

# STA <sup>2005 - Issue 4</sup> Newsletter

The Securities Transfer Association, Inc. A PUBLICATION OF THE SECURITIES TRANSFER INDUSTRY

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## Street Proxy Tabulation Results: Over-Voting Still Pervasive

During the 2005 proxy season, one major transfer agent conducted a thorough review of all street proxies submitted for banks and brokers through ADP. The objective of the review was to ensure the accuracy of the voting and to assess the progress in addressing over-voting and other voting conditions. The agent tabulated 341 U.S. equity issuers. Attempted over-voting of street positions occurred for every tabulation! The following is a summary of causative factors observed:

- **Multiple DTCC Participant Numbers:** This occurs when ADP's vote comes in under one DTC participant number, but the shares needed to sustain the vote are housed in more than one participant number. This was pointed out to ADP at least a year ago in various industry discussions. ADP issued a "Broker Association Table", which detailed and associated the participant numbers for 8 firms. The transfer agent independently received authorization to use multiple participant numbers from approximately 20 firms. The condition persisted through the 2005 proxy season.
- **Discussion** - The multiple participant number problem could and should have been resolved before the past proxy season. The agent looked for ADP's certification that their clients had given authority to include them in the Broker Association Table. This was not accomplished, resulting in situations where shares either could not be associated with multiple participant numbers or were more difficult to identify.
- **Respondent Votes:** The agent encountered instances where a DTC participant voted its entire record date position accurately through ADP and later had additional votes cast by ADP under their participant number. This apparently results from ADP contracting distribution/tabulation services with a clearing or custodial client of the DTC participant. Consequently, both the participant and the participant's custodial client directed distribution of materials and attempted to vote the same shares. In almost all of these cases, the agent resolved the over-voting by dropping the votes of the respondent institution, since no evidence could be found that a legal proxy had been issued by the participant for the shares held for the respondent.
- **Discussion** - The respondent vote situation raises questions in the area of due diligence, added unnecessary issuer expenses and compromised voting integrity. Unnecessary expenses may be generated when shareholder-meeting material is distributed twice to the same parties. Further, an over-voting condition will be generated if the DTC participant exercises discretionary voting while the custodial client or beneficial owner also votes the same shares. Simply lobbing a vote into the tabulator and hoping it gets sorted out correctly in the end is not an adequate approach. There may also be questions regarding a participant's obligations under 14b-1 or 14b-2. These proxy rules obligate custodians to render omnibus or legal proxies in favor of certain entities such as respondent banks or brokers for whom they act as custodians.

(Continued on Page 4)

## CANCELLED, UNRECORDED AND IMPROPERLY RECORDED CERTIFICATES: What to do if presented with a request to transfer one of these items

By Mark Harmon, esq.

It is possible that, sooner or later, a transfer agent will face one of the following predicaments:

- A request to transfer a certificate that is not recorded on the transfer records of an issuer;
- A request to transfer a certificate that was incorrectly recorded on the transfer records of an issuer; or,
- A request to transfer a certificate that has been cancelled on the records of the issuer.

(Continued on Page 2)

In This Issue ...

# President's Forum

Dear Member:

Since our last newsletter, your organization has joined with the Business Roundtable (BRT), the Society of Corporate Secretaries & Governance Professionals and the National Investor Relations Institute (NIRI) urging the NYSE Proxy Committee and the SEC to effect substantive changes to the existing proxy process in the United States. The STA will play an active role in assisting the coalition with developing alternatives to the current street name distribution and tabulation process. The coalition is scheduling a meeting with the Commission to discuss the views covered in our joint letter. Because of the significant management changes at

the Commission, coupled with the progress of the NYSE Proxy Committee, we do not feel that there will be any impact on the 2006 proxy season. However, we remain very optimistic that there will be changes in the 2007 proxy season.

Another priority that your organization set for 2005, is how to work together to present ourselves as an organization when dealing with DTCC and other organizations without running afoul of antitrust laws. To create this ability, we have engaged special counsel who has begun to work with the legal committee. This capability is critical as we begin to develop new services such as NFE. We will provide you updates on this and other initiatives at the annual conference.

I would also like to acknowledge our newest director representing the Canadian transfer agents, Richard Barnowski from Equity Transfer Services, located in Toronto, Canada. We are delighted to have Richard join our Board and look forward to his contributions. We want express our gratitude to our departing Board member, John Halse from Pacific Corporate Trust Company, for his service to the STA Board and transfer community.

See you at the conference!

Sincerely,



Charles V. Rossi  
President

## CANCELLED, UNRECORDED AND IMPROPERLY RECORDED CERTIFICATES:

(Continued from Page 1)

What these scenarios have in common is that they can arise from inaccurate, incomplete, or deliberately improper record keeping by a predecessor agent or the issuer. Even though the current transfer agent did nothing to cause the problem, it must proceed carefully to avoid sharing in the liability that may arise if the deficient record keeping is relied upon as accurate.

Where the cause of the discrepancy in the transfer records predates the transfer agent's tenure as agent for the issuer, the agent may be unable independently to correct or resolve the discrepancy. At a minimum, the agent may have reason to doubt the validity of the transfer records. How then does the transfer agent balance its responsibility to the issuer with its duty to the shareholder under Article 8 of the Uniform Commercial Code (UCC) to register transfers that satisfy the conditions of Section 8-401?

(Continued on Page 5)

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**CANCELLED, UNRECORDED AND IMPROPERLY RECORDED CERTIFICATES:**

(Continued from Page 2)

While there are no proven strategies to resolve these concerns, there are measures that can be taken to assess the situation and reduce the risk of taking a wrong step. We will first look at examples to illustrate the risk to which the transfer agent is exposed when it receives a presentment of this kind. Then, we will offer suggestions for ways of dealing with these situations to minimize the transfer agent's risk of liability to the shareholder and/or issuer.

**The Problem**

Consider the presentment of a certificate that on the records of the issuer has been marked cancelled and was not the subject of a lost certificate replacement. Is this a function of sloppy record keeping; did the shareholder somehow acquire the certificate improperly; or is it the issuer that has acted improperly by unilaterally "canceling" the shares? Given the duty to remain neutral between the issuer and shareholder, the transfer agent obviously is in a difficult spot.

Our most recent experience with a transfer agent that encountered a presentment of this kind involved a shareholder of a privately held company that was acquired by the agent's issuer. The shareholder presented a certificate from the acquired company and requested the issuance to him of shares of the parent company -- the agent's issuer. Although the transfer agent at one time had issued and delivered to its issuer certificates which were used in connection with the acquisition, the agent had no stock records for the acquired company and, therefore, could not confirm the validity of the certificate presented, let alone the shareholder's claimed right to exchange the certificate for shares of the issuer. The issuer's position was that the certificate had been cancelled, thus placing the agent exactly where it never wants to be - in the middle of a dispute between the issuer and a shareholder.

**Minimizing the Risk**

At the root of dealing with any non-routine item is the principle that the transfer agent must remain neutral. To side with an issuer at the expense of the presenting shareholder is a sure way to get sued. While the issuer may promise indemnification against a lawsuit, if the issuer becomes unable financially to honor that obligation, the transfer agent will be the only remaining "deep pocket". Therefore, never simply reject an item because it conflicts with the issuer's stock records. Instead, undertake an inquiry in order to discharge the transfer agent's obligation to the shareholder -- a statutory obligation created under UCC § 8-407 that holds a transfer agent liable to a shareholder for the wrongful refusal to register a transfer in any case within the scope of its functions where the issuer would itself be liable.

The first step to take may seem obvious: contact the issuer or its counsel and ask for an explanation of the cancellation or other discrepancy. Make the request in writing and fix a date by which you expect a response. Keep the shareholder informed by copy of your letter. Because the presentment is a non-routine item, there is no set period of time by which you must process or reject the item, but that does not mean that it can be left to linger. The SEC requires that non-routine items be given continuous treatment. But perhaps more importantly, in our experience, the longer an item remains in a transfer agent's custody, the greater the risk of its being sued for not handling the item properly.

The issuer may not supply an explanation, or the explanation it does provide may be inadequate and demonstrate simply that it is in a dispute with its shareholder. For example, the issuer may claim that the certificate was cancelled because the shareholder did not pay for the shares, or that the certificate was released by mistake. Even if these explanations are true, they rarely if ever will be an adequate basis for rejecting the item. To refuse to process an item on such grounds may well, at minimum, subject the transfer agent to the expense of a lawsuit. In the worst case, if a court eventually rejects the issuer's explanation, the transfer agent will be jointly liable with the issuer for the shareholder's loss. Yet it may be equally unacceptable for the transfer agent simply to disregard the issuer's explanation and accompanying instructions directing that the item be rejected.

The solution, we suggest, is to employ the mechanism established under Article 8 for resolving a demand that a transfer agent not register transfer of a certificate. Under that mechanism, which is set forth in UCC § 8-403, the transfer agent should send written notice to the issuer, with a copy to the shareholder: (i) identifying the certificate that has been presented for transfer; (ii) confirming that the issuer has instructed the transfer agent not to register transfer; and (iii) advising that the transfer agent will withhold registration of transfer for a stated period of time in order to provide the issuer an opportunity to obtain an appropriate injunction or indemnity bond. If the issuer fails to obtain an injunction or indemnity bond within the time stated, the transfer agent should proceed to register the transfer.

Although UCC § 8-403(c) speaks of the period of time as not to exceed 30 days, a significantly shorter period may be appropriate, particularly where the issuer's stated reason for rejecting the transfer appears dubious. A short time frame also is recommended because the issuer usually will not be an "appropriate person" to originate

(Continued on Page 10)

## The Securities Transfer Association at Work

(Continued from Page 3)

coalition with the Business Roundtable, the National Investor Relations Institute (NIRI), and the Society of Corporate Secretaries & Governance Professionals. The coalition has issued a joint letter to the SEC, to present its members' shared views on shareholder communications and to encourage expeditious SEC review of the present shareholder communications system. This letter may also be found at [www.stai.org](http://www.stai.org).

### ***Innovating Paperless Legal Transfers***

The STA continually seeks ways to make things easier for investors, transfer agents and other market participants such as the broker dealers and banks that guarantee signatures. A recent and significant undertaking in this area is the launch of the Paperless Legals initiative on July 5th after a successful Pilot Program and ongoing participation by 14 transfer agents. The goal of the program is to eliminate the need for transfer agents to examine, approve, and retain documents that accompany requests for non-routine transactions (i.e., those needing additional documents to support who can authorize the transaction). Basically, the responsibility for reviewing legal documents falls to the guarantors, who will perform the review, and keep the documents. The transfer agent need only ascertain that there is a valid Medallion guarantee on the transaction instruction. This innovative program provides benefits to all parties. Investors will only need to provide one set of legal documents to guarantors and will not need to bear the time and expense of collecting multiple sets of documents (such as trust agreements or death certificates) to make transfer requests for multiple securities. Transfer agents should benefit from realizing processing efficiencies in their back office operations and there should be a reduction in rejects. And guarantors will no longer need to duplicate and mail separate sets of documents to different transfer agents for the same customer.

### ***Eliminating the Drop***

A long standing regulation of the NYSE required securities transfer agents to maintain an office "south of Chambers St." in Manhattan (Rule 496). While this regulation was useful in years past, when certificate presentments were the norm, it presented an unnecessary expense and inconvenience for agents located outside of New York in 2005. The STA, at the urging of its members, was able to argue successfully for the elimination of this Rule.

### ***Training the Membership***

The STA continually seeks to keep its membership informed of new and changing regulations, of new technologies that are available to increase operational

efficiency, and provides training to members' employees on the "nuts and bolts" basics of the business. To that end, the STA is sponsoring a series of training seminars in major cities across the U.S. beginning in the fall of 2005. The course material will include the life cycle of a trade from purchase by the investor through broker, depository, transfer agent and delivery, discussion of the importance of setting up accounts properly and the liability that can result from erroneously issued securities, discussion of the purpose, history, and operations of DTCC, SEC turnaround regulations, legal transfers and "Paperless Legals," the proper way to deal with reporting requirements for lost and stolen securities and more. By offering this training to members, the STA can supplement the training provided by in-house resources with timely and up to date information.

### ***Distributing Information***

The STA also seeks to inform by utilizing its website and by publishing a quarterly Newsletter. The STA posts notices of important regulatory changes and other issues of the day on its website, [www.stai.org](http://www.stai.org). Members are kept informed by emails alerting them to documents as they become available. The website provides access to the STA Rulebook (currently under revision) which is a widely used resource for both guarantors and transfer agents. It also provides links to other useful websites such as those of regulators and other industry groups. The Newsletter is mailed to all members and contains articles on issues of the day, such as Proxy Distribution and Paperless Legals.

### ***Committees for the Membership***

The success of any organization may be ascertained by the participation of its members. The STA has three very active committees: The Processing Committee, the Legal Committee, and the newly formed Fraud Prevention Committee. The Processing Committee responds to issues raised by the transfer agent community, develops strategic direction, provides guidance on inter-agent issues, and recommends standards. At present it is finalizing revisions to the STA Transfer Guidelines and working with DTCC and SIA members to ensure a smooth transition to Paperless Legals.

The Legal Committee is charged with responsibility for examining major regulatory and legal issues on behalf of the Association and its members. It plays a significant part in satisfying the Association's mission to provide advocacy services to the transfer industry. The scope of its efforts includes review and comment on legislation/rulemaking affecting the transfer industry, legal review of new products proposed by the Association or other participants in the securities processing environment, and ongoing direct

(Continued on Page 10)

**CANCELLED, UNRECORDED AND IMPROPERLY RECORDED CERTIFICATES:**

(Continued from Page 5)

a demand not to register transfer. For that reason, we encourage transfer agents to inform issuers in writing at the outset that the agent may be required under the UCC to process the item and that, if the issuer intends to take legal action to secure an injunction, it should not await a formal notice from the agent.

It may appear to the agent that to register the transfer would violate securities laws, or there may not have been presented sufficient proof of compliance with federal and state law. In these circumstances, UCC § 8-403 may not offer a reasonable solution. Instead, your only remedy may be to commence an interpleader action. The object of such an action is to deposit the item with the court and leave the issuer and shareholder to litigate the matter. In a proper case, the transfer agent will be discharged from liability on the filing of the action. We caution, however, that filing an interpleader is not a substitute for registering a transfer that is rightful. In other words, if the shareholder is entitled to have the transfer registered, depositing the certificate into court still can result in a claim against the agent for its wrongful refusal to process the transfer.

If the issuer provides what appears to be a satisfactory explanation, you may consider approaching the shareholder about withdrawing the presentment or be subject to an interpleader action in a forum convenient to you and not the shareholder. If an interpleader is appropriate, the expense of commencing the action may

be charged against the certificate, another inducement to the shareholder to withdraw the request and seek to solve the problem on its own. While there certainly are risks inherent in commencing an interpleader action, they may be outweighed by the benefits of promoting an agreement with the shareholder or of having a court promptly determine the issues. Thus, interpleader may be a better alternative than merely rejecting the presentment and losing control of the determination of the dispute.

**Conclusions**

Inherited company records that are inaccurate or improperly maintained can pose difficulties for the transfer agent. Each fact pattern will be unique and must be reviewed and analyzed independently. However, by adhering to the provisions of the UCC, processing the non-routine items in a timely fashion, and avoiding taking sides in disputes between an issuer and shareholder, the transfer agent should be able to steer clear of liability.

***Mark A. Harmon, a partner at the New York City office of Hodgson Russ LLP, has represented transfer agents on general matters and regarding their responsibilities under UCC Article 8 for over 15 years. He can be reached at [mbarmon@hodgsonruss.com](mailto:mbarmon@hodgsonruss.com). Daniel S. Steinberg, also a partner at Hodgson Russ LLP, greatly assisted in the preparation of this article. ■***

**The Securities Transfer Association at Work**

(Continued from Page 8)

communication with the regulatory agencies who oversee the securities transfer business. Comprised of nine members, eight are attorneys who represent the securities transfer businesses of the firms they work for, all of which are Association members.

Initiatives over the last twelve months have included: review of a preliminary draft of proposed revisions to the SEC transfer agent rules, review of the possible impact of Gramm, Leach, Bliley on investment plan processing by transfer agents, and discussion with the US Department of the Treasury regarding the impact on transfer agents of the Customer Identification Procedures required by the USA Patriot Act.

The Fraud Prevention Committee seeks to identify policies and procedures that are effective in deterring the various types of fraud that transfer agents experience today, and to share these ideas with the STA membership. The Committee is also working to establish a system of "Fraud Alerts" where members can advise

other members if they are experiencing particular types of fraud or suspicious activity. In this way, the entire membership can be alerted and can give special scrutiny to certain types of transaction scenarios. To date, the Committee has identified defensive procedures that work to counter various types of check fraud, ACH and online fraud, and fraudulent transfer and redemption requests, and plans to share these strategies at the STA Annual Conference.

The STA also provides an opportunity for members to become informed about the issues of the day, to share experiences, and to network, through its Quarterly Meetings and Annual Conference. At these events, speakers address various regulatory and operational issues, and engage in question and answer sessions with attendees. These meetings allow face-to-face exchanges and are popular with the membership. Individuals wishing further information about the STA may contact Cynthia Jones, Executive Director, by email: [cjones@stai.org](mailto:cjones@stai.org). ■