

## Alerts and Updates

# TO SEEK EXCLUSION OF SHAREHOLDER PROPOSALS, COMPANIES MAY BYPASS "NO-ACTION LETTER REQUEST" AND GO DIRECTLY TO FEDERAL COURT

April 15, 2011

The SEC notes it will defer to a court's decision to exclude shareholder proposals. Companies faced with unwelcome shareholder proposals might consider seeking declaratory judgments to exclude them.

As an alternative to filing a Rule 14a-8 No-action Letter Request with the U.S. Securities and Exchange Commission (SEC), a company may seek a declaratory judgment from a federal court to exclude a shareholder's proposal from its proxy materials. A federal court recently allowed a shareholder proposal to be excluded from a company's proxy materials, based on the proposing shareholder's failure to properly demonstrate ownership of the company's shares.

The court concluded that:

- A company has standing under the Declaratory Judgment Act to challenge a shareholder proposal, even if the proposing shareholder promises not to sue if the proposal is excluded.
- A shareholder must comply with the proof-of-ownership requirements to submit a proposal.

On April 4, 2011, the U.S. District Court for the Southern District of Texas filed a memorandum and opinion in *KBR, Inc. v. Chevedden*,<sup>1</sup> permitting KBR to exclude John Chevedden's proposal from its proxy statement and reaffirming its decision in *Apache Corp. v. Chevedden*.<sup>2</sup> KBR filed a complaint seeking declaratory judgment to exclude Chevedden's proposal from its proxy materials for its May 2011 annual shareholders' meeting and moved for summary judgment.<sup>3</sup>

Chevedden contended that KBR did not have standing because he promised not to sue the company if it excluded his proposal from its proxy materials and that, accordingly, there was no case or controversy between him and KBR as required by the Declaratory Judgment Act.<sup>4</sup> The court determined that despite the company's requests that Chevedden withdraw his shareholder proposal, he refused to do so and that such refusal demonstrated a willingness to continue to litigate the dispute and created an uncertainty that the company was entitled to have clarified.<sup>5</sup> The court concluded that KBR had standing to pursue a declaratory judgment.

The only remaining issue was whether the SEC's rejection of no-action requests from other companies that raised arguments similar to those raised in *Apache* cast doubt on *Apache*'s validity. The *Apache* court concluded that Ram Trust Services (RTS) was not a record holder of Apache shares because RTS did not appear on the non-objecting beneficial owner list and was not a Depository Trust Company (DTC) participant. In *KBR*, Chevedden submitted a letter from RTS to establish his ownership in KBR, which contained the same deficiencies as the RTS letter at issue in *Apache*.

A few months after the *Apache* decision, the SEC adopted Rule 14a-11, which governs shareholder proposals seeking to establish a procedure in a company's governing documents for the inclusion of one or more shareholder director nominees with similar proof of ownership requirements as in Rule 14a-8.<sup>6</sup> The court noted that the SEC's comments on Rule 14a-11 are consistent with *Apache*'s findings that letters from RTS are insufficient to establish Chevedden's eligibility to submit a shareholder proposal. The court concluded that *Apache*'s reasoning remains persuasive, and the SEC's denial of no-action requests by other companies using arguments similar to those used in *Apache* did not undermine *Apache*. In addition, the court noted that the SEC has consistently stated that it will defer to a court's decision to exclude shareholder proposals.<sup>7</sup> The court ruled that KBR may exclude Chevedden's shareholder proposal from its proxy materials.

## For Further Information

If you have questions about the foregoing decision or how it may impact your organization, please contact one of the [members](#) of the [Corporate Practice Group](#) or the lawyer in the firm with whom you are regularly in contact.

## Notes

1. *KBR Inc. v. Chevedden*, 2011 U.S. Dist. LEXIS 36431 (S.D. Tex. Apr. 4, 2011).
2. *Apache Corp. v. Chevedden*, 696 F. Supp. 2d 723 (S.D. Tex. 2010).
3. Chevedden moved to dismiss KBR's complaint on the following grounds: (1) lack of personal jurisdiction over him; (2) improper venue; (3) the company's lack of standing to pursue a declaratory judgment; and (4) the failure to join the SEC to the action. In dismissing Chevedden's motion to dismiss, the court noted that the SEC and other shareholders are not necessarily precluded from challenging the exclusion of shareholder proposals because they are not parties to that litigation. The court also considered and rejected Chevedden's contention that the SEC was an indispensable party to litigation seeking to exclude a shareholder proposal. This court noted that KBR's declaratory judgment against Chevedden did not necessarily preclude either the SEC or other shareholders from challenging the exclusion of Chevedden's proposal because neither was a party to the litigation.
4. 28 U.S.C. § 2201(a).
5. Chevedden based his argument on the Supreme Court's holding in *MedImmune, Inc. v. Genentech, Inc.*, 549 U.S. 118 (2007). The *KBR* court disagreed with Chevedden's standing argument and analyzed it in light of *MedImmune*. In *MedImmune*, the Supreme Court considered whether the actual controversy requirement of the Declaratory Judgment Act requires a patent licensee to terminate or be in breach of its license agreement before it can seek declaratory judgment that the underlying patent is invalid. In that case, Genentech sought a

declaratory judgment that one of MedImmune's patents was invalid, but continued to pay royalties under its license agreement. The Supreme Court concluded that Genentech was not required to breach or terminate its license agreement in order to seek a declaratory judgment that the underlying patent was invalid. The court determined that post-*MedImmune* cases using *MedImmune's* analysis demonstrated that "a defendant's promise not to sue does not nullify an actual controversy if the defendant has shown a willingness to enforce his rights."

6. The SEC commented that for a nominating shareholder to establish ownership when such shareholder owns shares through a broker or bank that is not a DTC participant, such shareholder must (1) submit a written statement from the broker or bank with which the shareholder maintains an account that provides information about the relevant securities ownership and (2) submit a separate written statement from the DTC participant through which the securities of the shareholder are held that identifies the account of the broker or bank that has held at least the number of securities specified in the initial broker statement continuously for at least three years.
7. The SEC stated that "[o]nly a court such as the U.S. District Court can decide whether a company is obligated to include shareholder proposals in proxy materials" in a document titled "Division of Corporate Finance – Informal Procedures Regarding Shareholder Proposals." With respect to Rule 14a-8, the SEC stated that "[w]here arguments raised in the company's no-action request are before a court, our policy is not to comment on those arguments" in a document entitled "Division of Corporate Finance: Staff Legal Bulletin No. 14."

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