SECURITIES INDUSTRY news

HOW WALL STREET OPERATES

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MONDAY MONITOR

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'Superspend' on Financial Data Centers 'Dysfunctional'

By Tom Steinert-Threlkeld

CAN IT BE?

Trading firms and marketplace operators are wasting money on the big "monolithic" data centers they're building, as electronic networks proliferate, market data explodes and volumes surge?

That's the contention of Ronald H. Bowman Jr., author of *"The Green Guide to Power: Thinking Outside the Grid"* and *"Business Continuity Planning for Data Centers and Systems: A Strategic Implementation Guide."*

At a March 11 meeting of the Wall Street Technology Association, he said the financial thinking and planning—and, remember, this is America's finance industry—can be "remarkably dysfunctional."

The executive vice president of Tishman Technologies said the "superspend" on 100,000-square-foot data centers at $2,700 a square foot in New Jersey, where Wall Street essentially has moved, needs to be rethought. Tishman has built data centers for Morgan Stanley, Merrill Lynch and Bank of New York Mellon.

Where should the new capital be?

Maybe Iceland.

Here's the thinking.

The biggest two costs that need to be managed are energy and sales tax. Pick the right city and your charge per kilowatt hour can be 4 cents. Pick the wrong one, 14 cents. Go to Alabama and your sales tax can be 4 cents on the dollar. Pick California and it goes past 8 cents. Before adding in municipal sales taxes.

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Barometer of Wall Street's Health

1066.81

+ 53.83

▲ 5.3%

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SPECIAL REPORT

SEEKING THE SUPERGENIUS

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Proving a 'Beneficial' Shareholder Is, In Fact, a Shareholder

By Chris Kentouris

ABOUT 80 PERCENT OF U.S. shares held by individuals and institutions are recorded as electronic entries on the books of multiple financial intermediaries.

One of these has to be a participant in the Depository Trust Company, the U.S. central securities depository that settles millions of trades each year.

But just what does it take for an investor to prove ownership of shares, in order to submit a shareholder proposal? The answer isn't simple. It depends on just how many financial intermediaries stand in between a company and a "beneficial shareholder," who the intermediaries are and whether an investor meets the right deadline to file the correct paperwork.

Judge Lee Rosenthal of the U.S. District Court for the Southern District of Texas in Houston ruled on March 10 that Apache Corporation, a Houston-based oil and gas company, was entitled to exclude from its proxy materials and ballot a proposal submitted by John Chevedden, a shareholder activist, that

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Proving a 'Beneficial' Shareholder Is, in Fact, a Shareholder

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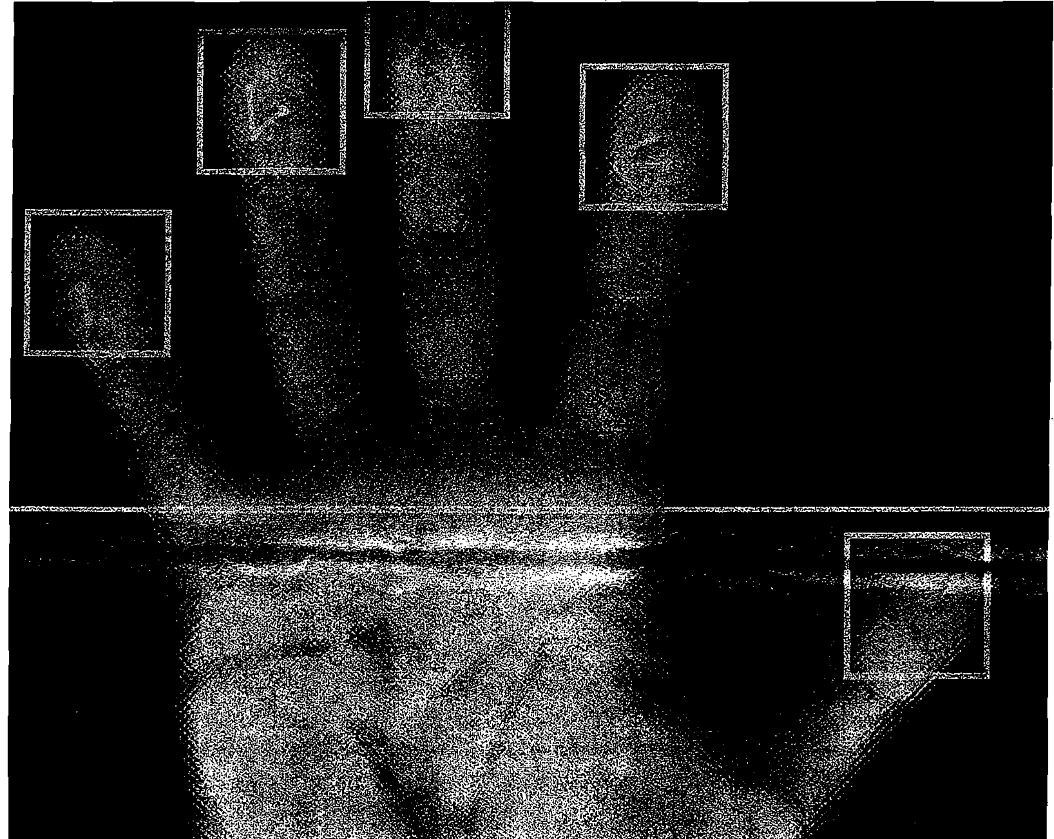
would have changed all shareholder supermajority voting requirements to a simple majority. The reason: He was a "beneficial shareholder" and couldn't actually prove he had owned 50 shares in Apache for about a year—a requirement under the Securities and Exchange Rule 14a-8(b)2.

The court did not take into consideration the letters Chevedden had submitted after the rule's 14-day deadline for presenting evidence that he owned the company's stock. Despite its win, Apache was also not entirely correct. Rosenthal ruled that although Chevedden's interpretation of the SEC's rule on how to determine he was an eligible shareholder wasn't valid, some of Apache's proposed interpretations were also too restrictive.

The SEC's Rule 14a-8(b)2 requires that a shareholder submitting a proposal for the company to include in its proxy materials prove he or she actually is a shareholder first. The case involving Apache marks the first time that an issuer has requested a court intervene to rule on a shareholder's eligibility. Such cases, say legal experts, are typically decided by the SEC itself in a no-action letter.



The SEC says that a beneficial shareholder must give the company a written statement from the record holder of the securities that the investor has held a minimum number of shares for at least one year and will continue holding the shares through the date of the shareholder meeting. Because the record holder—the entity listed on the books of the issuer—isn't Chevedden, determining just who the record holder is becomes critical to proving the shareholder's ability to file a proposal.

The case illustrates how the convoluted manner by which most U.S. investors own their stock poses challenges to corporate governance.

Because most shareholders hold their shares as beneficial owners, their holdings usually are overseen by banks and brokers, who in turn hold their accounts as members of Depository Trust Company (DTC). Typically, only the name of DTC, the U.S. securities depository, or its nominee, Cede & Co., appear as record owners on a company's stock ledgers. That means that banks, brokers and their clients technically own "security entitlements." They have many of the same legal rights as registered shareholders—those holding their accounts in their own name. That means that like registered shareholders, beneficial shareholders can also receive proxy materials, vote in corporate meetings and benefit from any corporate actions.

About 80 percent of beneficial owners are "objecting beneficial owners" (OBO) under SEC rules, which means they don't want the companies in which they invest to know who they are. Companies don't have access to OBO names and must work through an intermediary, such as Broadridge Financial, to contact them.

Both Apache and Chevedden agree that he was never listed as a shareholder in Apache's records. Chevedden, a retired employee from Hughes Aircraft living in Redondo Beach, Calif., claims he bought at least 50 shares in Apache through a company called Ram Trust Services (RTS), which in turn used Northern Trust as its custodian, which in turn, held Chevedden's account at DTC. By that point, the only name that Apache knew with respect to Chevedden's claimed shares was that of Cede & Co., the name of DTC's nominee.

Judge Rosenthal's decision in the case of Apache v. Chevedden comes in the midst of a debate about just how the SEC should reform the cur-

rent proxy system. Some issuer and transfer agency groups say that her ruling shows why direct communications with their beneficial shareholders will improve the current proxy system rather than requiring public companies to go through several layers of financial intermediaries to locate these shareholders and determine who they are.

"While the court's ruling is a narrow one, the opinion provides an excellent description of the multiple layers of financial intermediaries between a public company and its beneficial owners," says Niels Holch, a partner with the Washington, D.C. law firm of Holch & Erickson. "The dispute is one more reason why reform of the proxy voting and shareholder communications system is so important."

Holch is lobbying the SEC on behalf of the Shareholder Communications Coalition, an umbrella organization of issuers and transfer agents, to allow corporations to distribute their proxy materials directly to beneficial shareholders. But it is unclear as to whether even such a change would have been sufficient to prevent the lawsuit filed by Apache against Chevedden because owning shares through a financial intermediary would have still meant that Chevedden had to prove he owned the shares. That is because, unless a shareholder holds shares in his or her own name, the corporation likely only knows the name of Cede & Co. as the owner of the shares.

"If Mr Chevedden wanted to avoid having to prove he was a shareholder so he could submit a proposal, and if he really owned the shares he claimed to own, all he had to do was become a registered shareholder and hold the shares in his own name," says Geoffrey L. Harrison, a partner in the Houston office of Susman Godfrey, L.L.P., and the lead attorney for Apache.

In its suit against Chevedden, Apache argued that, under the SEC rules, the burden of proof was on Chevedden to prove his shareholder status and eligibility to submit a proposal. Judge Rosenthal agreed.

Chevedden did send Apache four letters, three from RTS and a fourth from Northern Trust. In its letters, RTS says that Chevedden held 50 shares in Apache and that Northern Trust was the master custodian of the shares.

At first glance it would appear that the letters from RTS would be sufficient to prove Chevedden's ownership, but Apache didn't think so and neither did Judge Rosenthal. Because RTS is not a participant in the DTC, its name doesn't appear on the books of DTC as the holder of the shares. So what would have been sufficient other than being a registered owner, according to Apache?

"We might have looked more favorably on receiving a letter from Ram Trust, a letter from Northern Trust, and a letter from DTC. But the letters from Ram Trust alone were suspect," says Harrison. He says that RTS was an investment advisor and not an introducing broker, as Chevedden claimed.

Chevedden countered that the record holder of shares is usually a bank or brokerage firm. Therefore, Apache's interpretation of the SEC's statute wasn't correct. He only needed a letter from RTS to prove his stake in Apache.

Rosenthal ruled that the SEC's interpretation of the word record holder has been contradictory at times—it has alternately allowed for letters from introducing brokers to be introduced, but Chevedden's stance was too broad. Chevedden could not prove his ownership based on a letter from RTS, which is not a registered broker nor is it a DTC participant.

"Chevedden's interpretation of the SEC rule would require companies to accept any letter purporting to come from an introducing broker that names a DTC participating member with a position in the company, regardless of whether the broker was registered or the letter raised questions," Rosenthal ruled. "Chevedden's interpretation of the rule would not require him to show anything."

By contrast, Rosenthal said, a separate certification from a DTC participant allows a public company to at least verify that the participant does in fact hold the company's stock. She did not agree with Apache's interpretation that a letter from DTC was necessary.

Glyn Holton, executive director of the United States Proxy Exchange, a trade group in Boston representing the interests of activist shareholders, says that while Chevedden lost his case, Apache was actually seeking a precedent that would have been devastating to the ability of shareholders to submit proposals.

"There is no way DTC could have known who the final investor was and Apache's attorneys never addressed whether Cede & Co. would even be willing to participate in the shareholder resolution process because there are no SEC rules requiring them to do so," he says.

One executive with knowledge of DTC operations agrees that DTC would not have granted Chevedden or any beneficial shareholder a letter evidencing ownership of shares. Instead, DTC would have referred the investor to the brokerage firm or bank through which the account was opened or the DTC's participant firm.

Still, it is not clear whether the court would have ruled in Chevedden's favor, even if he had obtained the letter from Northern Trust, the DTC's participant. Rosenthal said that she didn't need to decide whether the letter from Northern Trust in combination with a letter from RTS met the requirements of the SEC's rule to prove eligibility.

She only had to determine whether any letters submitted by RTS proved Chevedden's ownership of Apache stock within 14 days of when Apache notified Chevedden that he had failed to prove he was a shareholder.

On Dec. 3, Apache told Chevedden his letters from RTS weren't good enough. RTS sent its letter to Apache on Nov. 23 and Chevedden sent another letter to Apache confirming his ownership on Dec. 10.

It was not until Jan. 22 that Northern Trust sent his letter to Apache confirming his ownership in Apache shares. "Because these letters were submitted well after the deadline, this court does not decide whether they would have been sufficient," wrote Rosenthal. "The only issue before this court is whether the earlier letters from RTS—an unregistered entity that is not a DTC participant—were sufficient to prove eligibility under Rule 14a-8(b)2, particularly when the company has identified grounds for believing that proof of eligibility is unclear." ■

OWNERSHIP OF SHARES IN A "BENEFICIAL" NAME: A GAME OF WHO'S WHO

LAYER ONE: Shares acquired.
John Chevedden buys 50 shares of Apache Corp. through Ram Trust

Result: Ram Trust knows Chevedden as the shareholder in Apache.

LAYER TWO: Shares held elsewhere.
Ram Trust safekeeps its customers' holdings in Apache through Northern Trust.

Result: Northern Trust knows Ram Trust as the owner of the Apache shares

LAYER THREE: Name of holder removed.
Northern Trust holds Apache shares under its own name at Depository Trust Company.

Result: DTC knows Northern Trust as the owner.

LAYER FOUR: Disconnection of ownership.
Apache receives no record of actual Beneficial Owners of its stock. Instead, it keeps track of their existence through Cede & Co., DTC's nominee name.

Result: Apache knows DTC as the owner of the shares.

MULTIPLE INTERMEDIARIES CAN SEPARATE A PUBLIC COMPANY FROM THE BENEFICIAL OWNERS OF ITS SHARES.