

IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

APACHE CORPORATION,

Plaintiff

v.

JOHN CHEVEDDEN

Defendant

Civil Action: 4:10-cv-00076

UNITED STATES PROXY EXCHANGE
AMICUS CURIAE BRIEF

Contents

1. The 1975 Securities Acts Amendments	1
2. DTC Cannot Confirm Beneficial Ownership	4
3. Definitions for “Record Holder”	5
4. Accepted Practice.....	8
5. History of Rule 14a-8.....	9
6. SEC Staff Legal Bulletins and No-Action Letters	11
7. Proposed Alternative to Rule 14a-8(b)(2).....	19
8. Timing of Documentation.....	20
9. John Chevedden	20
10. Conclusion	24

In 1960, daily volume on the New York Stock Exchange (NYSE) was around 3 million shares.¹

Today that number is around 3 billion shares—a 100,000% increase in fifty years. All those transactions are processed by a clearing, settlement and custody industry that average investors know little about. To handle the dramatic increase in trading volumes, that industry was transformed. This didn't happen gradually over fifty years. It happened with a thunderclap in 1975.

This lawsuit is about what it means to “own” shares and how one might go about proving that ownership. These questions were a puzzle prior to 1975. Today, they are a Gordian knot. Prior to 1975, phrases like “street name”, “record holder” and “proxy” had clear meaning. Today, they do not. Apache's lawyers argue that the intent of SEC Rule 14a-8(b)(2) is “clear” so long as we literally interpret the phrase “record holder” according to its pre-1975 meaning. This is not accepted practice. The world has changed, and old definitions don't apply. Vice Chancellor J. Travis Laster summed the situation up in his decision in *Kurz v. Holbrook*—a case with issues similar to this one:²

I believe it will help rather than harm our law to treat the DTC participant banks and brokers who appear on the Cede breakdown as stockholders of record. Because this represents a change in how Delaware practitioners understand the stock ledger for purposes of voting, it is not a conclusion I reach lightly. Sir John Maynard Keynes famously observed, “When the facts change, I change my mind. What do you do, sir?” This case has forced me to evaluate critically the facts surrounding the DTC omnibus proxy and the relationship between DTC and its participant members. I find they are quite different from what our case law historically has assumed.

For that case and this one, in 1975, the facts changed. To understand the issues in this case, we need to understand what changed.

1. The 1975 Securities Acts Amendments

The practice of street name registration, in which a broker owns stock on a client's behalf, has existed for many years. In the early 20th century, perhaps 10% of stocks were held in this manner.³ Investors were generally cautioned against the practice. In the days before the Securities Investor Protection

¹ Daily volume data is available from the NYSE Euronext website: <http://www.nyse.com/financials/1022221393023.html>.

² *Kurz v. Holbrook*, CA No. 5019-VCL (De. Chanc. Feb. 9, 2010).

³ For an authoritative discussion of topics covered in this section, see David C. Donald's 2007 paper *The Rise and Effects of the Indirect Holding System - How Corporate America Ceded its Shareholders to Intermediaries*.

Corporation (SPIC), shares held in street name might be lost if a broker became insolvent. The advantage of street name registration was that it streamlined stock settlement. If investors directly owned stocks, settlement of a trade would require the selling party to endorse the certificates and deliver them to her broker. The broker would deliver them to the issuing corporation's transfer agent, which would record the change of ownership in the corporation's ledger of shareowners, void the certificates and issue new certificates to the broker of the purchasing party. That broker would then deliver the certificates to the purchasing party. The cumbersome process ensured accuracy. If an investor held shares in street name, her broker's name would appear on the stock ledger—the broker would be the “owner of record”, and the investor would be the “beneficial owner”. If the investor needed to prove beneficial ownership of the shares, she could have her broker write a letter.

During the late 1960's, trading volumes on the NYSE increased dramatically. Brokers could not keep up with all the settlements. Failed deliveries forced the NYSE to close on Wednesdays and abbreviate trading to give member firms time to catch up on paperwork. Brokers were forced to cover short positions caused by missing securities and over 100 went bankrupt or were acquired by competitors. The “paperwork crisis” led directly to the Securities Acts Amendments of 1975.

The Acts are primarily remembered for eliminating the system of fixed commissions. However, they also contained provisions that require the SEC to “use its authority ... to end the physical movement of securities certificates in connection with the settlement among brokers and dealers of transactions in securities ... ” This led to the formation of the Depository Trust Corporation (DTC).

Average Americans would be alarmed to learn most shares of US corporations are owned by a single entity: DTC. DTC did not eliminate stock certificates. It “immobilized” them in its vaults. A given share of stock may “trade” many times without its certificate ever leaving DTC vaults. DTC registers its ownership of shares under its nominee name Cede & Co. (pronounced “seedy and co”).

Under this system, shares belong to DTC. Investors buy and sell what are legally known as “security entitlements.” These are book entries on the computers of DTC or other financial institutions. If DTC holds shares for a broker, the shares belong to DTC, and the broker owns a security entitlement. If the broker holds that security entitlement on behalf of a retail investor, it records the retail investor’s interest as a book entry on its own computers—so the investor in turn owns a security entitlement. In this way, “daisy chains” of security entitlements connect stock certificates in DTC’s vaults with retail investors.

DTC is owned by some of its 600 or so participant financial institutions. Participants are the banks and brokers who hold security entitlements directly with DTC and are allowed to settle trades through DTC. All the large custodial banks—such as State Street, Bank of New York and Northern Trust—are DTC participant firms. The vast majority of banks or brokers hold security entitlements, not through DTC, but through DTC participant firms. Daisy chains of security entitlements routinely involve four or more parties.

For example, John Chevedden holds security entitlements for Apache stock through RAM Trust Services (RTS). RTS is not a DTC member firm, so it holds security entitlements in Apache stock through Northern Trust. Northern Trust is a DTC member firm, so it holds security entitlements directly with DTC. DTC holds the underlying Apache stock.

This convoluted system streamlines stock trading. When a broker “trades” security entitlements on behalf of a client, the broker updates its own computer systems to reflect the change in ownership. In a given day, a broker may transact “trades” in Apache stock for—and collect commissions from—5,000 of its clients, but if all those buy and sell trades combined represent a net sale of just 100 shares, the broker will only deliver that net 100 security entitlements to other brokers. Even that won’t entail a legal change of ownership. DTC legally owns the shares. The broker and/or the broker’s custodial bank simply enter offsetting credits to other brokers and banks, totaling a net credit or 100 Apache security entitlements.

Legally, security entitlements bear a marked resemblance to poker chips. As they have streamlined trading, they have impaired corporate governance and the exercise of shareowner property rights. When a security entitlement changes hands, the corporation's transfer agent isn't notified. The ledger of stock holders isn't updated. Stockholder ledgers used to list the actual owners of a corporation along with the names of brokers directly holding shares in street name for their clients. Today, a corporation's stockholder ledger lists, for the most part ... DTC. Corporations no longer know who their shareowners are.

Equally uninformative is DTC's list of member firms who hold security entitlements in a given corporation through DTC—the so-called Cede breakdown. The Cede breakdown is the starting point when a corporation wants to distribute proxy materials to its beneficial shareowners. Not knowing who the beneficial shareowners are, the corporation can only pass the proxy materials to the custodial banks listed on the Cede breakdown and ask them to pass the materials on down the daisy chain. There is no easy way to track if beneficial owners actually receive the materials. The system is difficult, if not impossible, to audit to any degree of accuracy.

2. DTC Cannot Confirm Beneficial Ownership

Apache's complaint describe efforts to confirm John Chevedden's ownership of shares:

Upon receiving Chevedden's purported proof of ownership, Apache reviewed its list of record owners of Apache stock to determine and verify whether Chevedden or RTS actually was a record holder of Apache stock ... Neither Chevedden nor RTS are listed in Apache's stock records as record holders ... Chevedden responded by forwarding another letter ... Upon receipt of Chevedden's new purported proof of ownership, Apache reviewed its list of record holders to determine and verify whether Northern Trust was a record holder ... Neither Chevedden, RTS nor the alleged custodian Northern Trust are listed in Apache's stock records as record holders ...

The lawyers are being coy. In our post-1975 world, there was no need to check Apache's shareowner ledger. Chevedden, RTS and Northern Trust would not appear there. The lawyer's narrative about diligently reviewing the shareowner ledger is just a roundabout way to say they would only accept a letter from DTC. What they fail to mention is that it would be *impossible for DTC to write a letter confirming Chevedden's ownership of Apache's shares*. In the daisy chain of security entitlements

linking Chevedden to the Apache stock he beneficially owns, DTC knows of Northern Trust's security entitlements, but has no information about RTS or Chevedden. Northern Trust knows of RTS's security entitlements, but has no information about Chevedden. Of the three financial institutions in the daisy chain, only RTS has knowledge of Chevedden's ownership of Apache's shares. Only RTS could write a letter confirming Chevedden's ownership of those shares.

If you take a careful look at the letters Chevedden forwarded Apache from RTS and Northern Trust, you will notice something interesting. As a convenience, we have attached the letters in Exhibit 1, although Apache's lawyers have already entered them into the record. Both the letters from RTS directly confirm Chevedden's ownership of security entitlements. The letter from Northern Trust does not. All it confirms is RTS's ownership of security entitlements. If Chevedden had managed to obtain a letter from DTC, all it could have confirmed would have been Northern Trust's ownership of security entitlements. That would be news to no one. As a major custodial bank, Northern Trust has sizeable holdings in most stock traded on the NYSE. If Apache really wanted confirmation that Northern Trust held Apache security entitlements, they could have checked the Cede breakdown. A letter from DTC would have—and could have—contributed nothing to confirming Chevedden's beneficial ownership of Apache stock.

3. Definitions for "Record Holder"

The first sentence of Rule 14a-8(b)(2)(i) describes one of two ways (the way that applies for most shareholders) that a proponent who is not the record holder of shares can prove beneficial ownership:

The first way is to submit to the company a written statement from the "record" holder of your securities (usually a broker or bank) verifying that, at the time you submitted your proposal, you continuously held the securities for at least one year.

The sentence is at the heart of this case. In their brief on merits, Apache’s lawyers quote the sentence a number of times, usually in some truncated form, as in⁴

Rule 14a-8(b)(2)'s requirement that, in order to prove his shareholder status and eligibility, Chevedden "must" submit "a written statement from the 'record' holder of [his] securities" is clear and unambiguous.

Apache’s lawyers don’t comment on the small detail of the quotation marks around the word “record”. That is atypical usage. More problematic is the parenthetical statement the truncation leaves out: “(usually a broker or bank)”. If the Apache lawyers’ interpretation of the sentence is correct, wouldn’t this more appropriately read “(usually DTC)”?

Apache’s lawyers suggest that the SEC is essentially saying in Rule 14a-8(b)(2)(i)

The proposal sponsor must get a letter from DTC, never mind our use of quotation marks and the parenthetical statement, not to mention that it is impossible for DTC to provide such a letter.

Another interpretation is that the SEC is essentially saying

The proposal sponsor must get a letter from its bank, broker or whatever firm would traditionally have been the record holder prior to DTC becoming technically the record holder for most everyone.

Prior to 1975, RTS *would have been* the record holder of Chevedden’s Apache stock. Today, DTC is only technically the record holder in the sense that it (under its nominee name Cede & Co.) appears on the stock ledger. RTS remains the sole financial institution capable of confirming Chevedden’s beneficial ownership of Apache stock. In this light, it is inescapable that the first sentence of Rule 14a-8(b)(2)—with its quotation marks around “record” and its parenthetical statement “(usually a broker or bank)” —indicates that a letter should come from RTS. For the practical purpose of confirming Chevedden’s share ownership, RTS was prior to 1975, and RTS remains after 1975, the effective record holder for purposes of Rule 14a-8(b)(2).

This is not a novel interpretation. In fact, it is the standard interpretation. In the post 1975 world, any financial institution in the daisy chain linking a beneficial owner to share certificates in

⁴ Apache’s Brief on Merits, p. 11.

DTC's vaults can be and often is—formally or informally—considered a record holder, depending on the task at hand. This is true under Delaware law and it is true under federal law.

Under Delaware law, not only DTC, but all firms listed on a corporation's Cede breakdown are considered owners of record for that corporation's stock. This has long been true for purposes of DGCL Section 220(b), and the recent *Kurz v. Holbrook* decision extends it to Section 219(c).

Nowhere do federal regulations define “record holder” for purposes of Rule 14a-8(b)(2). However, Rule 14a-1(b)(i) does define “record holder” for purposes of Rules 14a-13, 14b-1 and 14b-2 (enabling regulations for the 1975 amendments):

... the term "record holder" means any broker, dealer, voting trustee, bank, association or other entity that exercises fiduciary powers which holds securities of record in nominee name or otherwise or as a participant in a clearing agency registered pursuant to section 17A of the Act.

The notion that “record holder” applies only to parties appearing on a corporation's shareowner ledger is anachronistic. It is a pre-1975 definition that no longer applies. Yet, in their *Brief on the Merits*, Apache's lawyers claim that the only possible interpretation of “record holder” in Rule 14a-8(b)(2) is that of parties appearing on the shareowner ledger. *Their claim is false.*

Because SEC regulations do not define “record holder” for Rule 14a-8(b)(2), we must infer the significance of the phrase. We can do so according to

- what makes sense,
- accepted practice among market participants,
- the historical record for Rule 14a-8, and
- SEC staff legal bulletins and no-action letters.

We have already addressed the first avenue, explaining how it makes sense that the introducing broker (RTS in Chevedden's case) be considered the record holder for Rule 14a-8(b)(2) purposes because they are the only party in the security entitlements daisy chain with direct knowledge as to who are beneficial owners. Below, we address the other three avenues.

4. Accepted Practice

Apache's lawyers appear unfamiliar with the practicalities of shareowner resolutions. On p. 20 of their *Brief on the Merits*, they assert (our emphasis)

... Chevedden and other shareholders may, *as many shareholders do*, prepare a letter to be signed by the DTC or its nominee Cede & Co. (if that is the actual "record" holder of the securities at issue) that can be used to establish ownership.

This statement is patently false. Not only have we never heard of a shareowner obtaining such a letter from DTC, we have demonstrated in this brief that it would be impossible for them to do so. To further demonstrate this point, we approached individual and institutional shareowners who submitted shareowner proposals in recent years and asked them to submit affidavits. We asked each to go back over as many years as was convenient and indicate in their affidavit:

- 1) The number of shareowner proposals they have submitted over that period;
- 2) The number of those for which they provided proof of ownership with a letter from their broker, bank or custodian; and not with a letter from the "technical" record holder (DTC or some other firm appearing on the stock ledger);
- 3) The number of those proposals that were challenged by the receiving corporation on the grounds the proof of ownership was not satisfactory under Rule 14a-8.

We received a total of 14 complete affidavits from a variety of institutions and individuals, many of them prominent shareowner advocates. We did not "cherry pick" the affidavits. We solicited them broadly, and we include with this brief every complete one we received.⁵ Collectively, they portray the experiences of a broad cross section of shareowners who actively submit shareowner proposals.

Some of the fourteen affidavits list only approximate numbers. In total, though, the affidavits account for approximately 1,881 proposals submitted over the past one to twenty years. In about

⁵ Two were incomplete and were excluded. One of these was from an institution that is known to submit many resolutions. They indicated that they generally evidence share ownership with a letter from an institution not on the stock ledger, and in only two cases has their evidence been challenged. Because they did not provide the total number of resolutions they submitted, we could not incorporate their results into our analysis. The other excluded affidavit was from an institution that submitted 85 resolutions over the past 11 years. The number of times their evidence of ownership was challenged was inadvertently omitted from the affidavit.

1,871 of those instances, proponents documented their share ownership with a letter from their broker, bank or custodian; and not with a letter from DTC or any other party appearing on the stock ledger. In 6 of those instances was the proponent challenged for not providing evidence of stock ownership acceptable under Rule 14a-8.

We did not inquire as to the specific issues in the few cases where share ownership was challenged. There could be various reasons for a challenge, and each situation was likely unique.

What our affidavits demonstrate is that, as a matter of course, both shareowners and corporations routinely consider a letter from a bank, broker or custodian not listed on the stock ledger as acceptable evidence of share ownership for purposes of Rule 14a-8. By submitting to Apache a letter from RTS, Chevedden was following accepted practice.

Two of our affidavits—those by Adam Kanzer of Domini Social Investments and Timothy Smith of Walden Asset Management—indicate each submitting two proposals to Apache Corp. These were submitted in 2003, 2004, 2004 and 2005. The affidavits document that in three cases (and imply that in all four) the proponents provided evidence of share ownership from institutions that do not appear on Apache's stock ledger (Investors Bank & Trust and Bank of New York Mellon). Apache did not challenge any of the proposals due to unacceptable evidence of share ownership. It appears that, up until now, Apache has accepted letters documenting share ownership from parties not on their stock ledger. This raises the question of why John Chevedden is being sued in court for a practice Apache has willingly accepted of others in the past.

5. History of Rule 14a-8

SEC Rule 14a-8, which governs shareowner proposals, dates to 1942.⁶ Amendments were adopted in 1954, 1967, 1972, 1976, 1983, 1987, 1998 and 2007. Early versions of the rule required

⁶ *Federal Register*: Release 34-3347.

proponents to provide evidence of share ownership, if asked, but they did not indicate what might be acceptable evidence. Here is wording from the rule, as amended in 1983:⁷

At the time he submits the proposal, the proponent shall be a record or beneficial owner of at least 1% or \$1000 in market value of securities entitled to be voted at the meeting and have held such securities for at least one year, and he shall continue to own such securities through the date on which the meeting is held. If the issuer requests documentary support for a proponents claim that he is the beneficial owner of at least \$1000 in market value of such voting securities of the issuer or that he has been a beneficial owner of the securities for one or more years, the proponent shall furnish appropriate documentation within 14 calendar days after receiving the request.

The subsequent 1987 amendment was the first to explicitly identify what would constitute acceptable evidence of share ownership:⁸

Appropriate documentation of the proponent's claim of beneficial ownership shall include: (i) a written statement by a record owner or an independent third party, accompanied by the proponent's written statement that the proponent intends to continue ownership of such securities through the date on which the meeting is held ...

The SEC's notes accompanying the 1987 amendment are more explicit:⁹

The Commission also is amending Rule 14a-8(a)(1) to codify its interpretive position that a written statement by a record owner or an independent third party, such as a depository or broker-dealer holding the securities in street name, of the proponent's holding of the registrant's securities for the relevant one year time period is appropriate documentation for a proponent's beneficial ownership claim.

This explicitly indicates that a letter from an introducing broker, such as RTS, was acceptable evidence of beneficial share ownership.

The 1998 amendment did two things. It made a number of substantive changes to Rule 14a-8, and it rewrote the entire rule to put it in a "plain English" question & answer format. With this amendment, the language that is at issue in this lawsuit was introduced as Rule 14a-8(b)(2):¹⁰

... at the time you submit your proposal, you must prove your eligibility to the company in one of two ways:

⁷ *Federal Register*: Release 34-20091, Rule 14a-8(a)(1)(i).

⁸ *Federal Register*: Release 34-25217, Rule 14a-8(a)(1)

⁹ *Federal Register*: Release 34-25217, Discussion of the Amendments

¹⁰ *Federal Register*: Release 34-40018, Rule 14a-8(b)(2)

(i) The first way is to submit to the company a written statement from the "record" holder of your securities (usually a broker or bank) verifying that, at the time you submitted your proposal, you continuously held the securities for at least one year. You must also include your own written statement that you intend to continue to hold the securities through the date of the meeting of shareowners ...

This language is certainly more verbose than the language it replaced, but is its substance different?

The mere fact that the wording changed does not indicate an intended change of meaning. The *entire* Rule 14a-8 was rewritten in the new "plain English" question & answer format. Where the SEC did make substantive changes in the rule, it discussed those changes in the accompanying notes. Those notes made no mention of Rule 14a-8(b)(2). Accordingly, it is reasonable to conclude that the intent of the new language was the same as the old. A letter from an introducing broker, such as RTS, is acceptable evidence.

6. SEC Staff Legal Bulletins and No-Action Letters

Rule 14a-8 matters, such as those at issue in this lawsuit, are generally settled through the SEC's no-action process. No-action letters are informal. Parties to a dispute always have recourse to the courts, should they disagree with a no-action letter, but the cost of going to court can be prohibitive. No-action letters are a practical tool for conveniently and inexpensively settling disputes.

In their *Brief on the Merits*, Apache's lawyers assert

In this case ... the SEC staff has not issued a no-action letter indicating, even informally, whether it agrees that Apache may exclude Chevedden's proposal for failure to comply with Rule 14a-8(b). Nor is the SEC staff likely to issue a no-action letter or otherwise comment on the matters at issue in this case.

Let's be clear. The SEC staff "has not issued" nor is "the SEC staff likely to issue a no-action letter or otherwise comment on the matters at issue in this case" because Apache never requested a no-action letter of the SEC. If a corporation doesn't ask for a no-action letter, the SEC doesn't issue one. Furthermore, the SEC has a firm policy of not commenting on issues that are before the courts. In this dispute, Apache chose to bypass the no-action process and go directly to the courts. The SEC's silence indicates nothing more than Apache's decision to exclude them.

We believe Apache bypassed the no-action process because they expected SEC would reach the same conclusion as in *Hain Celestial*. In their *Brief on the Merits*, Apache’s lawyers claim *Hain Celestial* was an “anomaly”, reversed with the subsequent *Omnicom* no-action letter. As we shall explain, *both claims are false*.

Rather than simply ask the SEC for a no-action letter, Apache’s lawyers rummaged through past staff legal bulletins and no-action letters, trying to find statements they might construe as supportive of Apache’s interpretation of Rule 14a-8(b)(2). Let’s start with the staff legal bulletins.

SEC staff legal bulletins generally include a disclaimer to the effect

The statements in this legal bulletin represent the views of the Division of Corporation Finance. This bulletin is not a rule, regulation, or statement of the Securities and Exchange Commission. Further, the Commission has neither approved nor disapproved its content.

Both the legal staff bulletins the Apache lawyers cite include this statement. It means staff legal bulletins carry about the same weight as no-action letters.

The first staff legal bulletin the Apache lawyers cite is *Bulletin 14* of 2001. They quote¹¹ a particular section of that bulletin (emphasis as in the original bulletin):

(1) Does a written statement from the shareholder's investment adviser verifying that the shareholder held the securities continuously for at least one year before submitting the proposal demonstrate sufficiently continuous ownership of the securities?

The written statement must be from the record holder of the shareholder's securities, which is usually a broker or bank. Therefore, unless the investment adviser is also the record holder, the statement would be insufficient under the rule.

This does not in any way address Apache’s claim that, for purposes of Rule 14a-8, a record holder must be listed on a corporation’s stock ledger. Rather, this addresses the particular issue of whether an *investment advisor* can be the record holder. The term “investment advisor” is used broadly to describe a host of service providers. Some investment advisors are brokers who not only advise but also transact trades on behalf of clients. The bulletin indicates that an investment advisor who is also

¹¹ Apache’s brief on the merits, p. 11.

a proponent's broker may be considered the record holder. Many investment advisors give advice but do not actually perform transactions or take custody of security entitlements on behalf of clients. Such investment advisors would have no direct knowledge of a client's holdings, so they would not be in a position to confirm a client's holdings. For purposes of Rule 14a-8, they could not be the record holder. Stated another way, the legal bulletin says, in essence, "if an investment advisor is not one of the entities that form the daisy chain connecting a beneficial shareowner to shares in DTC's vaults, that investment advisor will not have direct knowledge of a client's holdings and therefore cannot be considered a record holder for purposes of Rule 14a-8." That is all the legal bulletin is saying. The conclusion makes perfect sense. It does not support Apache's contention that a record holder for purposes of Rule 14a-8(b)(2) must be DTC or some other party listed on the stock ledger.

Staff Legal Bulletin 14 is the basis for the Apache lawyers' footnote 7. They argue that RTS is Chevedden's investment advisor but not his broker or custodian—and therefore is not the record holder of his shares for purposes of Rule 14a-8(2)(b):

The December 10 letter from Ram Trust Services does state that it is the introducing broker, (X-6), but there is ample reason to doubt that unverified assertion.

They discuss the RTS website and a form used by RTS to assert that Atlantic Financial Services of Maine, Inc. is the broker—not RTS—and the letter from RTS should be dismissed.¹² However, the website of RTS includes the following¹³

Atlantic Financial Services of Maine, Inc.

Our clients also have the advantage of brokerage services offered by Atlantic Financial Services of Maine, Inc., a wholly owned subsidiary of Ram Trust Services ...

Since Atlantic Financial Services of Maine is a wholly owned subsidiary of RTS, RTS is Chevedden's broker as well as investment advisor. Scrutinizing the organizational structure of RTS to distinguish the overall company from its brokerage subsidiary would accomplish nothing more

¹² Apache's brief on the merits, pp. 18 and 19, especially footnotes 7 and 8.

¹³ http://www.ramtrust.com/affiliated_companies.htm as viewed on March 3, 2010.

than to introduce a new technicality with which to trip up proposal proponents—requiring that a letter documenting beneficial share ownership be on the letterhead of the “right” subsidiary. Not only investment advisors, but most large financial institutions, have multiple subsidiaries. Meaningless challenges over which is the “right” subsidiary could be endless. Suppose a financial institution has a trust bank, a brokerage and a custodian as subsidiaries. Which is the “right” one, and why shouldn’t a letter on the parent company’s stationary suffice? What is important is that RTS occupies a position on the daisy chain and can directly confirm Chevedden’s beneficial share ownership. Whether it does so under the parent company’s letterhead or the subsidiary’s is immaterial. Through its subsidiary, RTS is a record holder for purposes of Rule 14a-8(b)(2).

The second staff legal bulletin Apache’s lawyers cite is *Bulletin 14B* of 2004. That bulletin indicates that its purpose is to clarify five issues, which we quote verbatim:

- the application of rule 14a-8(i)(3);
- common issues regarding a company's notice of defect(s) to a shareholder proponent under rule 14a-8(f);
- the application of the 80-day requirement in rule 14a-8(j);
- opinions of counsel under rule 14a-8(j)(2)(iii); and
- processing matters relating to the availability of submitted materials and the mailing and public availability of our responses.

The bulletin is not intended to clarify the meaning of “record holder” under Rule 14a-8(b)(2).

In addressing the second of the above items, the bulletin described a corporation’s obligations under Rule 14a-8 to provide a proponent with fair notice if the corporation believes a proposal is somehow defective. In addressing this issue, the bulletin happens to quote some of the language of Rule 14a-8(b)(2). Apache’s lawyers quote from that quote,¹⁴ as if to suggest that the mere fact SEC staff quotes Rule 14a-8(b)(2) supports their claims as to the appropriate *interpretation* of Rule 14a-8(b)(2). *That is nonsense.* Staff legal bulletin 14B, despite the fact that it happens to quote language

¹⁴ Apache’s brief on the merits, p. 12.

from Rule 14a-8(b)(2), does not attempt to interpret or clarify the meaning of Rule 14a-8(b)(2). It has no bearing on the matters at issue in this case.

Turning to SEC no-action letters, the 2008 *Hain Celestial* no-action letter unequivocally concludes that an introducing broker, which doesn't have to be on the stock ledger, is a holder of record for purposes of Rule 14a-8(b)(2). Decisions in no-action letters tend to be short and curt. *Hain Celestial* is an exception. Its substance is worth quoting entirely:

We are unable to concur in your view that The Hain Celestial Group may exclude the proposal under rules 14a-8(b) and 14a-8(f). After further consideration and consultation, we are 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). For purposes of the preceding sentence, an introducing broker-dealer is a broker-dealer that is not itself a participant of a registered clearing agency but clears its customers' trades through and establishes accounts on behalf of its customers at a broker-dealer that is a participant of a registered clearing agency and that carries such accounts on a fully disclosed basis. Because of its relationship with the clearing and carrying broker-dealer through which it effects transactions and establishes accounts for its customers, the introducing broker-dealer is able to verify its customers' beneficial ownership. Accordingly, we do not believe that The Hain Celestial Group may omit the proposal from its proxy materials in reliance on rules 14a-8(b) and 14a-8(f).

Apache's lawyers assert that SEC staff interpretation in *Hain Celestial* was an "anomaly" because it conflicts with "at least one post-*Hain Celestial* SEC staff no-action letter ..." That is identified as the 2009 *Omnicom* letter. However, *Omnicom* cited two possible reasons for excluding the proponent's proposals. One reason was indeed the same flawed argument Apache is making in this case: that evidence of share ownership must come from DTC or some other party listed on the stock ledger. The other reason, however, was that *Omnicom* never received a facsimile documenting share ownership. The proponent, the United Brotherhood of Carpenters Pension Fund, indicates in their correspondence to SEC staff¹⁵ that they asked their custodian, AmalgmaTrust, to send *Omnicom* documentation of their share ownership. AmalgmaTrust says they sent the documentation in a facsimile. *Omnicom* represents they never received the facsimile.

¹⁵ Part of the attachments to the no-action letter.

The SEC no-action letter did concur with Omnicom that they were entitled to exclude the proposal, but the no-action letter is vague about why they concurred. Below, we quote the substance of the *Omnicom* no-action letter in its entirety

There appears to be some basis for your view that Omnicom may exclude the proposal under rule 14a-8(f). We note your representation that the proponent failed to supply, within 14 days of receipt of Omnicom's request, documentary support indicating that the proponent satisfied the minimum ownership requirement for the one-year period required by rule 14a-8(b). Accordingly, we will not recommend enforcement action to the Commission if Omnicom omits the proposal from its proxy materials in reliance on rules 14a-8(b) and 14a-8(f).

The no-action letter addresses only the timing with which documentation was provided. It makes no mention of—and certainly never endorses—Omnicom's position that documentation must come from DTC or some other party on the stock ledger. Accordingly, it does not reverse the *Hain Celestial* letter, as Apache's lawyers contend.

The Apache lawyers' contention that *Hain Celestial* was an "anomaly" also shrivels in the face of the SEC's 2010 denial of a no-action request from Pioneer Natural Resources USA, Inc. (*Pioneer*). In this case, Pioneer's lawyers informed the proponent, the United Brotherhood of Carpenters Pension Fund, that neither the proponent nor their custodian, AmalgaTrust, appear on the records of ownership maintained by the company's transfer agent.

Although the Company sought to omit the Proposal from proxy materials under Rules 14a-8(b) and 14a-8(f)(1), SEC staff responded as follows:

We are unable to concur in your view that Pioneer may exclude the proposal under rules 14a-8(b) and 14a-8(f)(1). Accordingly, we do not believe that Pioneer may omit the proposal from its proxy materials in reliance on rules 14a-8(b) and 14a-8(f)(1).

Irrespective of whatever other issues may have been raised in *Pioneer*, if the SEC accepted the contention that only DTC or another party listed on the stock ledger could be the record holder for purposes of Rule 14a-8(b)(2), then the SEC staff would have had no choice but to grant Pioneer's no-action request. The fact that the SEC's staff did not do so *refutes that position*. It is an endorsement of the earlier *Hain Celestial* no-action decision.

Apache's *Brief on the Merits* states they undertook "a broad and comprehensive survey of the SEC staff's no-action letters since May 21, 1998." They list 30 no-action letters in their footnote 6, and with little elaboration claim these reveal "near unanimous support ... both *before* and *after* the staff's issuance of the *Hain Celestial* no-action letter" for their position that documentation of beneficial share ownership must come from DTC or some other party listed on the stock ledger.

Our review of the no-action letters cited found *no* clear indication that proof must come directly from DTC or another party listed on the stock ledger, either before or after *Hain Celestial*. With *Hain Celestial* and subsequent no-action letters, SEC staff has consistently confirmed that introducing brokers or other parties on the daisy chain can be record holders for purposes of Rule 14a-8(b)(2). Mostly, the no-action letters Apache's lawyers cited have little or no relevance for the definition of "record holder".

With *EQT Corp*, *Microchip Tech*, *Rentech*, *McGraw Hill* (2008), *Verizon*, and *IBM*, proponents submitted broker letters that evidenced ownership prior to the date of the proposal. No-action was granted because Rule 14a-8(b) requires verification from the proponent's broker or bank "at the time you submitted your proposal," not before. *MeadWestvac* and *McGraw Hill* (2007) appear similar but we could not verify through Westlaw because of missing exhibits.

With *Qwest Communications*, *Yahoo!*, *JP Morgan Chase* and *Media General*, proponents failed to provide evidence of continuous ownership for the full year. The situation was similar at *Coca-Cola* for just one of five proponents. With *JP Morgan Chase*, the proponent was able to cure the issue but the company sought reconsideration and was granted another no-action letter on grounds the proposal would cause a violation of state law unrelated to this case.

With *Schering-Plough Corporation*, ownership was not evidenced until after the 14-day deadline. With *Western Union*, *AT&T* and *Robert Half International*, one entity held the shares but a differently named entity submitted the proposal. With *Cigna*, *Wells Fargo*, and *Allegheny Energy*, evidence of ownership came from an investment advisor instead of from a broker.

Apache's lawyers cite *Clear Channel Communications* despite its reconfirmation (pre-*Hain Celestial*) that a bank or broker not on the stock ledger can be the record holder. It did raise the issue of investment advisors, which we have already discussed. Clear Channel lawyers argued

... staff has found that, where a bank or broker submits proof of ownership on behalf of a proponent, that proof is sufficient, even though CEDE, Inc. is the actual holder of record. The staff appears to have based that position on the conclusion that CEDE, Inc. is acting as an agent for the bank or broker. See, e.g., *Dillard Department Stores, Inc.* (March 4, 1999). In this case, however, the documentary proof comes from the proponent's "investment advisors," who do not represent that they (or CEDE, for that matter) are record holders of the proponent's stock.

McCormick had two classes of common stock, only one is entitled to vote. It was not clear which class the proponent held. *AMR* and *General Motors* related to materially false or misleading statements under rule 14a-9. *EMC* had multiple issues. SEC staff granted the no-action request, but cited as their reason an issue unrelated to the definition of "record holder". *Sempra Energy* dealt with three proposals; each exceed the 500-word limitation imposed by Rule 14a-8(d). With *Oregon Trail*, the proponent died.

In addition to their misleading discussion of *Omnicom* and their "broad and comprehensive" investigation of other no-action letters (that failed to discover *Pioneer*), the Apache lawyers propose an additional form of evidence to support their claim that *Hain Celestial* was an "anomaly". This is their contention that *Hain Celestial* "has yet to be relied on in any no-action letter".¹⁶ The assertion is vague, and it appears to be at odds with the lawyers' own footnote 4, which states "*Hain Celestial* has been cited in only three no-action requests." Whatever significance the lawyers may attach to the frequency with which *Hain Celestial* has or has not been "relied on" or "cited", it is worth noting that corporations do not seek a no-action letter when they want to include a shareowner proposal, only when they want to exclude a proposal. *Hain Celestial* denied a request to exclude a proposal and, therefore, is unlikely to be cited by those subsequently seeking to exclude proposals.

¹⁶ Apache brief on the merits, p. 16.

7. Proposed Alternative to Rule 14a-8(b)(2)

An adverse ruling in this case could affect all shareowners. Because DTC *cannot* confirm beneficial shareowners' holdings, a ruling that proponents must obtain a letter from DTC would hand corporations an easy excuse for disallowing practically all shareowner proposals.

Apache's lawyers propose a solution. On p. 20 of their brief, they suggest shares might be directly registered rather than held in street name through a broker. A proponent's shares would then appear on the stock ledger, and there would be no need to prove ownership.

Direct registration of shares is possible, but it has several drawbacks:

1. Because a corporation's transfer agent could only confirm how long a proponent's shares had been directly registered (as opposed to confirming how long they were owned), proponents would have to directly register shares a year in advance of submitting a proposal. As a practical matter, they would either have to plan a year in advance or keep their shares permanently in direct registration.
2. Directly registered shares cannot be held in a brokerage account or traded on an exchange.
3. Directly registered shares cannot be margined.
4. Directly registered shares cannot be loaned out. This is an important consideration for institutional investors who earn income through lending their securities.

There is a more compelling criticism of the Apache lawyers' proposal. This lawsuit is about interpreting Rule 14a-8(b)(2), and the purpose of that rule is to provide proponents who own their shares in street name through a broker some means of documenting their beneficial ownership of those shares for the purpose of submitting a shareowner proposal. If the court rules in Apache's favor in this case—believing that direct registration of shares is an acceptable option—it will essentially be rewriting Rule 14a-8(b)(2) to read

A shareowner who holds her shares in street name through a broker and wants to submit a shareowner resolution should ... not hold her shares in street name through a broker.

This is what Apache's lawyers are asking the court to do.

8. Timing of Documentation

Apache's lawyers make an issue of the fact that Chevedden did not provide documentation of his share ownership at the same time that he submitted his proposal. The problem is—and this impacts most proponents—is that Rule 14a-8(b)(2) has incompatible requirements. One is

... at the time you submit your proposal, you must prove your eligibility to the company ...

The other is

... submit to the company a written statement from the "record" holder ... verifying that, at the time you submitted your proposal, you continuously held the securities for at least one year ...

Satisfying the first requirement requires requesting a broker letter in advance of submitting the proposal, but then the broker letter will be dated prior to the date on which the proposal is submitted. It will, therefore, not document ownership of the shares continuously for a year through the date the proposal is submitted, which will violate the second requirement.

Proponents usually get around this Catch-22 by submitting evidence of ownership only once the company issues a deficiency notice, since they then avoid having the broker letter dated before the date of submission. Chevedden generally doesn't wait for a deficiency notice but instead submits evidence of ownership as soon as he can obtain a broker letter dated on or after the date he submitted the proposal. Here is how one legal handbook explains accepted practice:

As a practical matter, a shareholder need not include proof of ownership at the time a proposal is submitted, but must do so only if the company furnishes a notice of deficiency pursuant to Rule 14a-8(f). Once such notification has been received by the shareholder, the shareholder has 14 days to respond and cure the deficiency.¹⁷

9. John Chevedden

Across pages 5 through 8 of their *Brief on the Merits*, Apache lawyers paint Mr. Chevedden as some sort of obstructionist crank who

¹⁷ *Shareholder Activism Handbook* by Jay W. Eisenhofer and Michael J. Barry, 2006, pp 7-10 and 7-11 (footnotes omitted).

... may be responsible for imposing a greater burden on the limited time, resources, and funds of the SEC staff in this area than any other person or entity in history.

We do not believe Mr. Chevedden has imposed any undue burden on the SEC. He, like any shareowner or issuer, merely asks the SEC to perform its appropriate role as the regulator of US securities markets.

The Apache lawyers continue:

On November 28, 2006, a purported shareholder named Lucy M. Kessler sent Apache a proposal with a "proxy for John Chevedden and/or his designee to act on my behalf." *Apache Corp.* (Jan. 12, 2007) (X-10). Apache responded by noting that Kessler "is not a record owner" and requested that she or Chevedden verify her shareholder status and eligibility under Rule 14a-8(b). *Id.* Neither Chevedden nor Kessler responded and, on December 18, 2006, Apache sent a request for no-action letter to the SEC staff. *Id.* In response, and rather than provide the required proof of shareholder status and eligibility, Chevedden withdrew the proposal. *Id.*

Chevedden has *withdrawn* a multitude of other proposals to other companies when he or the purported shareowner, naming him as proxy, has been faced with a company's request for proof of shareholder status and eligibility under Rule 14a-8(b). *See, e.g., Mylan, Inc.* (Jan. 4, 2010); *News Corp.* (June 4, 2009); *Johnson & Johnson* (Jan. 5, 2009); *Washington Mutual* (Jan. 12, 2007); *Verizon Communications* (Jan. 9, 2006); *IBM* (Jan. 9, 2006); *Univision* (Dec. 29, 2005). There is no record of Chevedden ever explaining his conduct, and no record of Chevedden ever apologizing to any company (or to the SEC staff) for causing them to devote time, attention and substantial amounts of money to dealing with his often improper submission of proposals.

Left unaddressed, this sweeping assertion gives an impression that Chevedden is acting with gross irresponsibility and abusing Rule 14a-8.

There is nothing inappropriate about withdrawing a proposal. It happens all the time for a host of legitimate reasons. Often, when corporations receive shareowner proposals, they call the proponent to discuss the merits of the proposal, point out why the proposal might not be appropriate for their corporation, and encourage the proponent to withdraw the proposal. Sometimes corporations make concessions, offering to implement some or all of what the proposal calls for. Sometimes, for whatever reason, a proponent will respond by agreeing to withdraw the proposal. Clearly, there is nothing inappropriate about the mere act of withdrawing a proposal.

Over a lifetime, Chevedden has submitted or assisted others in submitting over 1,000 proposals. This is not atypical. Over many years, other proponents have achieved similar feats. Apache’s lawyers mention the AFL-CIO as a frequent proponent. Among the affidavits we obtained for this brief, the one from the United Brotherhood of Carpenters indicates that organization has submitted 1,116 proposals over the past 20 years.

There is a reason for submitting numerous proposals, and it is the large number of exchange-traded corporations in the United States—approximately 9,000. If the Delaware legislature, Congress, or the SEC want to implement a corporate governance reform for all publicly-traded US corporations, they merely have to enact one statute or one regulation. If shareowners want to similarly implement a corporate governance reform for all publicly-traded US corporations, they must submit and win a majority vote for a proposal at every one of those corporations! Even then, a proposal may have to be submitted to the same corporation for several years in a row. Not every proposal receives a majority vote the first year it is submitted. Furthermore, most proposals are advisory only. Even if they win a majority vote, the board can ignore them. For example, one proposal has been submitted to First Energy for each of the last five years. Each year, it has received over 70% support from shareowners. Every year, the board obstinately ignores it.¹⁸

A good way to describe Chevedden’s work is that he submits a small number of proposals to a large number of corporations. He isn’t some crank drafting his own “improper submissions”. Rather, he tends to submit standard proposals shareowners have already embraced at other corporations—things like say-on-pay, majority voting and non-staggered boards. In this way, he provides a valuable service to all shareowners, affording them the opportunity to vote on proposals that have already been vetted and proven appealing to shareowners at other corporations.

¹⁸ This is documented in the corporation’s filings with the SEC.

Most of the expense associated with shareowner proposals is due to corporate executives bull-headedly trying to block proposals. The proposal at issue in this lawsuit is fairly benign and has already received majority votes at many other corporations. It is perfectly reasonable that Apache shareowners be given a chance to vote on it. This expensive lawsuit is not due to Chevedden submitting the proposal. It is due to Apache's executives doing whatever it takes to block a vote.

Apache's lawyers do not explain what they mean when they accuse Chevedden of "often improper submission of proposals". They cite no evidence to support the vague allegation. To support their claim that "Chevedden has *withdrawn* a multitude of other proposals to other companies ... ", the lawyers cite just eight incidents. Eight instances out of more than a thousand proposal submissions hardly constitutes a "multitude."

We asked Chevedden to submit an affidavit explaining the facts in the eight instances Apache's lawyers cited. To the best of his recollection, in all eight instances, he was assisting another shareowner submit their own proposal. In all eight instances, the withdrawal was due to some oversight on the part of the individual Chevedden was assisting. For example, the 2006 Apache proposal was withdrawn because the shareowner Chevedden was assisting didn't realize until she requested a broker letter that her holdings in Apache stock were worth somewhat less than the required \$2,000. In the 2010 Mylan case, the shareowner Chevedden was assisting forgot he no longer owned the stock. The mistake was unfortunate, but it was hardly Chevedden's fault. See the affidavit for more details.

The Apache lawyers complain

There is no record of Chevedden ever explaining his conduct, and no record of Chevedden ever apologizing ...

Chevedden's affidavit provides explanation, and we believe he has nothing to apologize for. Do corporations apologize to Chevedden if their board recommends against his proposals but shareowners overwhelming vote to support them? Do they apologize to the SEC when no-action

requests are denied? They do not. Corporations are entitled to advocate on behalf of their own positions, as is Mr. Chevedden.

Many shareowners are proud of Chevedden and grateful to him for his years of selfless service working to improve the corporate governance of publicly-traded US corporations. We consider the outpouring of affidavits in support of this brief to be a strong showing of support. A quick search of trade publications documents many of his successes. The following is one example:

The special meeting proposals are part of a successful multi-year campaign by Nick Rossi, William Steiner, and other retail investors affiliated with John Chevedden, a long-time shareholder activist based in southern California. Overall, 31 special meeting proposals filed by investors received majority support in 2009, according to RiskMetrics Group data. Of the 14 companies that so far have sought to exclude proposals under Rule 14a-8(i)(9), 10 had special meeting proposals that earned majority support last year.¹⁹

Character assassination has no relevance to the facts in this case.

10. Conclusion

In this *amicus curiae* brief, we demonstrated that it would be impossible to obtain a letter from DTC confirming beneficial ownership of shares. Because Apache's lawyers interpret Rule 14a-8(b)(2) as requiring such a letter, their interpretation is nonsensical. The court cannot uphold it.

We have shown that, although SEC rules do not explicitly define "record holder" for purposes of Rule 14a-8(b)(2), the term is defined for other purposes under both Delaware and federal law. Furthermore, those definitions explicitly allow parties not listed on a corporation's stock ledger to be record holders. This contradicts the Apache lawyers' suggestion that the only reasonable interpretation of "record holder" is a party listed on a corporation's stock ledger.

We have presented affidavits documenting standard practice among shareowners submitting proposals and corporations receiving them. We have also explored the history of Rule 14a-8(b)(2).

¹⁹ "Showdown Over Special Meetings", *Risk Metrics Group Insight*, by Ted Allen on January 20, 2010 1:36 PM, last viewed on March 2, 2010 at <http://blog.riskmetrics.com/gov/2010/01/showdown-over-special-meetingssubmitted-by-ted-allen-publications.html>

Both unequivocally support the conclusion that a letter from an introducing broker is acceptable evidence of beneficial share ownership under Rule 14a-8(b)(2).

We considered the two SEC staff legal bulletins Apache’s lawyers cited and found that neither was intended to, nor in actuality did, support Apache’s contention that, for purposes of Rule 14a-8(b)(2), only parties appearing on a corporation’s stock ledger can be record holders.

We considered SEC no-action letters, especially the *Hain Celestial* no-action letter, which affirms that an introducing broker can be the owner or record for purposes of Rule 14a-8(b)(2). We showed that Apache’s lawyers’ claims that *Hain Celestial* was an “anomaly” and that subsequent no-action letters reversed *Hain Celestial* were both without merit. We found in particular that, when no-action letters subsequent to *Hain Celestial* did express a clear opinion, they consistently reaffirmed *Hain Celestial*.

In short, we have demonstrated logical, legal and practical evidence in support of the conclusion that record holders do not have to appear on the stock ledger is overwhelming. We have found *no* convincing evidence in support of the alternative view.

We ask the court to conclude that an introducing broker can be the owner of record for Rule 14a-8(b)(2) and that Apache Corp. must include Mr. Chevedden’s proposal in its proxy materials.

We are the United States Proxy Exchange, and we thank the court for the opportunity to file this *amicus curiae* brief.



Glyn A. Holton
Executive Director
United States Proxy Exchange



James McRitchie
Publisher
CorpGov.net