

April 16, 2010

Federal Court Excludes Shareholder Proposal For Failure to Satisfy Eligibility Requirements of Rule 14a-8(b)(2)

The U.S. District Court for the Southern District of Texas recently allowed Apache Corporation to exclude a shareholder proposal from its proxy materials because the shareholder failed to present adequate proof of eligibility of stock ownership on a timely basis as required by Rule 14a-8(b)(2) of the Securities Exchange Act of 1934, as amended. The Court rejected Apache's argument that Rule 14a-8(b)(2) requires a letter from the Depository Trust Company ("DTC") confirming a shareholder's ownership, but ruled against the shareholder in what it described as a "narrow" holding that found the shareholder's written statement from an unregistered entity that was not a DTC participant inadequate to establish stock ownership eligibility under Rule 14a-8(b)(2). The Court did not rule on what would have been sufficient to establish the shareholder's eligibility to submit shareholder proposals.

Background

The *Apache* case arose out of a shareholder proposal submitted pursuant to Rule 14a-8 on November 8, 2009, by John Chevedden. Chevedden was not the shareholder of record for his Apache shares; rather, his shares were held in "street name" and the record owner of the shares beneficially owned by Chevedden was DTC's nominee, Cede & Co. Pursuant to Rule 14a-8(b)(2), an investor who is not a registered holder must submit a written statement from the "record holder" of the investor's securities "(usually a broker or bank)" verifying that, at the time the proposal was submitted, the shareholder had continuously held the securities for at least one year. On November 27, 2009, Chevedden submitted to Apache a letter from Ram Trust Services ("RTS"), his "introducing broker", stating that Chevedden satisfied the holding requirement. On December 3, 2009, Apache notified Chevedden that according to Apache's records neither Chevedden or RTS were listed as record holders of Apache shares and unless Chevedden could demonstrate his eligibility within 14 days of receipt of the December 3 notice of deficiency, Apache would exclude his shareholder proposal.

On December 10, 2009, Chevedden sent to Apache a letter from RTS stating that RTS was the "introducing broker" for Chevedden's account and that the shares were held by Northern Trust as custodian. It was undisputed in the lawsuit that Northern Trust was not a record holder of Apache shares. On January 8, 2010, Apache notified Chevedden and the staff of the Securities and Exchange Commission (the "SEC") that it intended to exclude Chevedden's shareholder proposal on the basis that an "introducing broker" is not a record holder of shares and that Chevedden had not satisfied the eligibility requirements of Rule 14a-8(b)(2). On the same day, Apache filed suit in federal court seeking declaratory judgment to exclude Chevedden's shareholder proposal. On January 22, 2010, two additional letters were sent to Apache

on behalf of Chevedden, one from RTS and one from Northern Trust, as a DTC participant, seeking to establish his eligibility for purposes of Rule 14a-8(b)(2).

Analysis

The Court, agreeing with Apache, stated that the burden of proof was on Chevedden to prove his eligibility to submit shareholder proposals and that Apache was not required to independently confirm statements made by Chevedden (e.g., by obtaining a NOBO list, which, in any event, the Court noted would have been inconclusive). Apache argued that in order to satisfy Rule 14a-8(b)(2), Chevedden was required either to prove his eligibility by providing a confirming letter from DTC, as the registered owner of his shares, or to become the registered owner of the shares. The Court did not support Apache's narrow reading. Citing the Rule's parenthetical notation that the record holder is "(usually a broker or bank)" and observing that DTC is "usually" the registered holder but that it is neither a broker or a bank, the Court held that the Rule "permits but does not require" obtaining a letter from DTC. The Court noted that if the SEC intended to require written statements from the registered or "street name" holder, it would not have used the term "record" holder. In addition, the Court noted, as a practical matter, DTC's netting system does not permit DTC to certify accurately that a participating broker (or that broker's client) has held the requisite number of shares continuously for one year.

In analyzing the letters submitted by Chevedden, the Court limited its ruling to the November 23, 2009 and December 10, 2009 letters, declaring that it would not decide if the January 22, 2010 letters, which included a letter from Northern Trust, the relevant DTC participant, were sufficient to prove Chevedden's shareholder eligibility because the January 22, 2010 letters were untimely pursuant to Rule 14-8(f). Chevedden argued that the December 10, 2009 letter, in which RTS stated it was an "introducing broker", was sufficient to satisfy the requirements of Rule 14a-8(b)(2) based on the SEC no-action letter issued in the *The Hain Celestial Group, Inc.* (October 1, 2008), in which the SEC staff said that they were "now of the view that a written statement from an introducing broker-dealer constitutes a written statement from the 'record' holder of securities, as that term is used in Rule 14a-8(b)(2)(i)." While the Court noted that SEC no-action letters are "persuasive" authority and declared that the December 10, 2009 letter was of the same type as presented in *Hain Celestial*, the Court concluded that RTS's December 10, 2009 letter was not sufficient to prove eligibility under Rule 14a-8(b)(2), as RTS was not registered as a broker with the SEC (or with FINRA or SIPC, the self-regulating industry organizations) and was not a DTC participant and Apache had previously "identified grounds for believing that the proof of eligibility was unreliable."

This memorandum is intended only as a general discussion of these issues. It should not be regarded as legal advice. We would be pleased to provide additional details or advice about specific situations if desired.