views of the key participants of this debate, we arranged a series of meetings on this subject. On June 14, 1985 the NASD hosted a meeting attended by the Chairman of New York and American Stock Exchanges and SEC Chairman Shad.

On other occasions Chairman Shad would meet with

the NASD Board of Governors and the NASD Corporate Advisory Board to discuss the voting rights question. Congressman Werth also met with the Board of Governors on the voting rights question.

At their July 1985 meeting all the Corporate Advisory Board and the NASD Board of Governors previewed the results of the NASDAQ survey and discussed the possible imposition of common stock voting right requirements on NASDAQ National Market System issuers. As a result, an extended deliberation of each of these meetings, the Board authorized solicitation of public comment on the concept of voting rights requirements for NASDAQ National Market System issuers.

On July 1985 the NASD solicited public comment on two approaches to the adoption of voting rights rules for a NASDAQ marketplace. The first would have imposed a one share, one vote standard on all NASDAQ NMS companies. The second would have permitted companies to provide disparate voting rights in a ratio not to exceed ten to one, with the approval of two-thirds of the outstanding shares.

This proposal also would have contained a sunset provision requring shareholder reauthorization at ten year intervals.

The proposals would have been limited to NASDAQ National Market securities and older grandfather compan-

with existing disparate voting rights of stocks.

The association received approximately 100 comment letters along with numerous telephone calls, telegrams, and other communications of issuers, broker dealers, and law firms. Over half of the commentators, 57, opposed out adaption of optionate ear proposal. Twenty-seven commentators supported the adoption of one or the other of the proposals. The remainder did not take a position for or against adoption.

Approximately 15 commentators felt that the shareholders or company should be free to structure the entity as they wish without external restrictions. Almost one quarter of the commentators argued that corporate structure is and should continue to be governed by state corporate law, and that has it as showing that state law is not sufficient, securities markets should not promulgate rules to supercede state law.

There were many other difficult questions raised by the commentators relating to the economic and market impact of the imposition of a particular set of voting rights rule criteria. These questions range from pragmatic ones relating to contemplated grandfather provision, to the theoretical and philosophical comments on the propriety of the NASD opposing such standards rather than allowing the market to assign an appropriate value to shares based on thei

voting rights.

The NASD also received a letter signed by the nine United States Senators expressing "the hope that the Board of Governors would at a minimum defer any action on the proposals until the numerous intricate issues which they contain can be fully debated from all points of view."

The Senators concluded by stating "we certainly do not believe that a majority of members of the Senate contends that the NASD should act in any but the most deliberate manner, and a matter of such critical importance."

The NASD Board after reviewing all the comment letters at its September 1985 meeting, concluded that the issue of shareholder voting rights encompassed many complex issues, and affected many interested parties, ranging, for example, from the small investor to the growing company looking to raise additional capital.

It was the view of the Board after substantial discussion that it was appropriate to retain an independent outside consultant to undertake a study on a number of the issues which were raised during that comment process.

In November 1985 the NASD retained Professor Fischel of the University of Chicago's Center for Law and Economics to undertake that study. Professor Fischel reported to the Board in March of this year copies of Professor Fischel's report, and provided it to the Commission

and in the interest of time we would like this report to be included as part of this record.

In the study Professor Fischel analyzed the status of multiple classes of common stock, the context of the "race to the bottom" thesis, the economics of share-holding, and the evidence developed by other studies of shareholder voting rights.

In addition, the study analyzed the cost and benefits in that, and the imposition and the prohibition on dual classes of common stock.

Upon receiving the Fischel study, the NASD Board determined that its best course of action would be to give the report wide distribution in order to benefit from a full spectrum of thinking for those interested on this subject. Over 14,000 copies of this study were mailed with a cover letter inviting comment. Included among the recipients of the study were all 4,100 NASDAQ companies, all 6,300 NASD member firms, 500 members of the print and broadcast media, 300 academicians, and 250 legislators and regulators.

In response to this mailing, the NASD received six comments, five of which supported Professor Fischel's conclusion.

(Laughter)

I believe this record indicates that the NASD

has vigorously undertaken a meaningful and serious analysis of the voting rights question. The Board of Governors has spent considerable time and effort analyzing the issue.

Up to this point, however, there has been no evidence offered which would justify additional regulation of NASDAQ National Market System company shareholder voting rights.

The subject of shareholder voting rights is indeed, however, one of widespread interest. Since our studies have been limited to the need for an impact of additional regulation in the NASDAQ National Market System, we are pleased that the Commission has initiated this broader inquiry.

We would like to help you in any way possible to develop a complete and comprehensive record on this subject, and would be happy to share any and all of our data we have gathered during the past two years.

CHAIRMAN SHAD: Thank you, Mr. Macklin.

In the course of your study, Mr. Fischel, did you -- let me start off by saying there have been economic studies that have indicated that today norm voting shares sell, all things being equal, sell at a 3 to 5 percent discount from the voting shares.

Did your study cover this issue? Did you also reach a conclusion in that respect as to the consequences

of a lot of companies going to different classes of voting rights, and in the price that they will pay in the marketplace, and when we get to the staff, I would ask as to whether or not disclosure should be required in the proxies of companies that wish to set up dual capitalizations.

Mr. Fishel?

MR. FISHEL: Mr. Chairman, I think you refer to two different pricing issues, both of which I think are discussed at length in my report. The one issue which I understood your comment about disclosure refer to, is the effect on share prices when firms announce re-capitalization which effectuate dual class common stock.

A second issue is the differential in the prices at which non-voting and voting shares of the same firm trade when they supposedly have identical rights to dividend in distributions of -- from the firms, and both of those subjects as you've correctly pointed out, have been the subject of academic attention, and the studies I think are summarized and discussed at some length in my study.

CHAIRMAN SHAD: I would ask as to those that do have two class of stock, does your study confirm a 3 to 5 percent discount all things being equal in the non-voting shares?

MR. FISCHEL: It does confirm that studies have found that voting shares tend to trade at a premium relative

to non-voting shares in terms of when you have both of them trading simultaneously in the same firm.

CHAIRMAN SHAD: And that goes to the second part of my question, as to whether or not there should be disclosure of that market phenomenon in proxies soliciting shareholder approval of a recapitalization to two classes of stock. Your views?

MR. FISCHEL: Well, I think there are a number of possible different situations that we have to keep separate One is when the shares are -- when you have an initial public offering, and people pay different prices for different packages of securities, in that situation I don't think there's any issue because the pricing mechanism has fully taken care of the differential rights associated with the superior --

CHAIRMAN SHAD: I'm talking about the recapitalization of companies that are already publicly owned, that have a one share, one vote requirement, and wish to go to a dual capitalization.

MR. FISCHEL: Well, in that situation the best test on the effect of the wealth of the security holders is going to be the effect on stock prices when the recapitalization is announced, and when it's implemented. In other words, if the situation were that you had a set of securities that was worth a certain value, and after the

recapitalization that those securities are going to be worth less as a result of the recapitalization, then what should occur if market participants are behaving rationally, is that the price of the securities should go down upon the announcement of the recapitalization.

As I indicated, there have been extensive studies on that phenomena, and particularly with respect to NASD and American Stock Exchange companies. The studies that have occurred today have not found any adverse price reaction that occurs when the recapitalization is announced.

So, therefore, I think the evidence to date does not support the proposition that investors perceive when recapitalizations occur in the very limited number of cases where they do occur. I think we always have to keep in perspective how rare a phenomena this is, even in situations where it's been permitted.

The evidence does not support the fact that shares after a recapitalization would be less valuable than they were prior to the recapitalization.

CHAIRMAN SHAD: Commissioner Cox?

COMMISSIONER COX: My question is in a different area. So far this morning we have heard three different views on shareholder voting rights from the New York Stock Exchange, from the American Stock Exchange, and now the NASD. My question regards the amount of competition between these

three security marketplaces. It seems to me that there's probably been a substantial increase in that competition over the past few years, but I would like your views on that, and then I would like you to comment briefly on the idea of a race to the bottom. We've seen that characterized, this suggestion about changes in listing standards, and I notice that it is used in your testimony, Mr. Macklin, with quotation marks, but Mr. Levitt used the quotation too. Do you regard this as a race to the bottom?

MR. FISCHEL: Commissioner Cox, let me answer your two questions in the order that you posed them.

First, with the extent of competition between the markets again, I would rely on the various academic studies on this precise question, namely, there have been a series of academic studies studying various aspects of the relationship between markets, studying the liquidity of the markets, the stock price effects of switching from one market to another, a number of recent papers by McConnell and Sanger, Senator McConnell, all those studies have concluded that the Exchanges have become increasingly competitive with each other as a result of the development of trading technologies.

So my evidence for the proposition that the situation is more competitive now than it was previously is the -- my understanding of the academic literature on that

question.

With respect to the race to the bottom question, I think a number of points need to be made. First of all, the concept of a race to the bottom is not a new concept. It has been proposed in a number of different contexts in the corporate area most recenty in connection with the argument that was popular in the mid to late 1970's that allowing state chartering of corporations promoted a race to the bottom, and there was a need to supplant the competitive process among state lawmaking bodies, and to implement federal chartering in corporations.

And in that connection where the phrase "race to the bottom" becamse popular, there were a series of academic studies on the question, and I would say it would be fair to conclude from those studies that the concept of a race to the bottom, namely, that competition is necessarily bad, and is going to produce an undesirable outcome, was discredited on both a theoretical and an empirical level.

In fact, I am unaware of a single academic study that exists in support of that propostion. Every study that I'm aware of tests the proposition and finds it contradicted by the data.

The second point that I'd like to make is that I don't accept the characterization that the issue here is whether we're going to raise standards because what we are

talking about here is one alternative that a small minority of firms have taken advantage of in a situation where there are -- as far as I can tell, informed shareholders contractin with their firms as to how to structure the firm with not a shred of evidence that there are negative wealth effects associated with that transaction.

I don't accept the argument that allowing that alternative to exist for a small minority of firms, when there's not a shred of evidence that it's been harmful for those firms that constitutes a lowering of standards. I think that's a perverse use of that term.

Finally, I don't understand the argument that has been made repeatedly in the context of this discussion that no Exchange can do the right thing because they're forced by competitive pressures to do the wrong thing.

It seems to me that if it were really possible for an Exchange in connection with this particular rule to adopt something that investors valued, what we'd be saying, in effect, is that that Exchange has the ability in connection with this rule to raise the traded prices in every security listed on that Exchange by adopting the right rule. That is -- investors value this protection. That's what we're talking about. We're saying that the New York Stock Exchange, or the NASD, or the American Stock Exchange, can adopt the rule that they think they maximizes a shareholder wealth,

and investors would value that, and stock prices would go up.

And people are saying they can't do that because of the competitive pressures. I would think precisely the opposite argument is correct, that it's precisely because the market is so competitive, and the Exchanges are so competitive with each other, that if it were possible for any Exchange to effectuate this massive increase in the value of equities that are traded on that Exchange, it's precisely because of that competitive pressure that they would have every incentive to do so.

MR. MACKLIN: I would like to add just a bit to that. We have well over twice as many AMEX-eligible companies included in NASDAQ, and yet their ratio of companies with disparate voting rights is twice the ratio in NASDAQ's. If you see their 10 or 11 percent split voting right ratio, and our 5 percent ratio, maybe we ought to redefine what bottom is if you say these companies are equal.

CHAIRMAN SHAD: Thank you.

Commissioner Peters.

COMMISSIONER PETERS: I am sorely tempted to comment on both Mr. Macklins' and Professor Fischel's last comment, but I think I'll just ask a question instead.

Mr. Macklin, I have to say that I found the statistics that you're putting in your testimony is a result

of your May 1985 study, indeed interesting. And my question relates to those statistics, and tangentially I suppose your last comment.

That is, if -- I wondered if you had seen an increase over the past year which statistics related to '85. It's an increase of your NASDAQ listed companies, your eligible, have been designated as eligible for trading in a National Market System, more than change to the dual capitalization structure.

And if -- depending on what you have seen in that regard, would you expect if the Commission approved the New York Stock Exchange proposed rule, changing its listing standards in this regard, would you expect more of your companies to change their present capital structure to permit disparate voting rights?

MR. MACKLIN: I believe the trend has been about constant. Let me just check with my associate.

Yeah, the trend has been about constant of 5 percent over the past few years.

COMMISSIONER PETERS: Okay.

MR. MACKLIN: If I understand your question, I don't know why a change in New York Stock Exchange rules would inspire NASDAQ companies to change their capital structure.

CHAIRMAN SHAD: Thank you.

Commissioner Grundfest?

COMMISSIONER GRUNDFEST: Thank you, Mr. Chairman. I was, needless to say, shocked to learn that only six responses were received to the mailing of 14,000 copies. I think this response rate of 43 to 1,000ths of one percent are -- is a clear example of a potential market failure that might warrant some regulatory intervention under these circumstances.

(Laughter)

Nonetheless, I will confess to having read the study, and having read it carefully, and with great interest. I will also confess to having read an article that appeared in the 1983 Journal of Law and Economics authorized by a Judge Frank Easterbrook and a Professor Daniel Fischel, and let me quote from a portion of that article.

"The presumptively equal voting right attached to common shares is, however, a logical consequence of the function of voting that has been discussed above in this article.

Voting flows with the residual interest in the firm, and unless each element of the residual interest carries an equal voting right, there will be a needless agency cost of management.

Those with disproportionate voting power will not receive shares of the residual gains or losses from new

endeavors, and arrangements commensurate with their control, as a result, they will not make optimal decisions.

This explains why there is so little non-voting stock, and is also a justification for the New York Stock Exchange's policy of not listing firms with non-voting issues. The greater the departure from equal wading of votes among residual claimants, the greater the unnecessary agency costs. Non-voting bonds, and non-voting employees, are not troublesome, however, because neither group has a residual claim.

This explains too why cumulative voting has all but vanished among publicly traded firms, and why most state statutes contain the presumption against cumulative voting.

Cumulative voting gives disproportionate weight to certain minority shares, and the lack of proportion once more creates an agency cost of management. It makes realignments of control blocks very difficult by distributing a form of hold-up power widely. Although every share has the same hold-up potential, the aggregate value exceeds the value of the firm, and thus makes negotiation very difficult."

Now, if this earlier article with Judge Easterbrook is correct, then let me pose a couple of questions based on that analysis.

First, what adoption of the New York Stock Exchange proposal increase what you call in this article unnecessary agency costs.

And, second, what disenfranchisement transactions of this sort we see now motivated in large part by a concern over the potential for a takeover caused disproportionate relationships between the holders of voting rights and the residual gains or losses resulting from their decisions, and, therefore, in the words of this article, cause management with disproportionate voting power not to make optimal decisions.

CHAIRMAN SHAD: In one minute, please.

(Laughter)

COMMISSIONER COX: You can answer only 43/1,000ths of one percent of the question.

MR. FISCHEL: The first thing that I was going to say, as is obvious from the six responses to the 14,000 mailings, I need help in disseminating things that I've said, so, thank you for quoting from my article at length, because there are certainly more than six people here, so I'm now one step ahead.

What the article was trying to explain is why is it that in a world in which firms have the choice of adopting one share, one vote, or not, they overwhelmingly adopt one share, one vote. That is true as a matter of stat

law. It's also a matter --it's also true as a matter of the NASD's permissive rule where firms have the choice but 95 percent choose to adopt the rule of one share, one vote.

And what Judge Easterbrook and I were trying to do was try and provide an economic explanation for the dominance of the one share, one vote rule. I might add, a dominance which at least I am confident is going to continue to exist regardless of what the New York Stock Exchange does regardless of what anybody else does, so long as firms continue to have the option of choosing one share, one vote. I am confident that a vast majority of firms will continue to choose a rule of one share, one vote for the reasons that are stated in the article.

The question, however, is just because a particular contractural arrangement is dominant for the overwhelming majority of firms, does that necessarily mean that no firm should be allowed to be structured using a different rule. And what my report in the academic literature find the subjects suggests, is that for those small minority of firms that choose to adopt a different rule, they have different types of monitoring mechanisms in place which makes the takeover mechanism relatively less valuable, and, therefore, it is not a breakdown in accountability, or whatever other term has been used. It's just a substitution of one type of monitoring mechanism for another in a very small minority

of firms.

Now, some of those substitute monitoring mechanisms have already been alluded to. Family control is one. Another one that was mentioned, I think, in some of the comments earlier, is that studies of the firms that adopt all class common stock, show that the insider voting and equity interest for firms that adopt all class common stock is far higher than for the typical firm.

So there is, in effect, an alternative type of safeguard to align the interests of managers with those of investors that doesn't exist for many other firms, so, therefore, have -- or the vast majority of firms that therefore have the rule of one share, one vote.

I have no doubt that for many firms a deviation from one share, one vote would impose a needless agency cost to match, but that is the point of that article. But for firms that have alternative monitoring mechanisms in place to control for the problem for that small minority of firms, particularly given the academic evidence which suggest that there's no negative wealth consequences of adopting this structure, I don't see the basis for the argument that what's good for the vast majority of firms necessarily has to be good for all firms.

CHAIRMAN SHAD: Mr. Macklin, Mr. Fischel, we'll reverse the order of our Commissioners' questions and the

next panel so that Mr. Fleischman will have an opportunity to start it off.

Thank you very much.

We're now going to a panel that consists of a number of distinguished academicians and others, and when they've taken their seats I'll briefly mention the rules that we'll proceed by.

Ladies and gentlemen, we're very pleased to welcome you to this hearing, and you'll see up in the front a gadget that flashes lights, and please begin by stating your name and affiliation.

The green light will flash when three minutes remain, and this is for your opening statement. The yellow light will flash when one minute remains. The red light will flash when your time is expired and we must enforce that five minute rule if everyone is to be heard.

So please stop talking at -- you better start winding up when you see the yellow light, and then stop talking when you see the red.

And the Commission's staff will refrain from asking questions until all speakers on the panel have made their presentations. Please speak loudly and clearly.

We'll start with Mr. Jeffrey Gordon with the New York University.

Each of you as you go down the table please state

your name and affiliations.

On my list, I guess it's alphabetical, Mr. Gordon is first, and so let's proceed alphabetically with this panel.

Mr. Gordon.

MR. GORDON: My name is Jeff Gordon.

CHAIRMAN SHAD: Pull up your mike, please.

MR. GORDON: My name is Jeff Gordon. I teach corporations the regulation of financial institutions, and mergers and acquisitions, at NYU Law School.

Today I'd just like to underscore a few points drawn from my written testimony.

My basic position is that the Commission should refuse to approve the New York Stock Exchange rule change. Instead, the Commission should protect the NYSE's competitive position that requiring the AMEX, the regional Exchanges, and the NASD, at least as to National Market Systems stocks, to adopt a rule that prohibits listing of any firm that has been delisted by the NYSE because of violation of its single class common rule.

The argument has four main points. First, that dual class recapitalizations are likely to decrease shareholder wealth, and to receive shareholder approval only because of shareholder collective action problems.

Second, that the NYSE single class common rule

has served as a sort of bond in which shareholders can protect themselves against such abusive tactics, and in this way the rule lowers the cost of capital to the firm.

Third, that the loss of the bond provided by the NYSE single class common rule will therefore have negative impact not only for firms that subsequently undergo a dual class recapitalization, but for all firms listed on the NYSE.

Fourth, that the best way to protect the single class common rule is the sort of SEC intervention that I suggest, which operates only to reinforce agreements on capital structure previously entered into by managements and shareholders.

Let me elaborate on some of this but briefly.

As part of a long project on this issue, I examined proxy materials from all NYSE firms that have recently undertaken a dual class recapitalization. This examination persuades me that the likelihood of abuse in these transactions is enormous. The pattern is that family management blocks holding on average 30 percent of the stock are simply stripping public shareholders of equal voting rights.

In most cases, public shareholders receive no compensation for their radically diminished voting rights. In other cases where, for example, holders of limited voting stock receive some given end preference, there is no reason to believe that the relatively insignificant preference is

in any way compensatory.

It seems almost certain that the shareholder approval that allegedly blesses the recapitalizations is the result of the well known problems that aflict dispersed public shareholders in voting on management proposals. These problems which economists call collective action problems, drive the approval, not a considered judgment that the recapitalization is good for shareholders.

One striking fact is the virtual absence of significant institutional ownership in these firms. If dual class recapitalizations were good for shareholders, we would not see this pattern.

This brings me to the importance of the NYSE rule on one share, one vote. A public shareholder will ordinarily pay more for stock in a firm with single class common stock.

For example, in the case of a family dominated firm, single class common means that the family retains control only by holding onto a very large block of stock. This stock ownership position aligns the interest of family members with those of the public shareholders.

From the firm's perspective, single class common will lower the cost of the capital. The problem, however, is this. How is the firm persuasively to promise that it will not adopt the dual class capitalization in

midstream because in the absence of a persuasive promise not to recapitalize, what I've called a bonded promise, public shareholders will not pay full value for a single class common.

I've argued in my paper that under present institutional arrangements the most secure bond is membership on the NYSE with its single class common rule. In particular, the law of a single state cannot provide such a bond because of the ease with which firms can move from state to state via reincorporation.

But the effectiveness of the bond of the NYSE works only if firms are unable to migrate to Exchanges with disparate rules. Until recently, the NYSE provided listing, provided unique liquidity, and reputational benefits that made such migration unlikely.

The success of NASDAQ in the National Market System has apparently reduced the cost of delisting to the point where an NYSE listing alone no longer serves as such a bond.

That's my proposal for the SEC rule, which would provide simply a bond for a -- provide a different mechanism for a bond that has previously existed. The SEC action would not usurp state law, but simply reinforce choices made by managers and shareholders.

Thank you.

CHAIRMAN SHAD: Thank you, Mr. Gordon.

Roberta Karmel.

4A MS. KARMEL: My name is Roberta Karmel. I'm Professor of Law at Brooklyn Law School in Brooklyn, New York. I have a number of rather current and past affiliations, one of which is that I am a public director of the New York Stock Exchange; however, I'm testifying here this morning solely on my own behalf. Things expressed are my personal views. Let me summarize those views.

The New York Stock Exchange proposed modification to its one share, one vote listing standard should be approved unless the SEC asdopts a uniform one share, one vote policy for all qualified securities trades in the National Market System.

Secondly, a uniform one share, one vote policy should be adopted by the SEC for all such qualified securities, but certain exceptions from that standard could be fashioned by the Commission.

I've accepted in my prepared statement some exceptions along these lines. They're all addressed to situations where there would be no disenfranchisement of shareholders.

Thirdly, regardless of whether any one share, one vote policy is adopted by the SEC, I think the SEC should not permit any issuers which do not have such a

policy to take advantage of F3 or F2 treatment.

Finally, I believe the SEC has the legal authority to mandate a one share, one vote policy for qualifying National Market System securities, but it probably would be preferable if Congress mandated such a standard in connection with legislation curbing tender offer abuses.

In this event, the type of exceptions I have suggested to the SEC at this time might not be necessary.

It's apparent from everything that the New York Stock Exchange has thus far said in connection with its rule changed proposal, that it is abandoning the one share, one vote standard with great reluctance, and it is doing so for compelling business reasons.

In general, however, investors in the business community and the national economy have benefitted from corporate laws which are enabling and permissive, rather than regulatory. Nevertheless, in order for large public corporations, which represent enormous aggregates of wealth and power to enjoy the freedom they need to operate effectively, there are some public policy limitations which necessarily must be imposed by the government upon that.

It seems to me that the one share, one vote policy is one such policy.

The New York Stock Exchange can longer enforce this standard without government intervention. And it would

be unfair for the SEC to disapprove the New York Stock Exchange's filing, and not compel other Exchanges and NASD to adopt in one share, one vote policy since the result nearly would be a loss of the NYSE listings.

This is why I have to formulate and have supported the New York Stock Exchange for closed amendment. Although imposing traditional -- would be traditional NYSE policy in all marketplaces, might be the best public policy rules since the NASD has no standard, and the American Stock Exchange does not come up to the New York Stock Exchange standard. It says that some compromise might be the best course for the SEC at this time. This is why I have suggested the earliest possible exceptions to a one share, one vote policy.

If the SEC declined to mandate a one share, one vote policy, the Commission could nevertheless deny public issuers the benefits of F3, F2 treatment unless they have such policy.

In any event, I urge the SEC to take some action to express its disapproval of shareholder disenfranchisement, and in my view, the stronger the action, the better.

I come to this conclusion with extreme reluctance since as a general matter I do not favor federal intrusion into corporate governments.

In terms of the SEC's authority, I believe that

the Commission has ample authority to mandate a one share, one vote rule, and that the Commission should not use lack of authority as an excuse for facing up to its responsibiliti to shareholders on this important investment protection issue.

CHAIRMAN SHAD: Thank you, Ms. Karmel.

Mr. Mikkelson?

MR. MIKKELSON: Thank you.

My name is Wayne Mikkelson. I'm an Associate Professor of Finance at the University of Oregon.

As a matter of fact, your first choice to present this testimony is Professor Megan Partch, a colleague of mine at the University of Oregon. She is unable to attend and asked me to present her testimony.

Before I begin, I'd also like to point out that this research has been supported entirely by the University of Oregon, no support provided by a party interested in these hearings, nor have Ms. Partch or I been employed by someone who has interest in these hearings.

Firms that create in second class of common stock tend to have special characteristics. Relative to nationally listed firms, these firms tend to be small, young, and characterized by substantial holdings of common stock by corporate officers and directors. Many of these firms are controlled by a small number of founding share-

holders who recognize that further growth requires additional equity capital, but are reluctant to sell common stock because of a dilution of their voting control.

The special characteristics of the firms indicate that creating limited voting common stock is a viable way for these firms to restructure ownership claims that does not necessarily conflict with the interest of shareholders.

An important fact is that a firm cannot create a second class of common stock without the approval of at least the majority of its shareholders. It must be noted, however, that in many publicly traded firms that create a second class of common stock, corporate insiders own a substantial enough fraction of the firm's equity to guarantee approval of a change in voting rules. But in these cases, managers' interests are aligned with those of outside shareholders because managers own a substantial portion of the firm's common stock.

It seems unlikely that insiders would propose a change in voting rules that decrease their own wealth.

There are two methods commonly used to create a second class of common stock. In the first, share of the new class are distributed on a pro rata basis to current shareholders. If the shareholders owns 10 percent of the firm's common stock before the distribution, the shareholder owns 10 percent of each class after the distribution.

Thus, the shareholder still owns 10 percent of the firm's claims to cash flows as well as voting rights.

In a second method shareholders are offered an opportunity to exchange shares of one class for shares of the other class. Each current shareholders has exactly the same proportionate claim on the firm's cash flows both immediately before and immediately after the change in voting rules.

Therefore, only the voluntary decision of shareholders to participate in the exchange offered, and to trade voting rights for dividends, can affect the existing distribution of voting rights.

There is no evidence that the wealth of current stockholders is affected by the creation of a second class of common stock with limited voting rights. Identified -- I see Professor Partch identified -- 44 publicly traded firms that created a second class of common stock between the years 1962 and 1984. Most of these firms are traded in the over-the-counter market. Fifteen are traded on the American Stock Exchange, and six are traded on the New York Stock Exchange.

Professor Partch examined the normal stock price response to the announcement of plans to create a class of common stock with limited voting rights. The average price response is positive and statistically significant. However,

a majority of the price responses are negative, but the proportion of negative price responses in the sample is not significantly different from one half.

Although not reported in the recent version of her paper, I should add that the average stock price respons for the New York Stock Exchange firms, and in this sample there were six of them, is negative but is not significantly different from zero.

The evidence suggests that current stockholders are not harmed by changes in voting rights of common stock. Thus, any proposed regulation must be justified on other grounds.

Although current shareholders' wealth does not appear to be affected by the creation of limited voting in common stock, one might ask whether managers' incentives change once new voting rules are adopted with an adverse effect on future shareholders' wealth.

Several points can be made about this possibility First, the market's expectations regarding the effect of the future managerial behavior should be captured in the stock price response to the first announcement of the proposed change in voting rules.

Second, the mere fact that many dual class firms have existed and prospered over long periods of time, sugges that having two classes of common stock is a viable form of

corporate organization.

Third, the shareholders dislike the creation of limited voting shares. Shareholders can sell their shares apparently without incurring a loss in share value.

A final note, I'd like to point out that limited voting common stock is not special in that there exists other equity-like securities that do not have full voting rights. For example, preferred stock often has many of the characteristics of common stock, yet it is not uncommon for preferred stockholders to have no regular voting rights. It is unclear why limited voting stock should be prohibited when other equity-like securities restricted voting rights are allowed and accepted as conventional financial claims on firms.

In summary, I see no reason that one share, one vote rule must apply to all firms. First of all, shareholders must approve the relaxation of this rule for their firm. Secondly, shareholders' proportionate voting rights and claims to the firms' cash flows, are not adversely affected by the creation of limited voting common stock.

Finally, the evidence indicates that the value of common stock is not lowered by creation limited voting shares.

Thank you.

CHAIRMAN SHAD: Thank you, Mr. Mikkelson.

Mr. Rubeck.

MR. RUBECK: My name is Richard Rubeck. I am an Associate Professor at MIT's School of Management.

CHAIRMAN SHAD: You have to pull it up closer.

MR. RUBECK: My testimony today is based on a report that I prepared for Institutional Shareholder Service. That report and my remarks today will reflect my own opinion, and may or may not agree with the position by SS (ph.).

My position of the New York Stock Exchange cannot be allowed to change its prohibition against listing firms with multiple classes of common stock until it provides the shareholders with protection from cohersive recapitalization.

When I first began research on this topic, my initial reaction was an intervention by the SEC was not required because outside shareholders had two important safeguards to protect them.

First, shareholders must approve any recapitalization plan, and, second, the decision to exchange their ordinary shares for limited voting shares is voluntary.

I do not specifically address the proxy mechanism, my review of this research in this area indicates that the safeguard is not reliable. My research focuses on the second safeguard. It indicates that voluntary exchange does not, in fact, protect shareholders.

In terms of a dual class recapitalization can be

structured to compel individual outside shareholders to exchange their shares for limited voting shares even though the same outside shareholders, and the same circumstances, but acting collectively, would choose not to exchange.

In my research I develop a model to trace the impact of recapitalization on share prices. In the analysis shareholders are given the opportunity to trade their shares for limited voting stock on higher dividends. This presents outside shareholders with a classic prisons' dilemma. It exploits the inability of individual shareholders to act together. Each shareholder's rational choice leads to an outcome that is worse than if all shareholders retain their original shares. This occurs because small shareholders generally ignore the impact of their exchange decision on the probability of receiving a takeover bid.

Since managers and insiders do not participate in the exchange that results in a concentration of ownership of voting power by insiders. This concentration effectively blots all honest takeover attempts.

To complete a -- takeover attempt the bidder has to either replace the time of its Board of Directors, or has to merge with the timing. Both of these avenues are foreclosed by dual class plans. Therefore, dual class plans may be the most effective universal takeover device -- most effective universal anti-takeover device ever invented.

The recapitalization plans I examined, entice outside shareholders with higher dividends for the limited voting class shares. Examples of this type of plan include Wayne Laboratories, Hershey, among others.

If all stockholders received a higher dividend, no change in value would result. The dividends would simply be financed by reducing investments to just break even. But the plan provides the opportunity for wealth transfers between shareholders.

This provides an enticement to exchange. The perceived cost of the individual shareholder from exchanging present rule for dividing the gains from takeover offer are cross classes of common stock. These rules are, of course, uncertain. But an interesting result of my research is there's more potential takeover benefits asigned to limited voting class shares, the more effective is the cohersion and the recapitalization plan.

For example, suppose the rule required that in the event of a takeover limited voting stock would receive twice the per share takeover premium that the ordinary common stock received. For small outside stockholders such a rule would mean that there was a double benefit to taking the limited voting shares. Higher dividends, and higher take-over benefits.

But both of these benefits are illusions. The

higher dividends come from reduced investment, and the higher takeover benefits never occur because insiders use the veto power to reject all possible bids.

This implies that plans like Wayne Labs which requires a majority approval of both classes of stock for mergers are especailly cohersive. Or I focus on dividend plans there are other cohersive plans.

For example, Dow Jones dramatically restricts the trading of its shares with superior voting rights. Shares automatically convert to limited voting stock when sold at arms-length transaction.

Just lack of marketability makes Dow Jones' plans at least as cohersive as dividend plans I examined.

The last from recapitalizations come from limiting external market for corporate control. The losses can be substantial, and include the loss of expected takeover premiums, and the losses resulted from less efficient management as insiders enjoy the benefits from being insulated from the market from corporate control.

My analysis, therefore, predicts falls in the stock prices of firms in adopting capitalizations.

The empirical studies do not find such faults, but these studies examine firms that have very high inside ownership. Such large inside ownership probably means that insiders have veto power before the recapitalization. If so

these empirical results may not be used in forecasting the impact of recapitalization by a typical New York Stock Exchange firm. Such firms have substantial inside ownership and options to takeover bid.

Let me conclude with a suggestion that avoids such cohersive recapitalization.

The key to my suggestion is the use of capital market to price both classes of stock separately. The shares -- the limited voting shares would be issued through initial public offering, and the proceeds used to repurchase the outside stockholder shares in the marketplace.

This method still results in a loss to expected takeover premium as insiders obtain veto power. But on my cohersive exchange offers, this method forces insiders to purchase the control rights to the firm at the fair market price using their own money.

Thank you.

CHAIRMAN SHAD: Thank you.

Professor Seligman.

MR. SELIGMAN: My name is Joel Seligman. I'm now a Professor of Law at the University of Michigan.

I oppose the New York Stock Exchange proposal was made before you today. At the very least, I think the Securities and Exchange should reject it.

Like former Commissioner Karmel, I would favor

some form of generic rule applicable to the New York Stock Exchange, the American Stock Exchange, and some portio of the NASDAQ securities subjecting them to a one share, one vote rule.

At the very least, if the Commission was not inclined to adopt that form of generic rule, I would certainly be sympathetic to the proposal made by Professor Gordon for a delisting regulation of some type. And I will note that there is precedent for Gordon's proposal in the instance of the Pacific Resources Corporation, which delisted from the Pacific Stock Exchange in February 1981, and at the same time while being solely traded in the OTC market, the Pacific Stock Exchange specialists were allowed to continue to trade, startingly in contrast to the existing rules of the Commission at that time.

Now, to deal with the key matter at hand. What you're witnessing here today is an extraordinary event. I do not believe in the history of the SEC there has ever been a more tentative halting or contradictory presentation of a rule proposal to the Securities and Exchange Commission that was made earlier today by the New York Stock Exchange. You literally had John Phelan tell you he doesn't really like the proposal he's making. He's almost begging you to adopt a generic rule of some sort.

You then heard the American Stock Exchange's

Arthur Levitt seem to sympathize with the generic rule, and even the NASDAQ, which obviously has not favored such a generic rule. You heard Professor Fischel indicate that he recognizes there will be agency cost problems, particularly in recapitalizations, and implicitly in New York Stock Exchange type firms.

It seems to me the advantages of a generic rule as several-fold. Number one, like Roberta Karmel, I believe the SEC has the authority to adopt such a rule, and have spelled this out in an article that I presented for your benefit.

Number two, I do not agree that shareholder approval of a deviation from one share, one vote, adequately addresses the serious problems involved. To begin with, as was well pointed out by the previous speaker, shareholder approval can be influenced by sweeteners and other techniques that lead to collective action problems.

Second, if you have shareholders approve some form of deviation from one share, one vote, you then have a series of enduring problems, and I say this in part in response to the three hypothetical cases that Commissioner Grundfest posed earlier.

First, you have the question of a permanent lack of monitors. You will no longer really have an independent Board of Directors where the insiders control

all of the voting shares.

You will no longer really have a tender offer market to serve as a monitoring technique. You will no longer really have shareholders to serve as an outside monitoring device of some form.

Next, you also then will have the problem of the possibility of disparate rewards in the sale of control context. In effect, it would be striking if the SEC on the one hand seemed very concerned to its all holders rule and best price rules with equalizing the positions of recipients of tender offers, and on the other hand, authorize the New York Stock Exchange to adopt a rule where a share control could be effected by a private sale of a trivial percentage of the outstanding common stock equity with all of the rewards going to the insiders.

Finally, let me point out that what gives special poignance, I think, to the consideration today is that we all recognize the real force behind the New York Stock Exchange proposal is the tender offer context. It has placed enormous new stresses on corporate managers and created a desire in some instances apparently to delist from the New York Stock Exchange.

I think for the SEC to adopt a rule, or permit the New York Stock Exchange to adopt a rule which would create the leading tender offer defense that we have ever

seen would be strikingly in conflict at least with the neutrality implicit in the Williams Act, with the concept of fair corporate sufferage underlying the legislative history of Section 14(a), and with the notion, I think, implicit at the time of the 1975 Securities Acts amendments, that we would adopt a single standard presumably elevated to the highest level for all stock within a National Market System.

CHAIRMAN SHAD: Thank you, Professor Seligman.

Mr. -- Professor Steinberg?

MR. STEINBERG: Thank you. My name is Bob Steinberg. I'm a Professor of Law at the University of Maryland Law School, and I am now counsel to a law firm with offices in Baltimore, Maryland and Washington, D.C. I wish to stress, however, that I'm speaking solely on my individual capacity.

Also, as a former SEC attorney, I'm especially pleased to be here.

Contrary to those who look at this at solely an economic efficiency viewpoint, I think there are very important polity issues at stake here. What we are addressing here is an abandonment of a rule of policy promulgated by the New York Stock Exchange in 1926, and which is certainly contrary to the Exchange's longstanding commitment to encourage high standards of corporate

democracy.

Indeed, that language is in the New York Stock Exchange's company manual.

I think the broader themes here are simply corporate governments, corporate accountability, and fairness of the securities markets. And I should say that this Commission has shown concern on a number of occasions for these values. Similarly, the Commission's recent cases brought against insider trading have simplified this theme.

The Commission's promulgation last summer of Rule 14(d)(10), the "all holders" rule, which requires the tender offers must be open to all shareholders, is another example of the Commission's concern that shareholders be treated fairly. Indeed, in that rule adoption, the Commission in effect nullified the decision of the Delaware Supreme Court in the Unical decision, which permits tender offers to be made on a selective basis.

And another example is the Commission's amicus curiae brief in the Household International Company case before the Delaware Supreme Court where the Commission argued against the poison pen rights there. And in that decision the Delaware Supreme Court overthrowed the rights plan under the Business Judgment Rule.

I think the problem here simply is with respect to takeover strategies and tactics is that provid-

there is full disclosure that the legitimacy of takeover techniques is measured under the state Business Judgment Rule. The Commission's concern with the neutrality of the Williams Act is at a forefront here. I think that the permission of the New York Stock Exchange to abandon its one vote, one share rule would, in effect, create a de facto poison pill. That, in effect, would permit companies to market capital around the world, and yet maintain -- management irrespective of efficiency and shareholder interest.

But again, I think the broader theme is the fairness of the American markets. I believe that the American markets are viewed as the first in the world, that this Commission is here, is a very competent agency.

I have just returned from a trip to Sweden and Finland where I was asked to advise and counsel on securities regulations. One of the reasons I was asked to go there to counsel was because these markets, the United States markets, and the SEC, have the image of having the fairest system in the world, and although other countries may not adopt our system, they learn from it, and they seek our advice.

I believe that the SEC's approval of the New York Stock Exchange proposal at this time would send a very wrong signal. I believe that there's concern out there in the

public domain right now regardless of economic efficiency, that the markets are not fair.

I think to permit the New York Stock Exchange to change its rule would create the impression that indeed the SEC really doesn't care whether the markets are fair. And I don't think that's an impression that the SEC wishes to impose out there.

Another point is I understand the New York Stock Exchange is at a competitive disadvantage. The answer to me is clear. As was stated in the 1980 staff report, SEC staff report on corporate accountability, the SEC clearly has the authority under Section 19(c) of the Securities Exchange Act of 1934, to require the Exchanges and the over-the-counter NASDAQ market to have a one share, one vote rule.

My recommendation is for the Commission to promulgate a rule requiring the National Securities Exchanges and the NASDAQ system to adopt a one share, one vote rule.

Thank you.

CHAIRMAN SHAD: Thank you, Professor Steinberg.

Professor Weiss?

MR. WEISS: Thank you. My name is Elliott Weiss. I am Professor of Law at the Benjamin N. Cardoza School of Law in New York City. Perhaps pertinent to these proceedings, I also served as the first executive director of the

Investor Responsibility Research Center, and was a member of the SEC's Advisory Committee on corporate disclosure.

Today I will summarize a written statement which I have submitted to the Commission and which I assume will be made a part of the record.

For more than 50 years the vast majority of public traded American corporations have had outstanding only one class of common stock, and each share of that stock has had one vote. For the Commission to acquiesce in the New York Stock Exchange's proposal to amend its rules, so as to open the door to widespread deviations from the norm of one share, one vote would, in my view, involve an unwise and unnecessary set of risks.

A far better approach, I believe, would be for the Commission to adopt rules warranting trading of dual class common stock on all national markets, the New York Stock Exchange, the AMEX, other exchanges, and the NASDAQ system.

The proponents of dual class common stock have advanced only one credible claim in support of such stock. They argue that if investors buy low or no vote common stock, or shareholders offer -- authorize such common stock in uncohersed transactions, the Commission should assume that dual class common stock serves some useful purpose. But that claim, at least insofar as it relates to dual class common issue following a recapitalization, is quite suspect.

Where recapitalization has been authorized by the votes of individual shareholders, it seems clear that the collective action problems, economic theories such as Professor Rubeck identified, undermine the claim of other economic theorists that shareholder votes represent convincing evidence that the fact shareholders have approved a recapitalization is convincing evidence that the recapitalization is beneficial.

Most proponents of dual class common stock recognize the force of these collective action arguments. They claim the concerns about collective action problems are not pertinent, however, to votes cast by institutional investors. Indeed, this was the central argument I think made by the subcommittee of the New York Stock Exchange.

That may be a true statement, but it is at best only a half truth. Institutional investors by and large vote shares that they do not beneficially own. Consequently, as I point out in more detail in my written statement, institutions voting decisions often reflect the interests of investment managers who vote those shares rather than the interest of the beneficial owners of those shares.

The best evidence in support of this proposition is found in the voting pattern of institutional investors. Those that face the fewest conflicts of interest with regard

employee pension funds, predominantly the institutions that will be testifying here tomorrow, have been the most consistent opponents of anti-takeover measures of the sort the Commission's own economic studies suggest, frequently reduce the wealth of corporate shareholders.

The best way for the Commission to deal with problems posed by dual class common recapitalizations, I believe, would be to issue rules extended to all other national markets, the prohibition on listing dual class common, currently embodied in the New York Stock Exchange rules.

Such a universal prohibition would have two important advantages. First, it would preclude a contest among different markets to see which can develop rules that corporate managers who seem to be increasingly preoccupied with protecting themselves from unwelcome takeover bids, would find most attractive.

The market for listing standards is not effective here any more than it is effective as regards defensive tactics.

Secondly, a universal prohibition would avoid the enormous interpretative and administrative problems that are sure to arise if the Commission were to elect to bar listing of only some dual class common rather than all such stock.

In the written statement I submitted to the Commission I elaborate on this latter point, and discuss some of the economic problems associated with the state law issues that are likely to arise should issuance of dual class common become widespread.

I also make some suggestions concerning additional disclosure requirements that the Commission may wish to consider should it decide to allow the New York Stock Exchange to list dual class common.

And I might elaborate on these points today, but I would be pleased to respond to any questions you may have.

CHAIRMAN SHAD: Thank you, Professor Weiss.

Let's start with Commissioner Fleischman.

COMMISSIONER FLEISCHMAN: I think a question for all of you who have presented is very difficult.

Let me, if I may, ask particularly Professors Seligman, Karmel, a question derived from the materials they submitted.

Surprisingly, after your vehement presentation, Professor Seligman, I find that you conclude that the Commission probably has authority in this matter. And surprisingly, Professor Karmel, I find that you advance possible sources of authority.

Looking at the materials that have been presented,

standards are, in fact, rules of a self-regulatory agency within the meaning of Section 19, and if so, are they the type of rules to which the authority of this Commission extends beyond the Unfair Discrimination Divisions of Section 6(c)?

It doesn't have to be a ladies first.

MR. SELIGMAN: I should have thought after your recent experience with Rule 3(b)(9) you would understand my use of the word probably perhaps better than you might have before.

It's my considered opinion that you have stronger authority for a rule in this area than you did in the 3(b)(9) area. However, as you correctly suggest by your question, there are analytic questions that are not fully resolved and not fully addressed in the legislative history of the respective sections on which I rely, and specifically the kind of question you pose is one that I believe would be a first impression.

What I suggested in the writing that I submitted to you was that it was -- I don't know what magnitude, but the overwhelming probability would be, I believe, a reasonabl court would conclude the SEC would have authority to issue a rule here. But I can't say with 100 percent certainty.

MS. KARMEL: I believe, and I state in my testimon that was submitted, that the SEC has authority to mandate

a one share, one vote policy under Section 19 of the Securities Exchange Act of 1934. It's amended by the '75 Act amendments, I think.

Your specific question was whether the listing requirements of the New York Stock Exchange are a rule of a self-regulatory organization under that statute. All I can say in that regard is that these types of requirements have been treated as rules since the statute was enacted for over a decade now.

The Stock Exchange cannot in my view, and I think in my their view, change its listing requirement without the SEC's permission. This clearly gives the Commission the authority to tell the Exchange whether or not it could change its rules, and beyond that, to mandate an across-the-board rule for all marketplaces.

In my testimony I talk about possible other sources or additional sources of SEC authority to be found either in the proxy rules or the tender offer rules. While I think there is some possible authority in those sections of the Exchange Act, I don't think the authority there is as strong in Section 19; however, I think that the possibility or some authority there bolsters the argument that Section 19 would reach this kind of a listing requirement.

Obviously there are some limitations, probably severe limitations on the Comission's ability to mandate

various corporate governments' mechanisms.

John Phelan was asked by one of you isn't this a slippery slope, and it is a slippery slope. I think, however the Commission has been on a lot of slippery slopes now for 50 years; has always had the political acumen and legal professionalism to avoid falling off, and I'm sure that you can find a way to do that here too.

CHAIRMAN SHAD: Thank you.

Commissioner Grundfest.

COMMISSIONER GRUNDFEST: Thank you, Chairman.

I'd like to begin with the observation that perhaps what we're talking about here is not really voting rights, per se, but rather voting power, and that the -- from the concept of voting rights to voting powers often fall more complex than one suggests when one uses the shorthand label one share, one vote.

In particular, if one has a look at transactions in the marketplace that we see on an ongoing basis that we would observe for over a century, one quickly observes that there are more ways than one possibly thought imaginable to disenfranchise some stockholders, or to reallocate voting rights, and in one particular voting power among individuals who otherwise are perceived as having voting rights.

Let me give you three examples of the way these transactions can occur [illegible]

spectrum. One going from what I call a most market mediated type of transaction; the other falling towards the most voting mediated type of transaction.

First example, all these involve a company, let's say, that has a 25 percent shareholder, and the other shares are spread pretty much evenly among the large number of public shareholders.

In the first one the 25 percent shareholder decides it's going to do a leverage buy out of this publicly traded firm. Goes to a bank, he weighs his money, he buys the shares from the other 75 percent of the public stockholders.

Now, clearly, this eliminates all voting rights and all voting power from the other 75 percent and the company thereafter becomes takeover proof. This, however, appears to be a highly market mediated type of transaction.

Second hypothetical, the 25 percent stockholder persuades the Board of Director to cause a repurchase of 50 percent of the outstanding shares, and he doesn't tender into the repurchase. After the repurchase of 50 percent of the outstanding shares, his 25 percent interest represents a 50 percent interest. And at that point he effectively has total voting power over the corporation because his 50 percent will always prevail. So even though he has 50 percent of the voting rights, he has 100

of the voting power.

Third scenario involves the A/B recapitalization. In that situation the stockholder uses the voting mechanism and without any compensative exchange in the market for anyone, is able to obtain a situation whereby he again has total voting power over the corporation even though he may not have total voting rights.

. In general, a question to the panel anyone who wants to take it up in any sequence, is there a reason to prefer the more market mediated transactions such as the leverage buy out or the 50 percent repurchase to the electoral mediated type of transaction, for example, the recapitalization.

Mr. Rubeck?

MR. RUBECK: I think there is. First of all, let me tie your plan to ones that I have analyzed.

In your first example, you leverage buy out. Presumably the firm says you've got to repurchase the shares of outside stockholders, and my plan identical to that is that it is not --

Both plans have the features that the additional capital is being provided by an agent in an arms-length transaction where no cohersion is possible.

In the second choice with the repurchase of 50 percent, presumably the money has to come from somewhere to

get their 50 percent ownership. Again, it could come from equity or -- and the same analysis would apply.

In the third, the A/B recapitalization of the kinds that I examined in great detail, the disadvantage of using a recapitalization is that you're using a tying mechanism to tie the issue of the limited voting stock with the redemption of the ordinary voting stock. Net result is that you provide an element for cohersion and an ability to use corporate funds to induce shareholders to give up their vote.

Quickly, in your first alternative or my plan, those who buy the voting rights buy them at fair market value using their own funds. In the recapitalization that may occur, there's also great opportunity for it not to occur. That is, to use corporate funds to reduce the investment, to reduce shareholders to accept limited voting stock, and thereby use corporate funds to extinguish the voting rights.

COMMISSIONER GRUNDFEST: Mr. Weiss?

MR. WEISS: Yes, Commissioner Grundfest. I think going at it from the other end, so to speak, I attempted to outline support for my details what are the reasons why it seems to me one ought to be suspicious about transactions effectuated through voting. The combination of the fairly well-known collective action problems

which Professor Rubeck and others have mentioned, and I mentioned. And the somewhat different problems, but nonetheless, I believe, quite real, relating to votes by institutional shareholders.

All raise very grave suspicions that shareholder votes do not equate with arms-length transactions to which people need not cash proxies but take money out of their pockets.

The difficulty which goes beyond that is that if one has a prohibition on recapitalization type transactions, there is often the possibility of a different kind of restructuring, and there's a kind of drafting problem one might say.

For example, the idea of a downstream merger a corporation with one class of common stock into a wholly-owned subsidiary with two classes of common stock. Is that picked up on a prohibition on recapitalizations?

I have every confidence that the corporate bar with its demonstrated ingenuity to be able to come up with 50 or 100 other variations of this theme, that are well beyond my imaginative powers at the moment.

So it seems to me that if one moves to the positi that the recapitalization transaction is suspect, there is a strong case made for broadening out that prohibition to get at transactions that are de facto, equivalent, or very

close to equivalent, to the classic recapitalization.

COMMISSIONER GRUNDFEST: Let me just ask Professor Mikkelson, to the extent that the data are correct, and they show no net stock -- negative stock price effects on average in conjunction with recapitalization programs, might there be a reason to suspect that all other conditions being equal, occurred in the same company, same growth rate, same other benefits and other incentives being provided to the stockholders, that a market mediated transaction might lead to a greater efficiency effect, greater efficiency benefit, than a voting mediated transaction.

MR. MIKKELSON: Well, you say might. I can't ever reject that statement. But in terms of stock price reactions, there is quite a bit of evidence out there in terms of how the market responds to stock repurchases of leverage buy outs. And the evidence is quite strong that market reacts favorably, and to a large degree we're talking of 125 percent or more price appreciation in a two day period on average, when a company announces a stock repurchase or a public buy out.

In terms of stock price reactions, I'm not answering in terms of efficiency now, in terms of stock price reactions there certainly is a case to be made that on average from past experience there has been more favorable price response, but that just raises the question why in some

cases firms choose recapitalization, in other cases they choose to repurchase. It's hard to generalize.

COMMISSIONER GRUNDFEST: And I think an examination of some specific situations where you find negative net price effects in conjunction with recapitalization to be very revealing with a record as strategic.

MR. MIKKELSON: Could I say one other thing?

In terms of Professor Partch's study, she has broken down in some detail this sample of 44 changes to a limited voting share structure. And one sample, sub-sample, includes the 20 cases in which -- let me get this right now -- 35 cases of a pro rata distribution to share-holders, no significant negative stock transaction. In other words, all these different sub-samples she looks at in terms of the menas of recapitalization, none of them individually, the sub-samples, show a negative stock price reaction.

But even further beyond that, if you look at 44 cases individually, you're using some power in terms of statistical tests here, if you look at 44 cases individually, you don't find a single case in which a firm has experienced a negative stock price reaction.

You do find six cases in which stock will have a majority of reliable positive stock prices.

COMMISSIONER GRUNDFEST: Mr. Chairman, I am willin to see -- you're in charge of time.

CHAIRMAN SHAD: We may be able to come back to you. Commissioner Peters?

COMMISSIONER PETERS: Thank you, Mr. Chairman.

I must confess that I find it real ironic that many of our panelists argue that the individual shareholders are not capable of exercising rationally to vote that the panelists urge --

But, do recognize that there is some basis for the arguments that in voting -- and recapitalization along dual class structure, that vote presents issues that are difficult choices, or at least present difficult choices to shareholders.

But I would remark that I think that almost any circumstance over which one is asked to vote or elect between one or more -- well, from two or more alternatives, you have similar difficult choices to make.

But it seems to me that the comments seem to be directed more to the choices that one makes in light of the fact that this dual class structure presents, I think, one panelist used the term "the ultimate takeover device." And so many of you are concerned about the effect that this will have on the market for corporate control if we permit

I'd like to ask any of you, particularly Mr. Rubeck, or Weiss and Seligman, whether Professor Karmel's, or Commissioner Karmel's, suggestion that disenfranchised shareholders be compensated for their fair vote -- whether that eliminates your concern about the effect of this change with -- in light of takeovers.

I'm assuming that one could calculate the value of that -- seems to be able to calculate the premium that attaches to vote within the hostile takeover situation.

MR. SELIGMAN: Commissioner Peters, can I go first on this one?

COMMISSIONER PETERS: Yeah. I'm glad I made myself clear. Yes, please do.

MR. SELIGMAN: First, it seems to me you can't just focus on the transfers and control market. If you adopt this proposal you will radically change our corporate proxy system. You will create a situation with insiders with an almost trivial statistical minority stock under the New York Stock Exchange proposal, could control a statistical majority of the votes.

All of the language supporting Section 14(a) in the 1934 Securities Exchange Act, which envisions fair corporate sufferage and so on, seems to me to be a very clear mandate to the Commission that you have a responsibility to protect the integrity of the proxy system. And

if nothing else, this proposal besides being an ultimate takeover defense, is going to subvert the proxy system as we now have it.

Second, let me just observe -- and this is an observation as much related to Commissioner Grundfest's last set of three hypotheticals, as to your question, that it's very important I think for the Commission to bear in mind you're not writing on a clean slate here. You do have a legislative history for at least four separate sessions of the Securities Exchange Act which seems to suggest there is a conviction on the part of the Congress that adopted the 1934 Securities Exchange Act, the '68 and '70 Williams Act amendments, the 1975 Securities Acts amendments, that there would be a system of corporate sufferage of some sort.

And it seems to me that that system of corporate sufferage would not only envision a proxy system, but presumably also would envision independent directors.

If you adopt this proposal, you not only will deal with a system that subverts the tender offer as a monitoring device, and the proxies as a monitoring device, but you're also effectively going to end independent directors as a monitoring device.

And this is a very broad dimension, so the