

BUSINESS DEPARTMENT E-NEWS ALERT — NOVEMBER 25, 2003

SEC Final Rules Regarding Nominating Process Disclosure and Shareholder Communications

The Securities and Exchange Commission ("SEC") issued final rules¹ yesterday that require companies to make enhanced disclosures regarding the operation of their board nominating committees and new proxy statement disclosures regarding the means, if any, by which shareholders may communicate with directors.

The new rules are effective January 1, 2004. Companies that are subject to the SEC proxy rules must comply with the new disclosure requirements in proxy statements that are first sent to shareholders on or after January 1, 2004. The SEC encourages companies to comply voluntarily with the new disclosure requirements before the mandatory compliance date.

EXPANDED DISCLOSURE REGARDING THE NOMINATING PROCESS

Much of the new disclosure requirements center around a company's nominating committee ("NC"). The final rules amend Schedule 14A under the Securities Exchange Act of 1934 (the "Exchange Act") to require discussion of the following items in a company's proxy statement:

- Whether the company has a standing NC or committee performing similar functions and, if not, why not and who determines director nominees;
- Whether the NC has a charter. If it does, a current copy of the charter must be either available to shareholders on the company's website or attached as an exhibit to the company's proxy statement once every three fiscal years. If a company does not have a charter, the absence of a charter must be disclosed in the proxy statement;
- Whether each member of the NC is "independent," as independence is defined by the applicable listing standards (e.g., NYSE, Nasdaq);²
- Whether the NC will consider director candidates recommended by the company's shareholders. If so, the proxy statement must include the material terms of the company's policy and procedures for considering such nominees. If the company does not allow such nominations, the proxy must detail the reasons why not;
- A description of any specific, minimum qualifications that the NC requires for director nominees and any specific skills or qualities that the NC believes are necessary for one or more specific positions;
- An explanation of the NC's process for identifying and evaluating director nominees, and any differences in the manner in which the NC evaluates director nominees that are recommended by a shareholder;

¹ Final Rule: Disclosure Regarding Nominating Committee Functions and Communications Between Security Holders and Boards of Directors. Available at <http://www.sec.gov/rules/final/33-8340.htm>

² If the company is not listed, then it must use a definition of independence used by one of the national securities exchanges or by an automated inter-dealer quotation system of a national securities association.

- A statement regarding the “category” of person or persons who recommended a new nominee that was approved by the NC for inclusion in the company’s proxy card (“categories” include shareholders, non-management directors, the CEO, other executive officers, third-party search firms, or “other, specified source”);
- Whether the company pays a fee to any third party to assist in the process of identifying or evaluating director candidates; and
- Whether the company has rejected a timely director nominee from a shareholder or shareholders who own more than 5% of the company’s voting stock. If so, disclosure of the name or names of the shareholder(s) who recommended the candidate and the name of the candidate (provided that both the shareholder and the candidate consent to being identified).

While the SEC adopted the final rules substantially as proposed³, there were some significant differences. Some of the material differences are noted below:

- The material terms of the NC charter do not have to be described, rather the charter must be made available on the company’s website or as an appendix to its proxy statement.
- A description of “specific standards for the overall structure and composition of the company’s board of directors” is not required.
- The name of the source of each nominee (other than nominees who are executive officers or directors standing for re-election) will not have to be disclosed. Instead, the company must disclose the source by “category” as discussed above.
- The beneficial ownership trigger to require additional information where the NC does not nominate a candidate recommended by a shareholder was increased from 3% to more than 5%.
- The requirement to disclose the specific reasons for the NC’s determination not to nominate a recommended candidate in certain circumstances was removed.
- The name of the recommended nominee will be disclosed in addition to the name of the nominating shareholder(s) where the NC rejects a candidate recommended by a 5% shareholder(s). However, written consent to the disclosure must be given by the recommended nominee and the nominating shareholder(s).

DISCLOSURE REGARDING SHAREHOLDER COMMUNICATION WITH THE BOARD

The new rules require a company to disclose in its proxy materials whether the board of directors provides a process for shareholders to send communication to the board of directors. If the company doesn’t provide for such a process, then it is required to disclose the specific basis for that decision.

- If the company provides a process, it is required to disclose:
 - The manner in which shareholders can send communications to the board of directors, and, if applicable, to individual directors; and
 - The company’s process (if any) for determining which communications will be relayed to board members.⁴

³ The proposed rules can be found at <http://www.sec.gov/rules/proposed/34-48626.htm>.

- Additionally, the company must disclose whether it has a policy about board members' attendance at annual meetings and information regarding directors' attendance at the previous year's annual meeting.

The final rules provide that, in lieu of describing the information required by the bulleted points above in the proxy statement, the company may provide this information on its website. The final rules also clarify the scope of the disclosure requirement — routine communications from employees and agents of the company and from officers and directors will not be captured by the new disclosure standards. Also, shareholder proposals pursuant to Exchange Act Rule 14a-8, and communications made in connection with such proposals, are not included for purposes of the new disclosure standard. The final rules also require companies to disclose any material changes to the procedures for shareholder nominations in its quarterly or annual reports.

The final rules do not adopt the proposed requirement that a company identify the department or other group within the company that is responsible for determining which communications are forwarded to directors. Also, the final rules do not adopt the proposed requirement that companies describe any material action taken by the board of directors in response to shareholder communications.

PROPOSED DIRECTOR NOMINATION AND ELECTION RULES

The SEC has also proposed rules that would require companies to include in their proxy materials director nominees designated by shareholders where certain conditions are satisfied. These proposed rules are described in detail in our [E-News Alert dated November 13, 2003](#). Comments on these proposed rules are due on December 22, 2003.

For more information on this E-News Alert, please contact Stephan Coonrod (stephanc@prestongates.com) or any other attorney in the Securities Group at Preston Gates & Ellis LLP.

The enclosed materials have been prepared for general information purposes only and are not intended as legal advice.

⁴ Note: A company's process for collecting and organizing security holder communications, as well as similar or related activities, need not be disclosed provided that the process is approved by a majority of the independent directors.