



FENWICK & WEST LLP

CORPORATE & SECURITIES LAW UPDATE

SEC Rule Proposals would Require Disclosures about Director Nomination Processes and Shareholder Communications with Directors

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SEC Rule Proposals Would Require Disclosures About Director Nomination Processes and Shareholder Communications With Directors

On August 8, 2003, the SEC issued for comment proposed rules that would expand disclosures about director nomination processes and establish new disclosure requirements about how security holders may communicate with directors. The proposed rules are designed to improve the transparency and openness of board operations. While the proposals do not directly mandate specific practices, if they are approved they may well influence those practices indirectly.

Enhanced Disclosure About How Board Nominating Committees Operate

What information about nominating committees is currently required to be disclosed?

Public companies are currently required to disclose whether they have a nominating committee and, if so, whether that committee will consider nominees recommended by security holders and how those recommendations may be submitted.

What's wrong with the existing rules?

The SEC has concluded that currently mandated disclosures have not provided sufficiently transparent disclosure into the workings of director nomination processes. For many years some commentators have complained that the existing disclosure requirements have led to mere boilerplate disclosures which does not provide investors with information needed to understand and evaluate nominating policies and processes of the companies in which they invest. From time to time, commentators have urged the SEC to adopt rules that would give shareholders more access to the director nomination process. Many commentators have noted that prevailing nomination processes afford little opportunity for meaningful participation by shareholders. These longstanding areas of concern have gained new prominence as a result of the widespread crisis of confidence in public company corporate governance sparked by the collapse of Enron and other companies.

Would the proposed rules require a public company to have a nominating committee?

No, the rules proposed by the SEC only mandate specific disclosures, not particular actions. However, new proposed listing standards for companies traded on the New York Stock Exchange and the Nasdaq Stock Market would require listed companies to have independent nominating committees.

What disclosures about the director nominating process does the SEC propose be made?

Under the proposed rule, companies would continue to indicate in the proxy statement whether they have a standing nominating committee or a committee performing similar functions. Those that do not have such a committee would be required say why not. In

particular, they would be required “to state the specific basis for the view of the board of directors that it is appropriate for the company not to have such a committee” and to identify each director who participates in the consideration of director nominees.

If a company has a standing nominating committee, proxy rules require identification of its members. If a company has no such standing committee, the proposed rules would require identification of each director who participates in the nominating process.

The proposed rules would also require a variety of other proxy statement disclosures about the nominating committee or other committee (or the board, if it performs nominating functions)¹ as follows:

- If the nominating committee has a charter, a description of the charter’s material terms and disclosure where a copy of the current charter is available (for example, on the company’s website), and if the committee has no charter, disclosure of that fact;
- If the company is listed on the NYSE or NASDAQ, disclosure of any instance during the last fiscal year where any committee member did not satisfy the definition of independence in the applicable listing standards;
- If the committee (or board performing that function) has a policy on whether or how it will consider director candidates recommended by security holders, a description of the material elements of that policy, and if there is no such policy, a statement to that effect;
- If the committee or board will consider candidates recommended by shareholders, a description of the procedures to be followed by shareholders in submitting recommendations;
- Any specific minimum qualifications that the committee or board believes must be met by a nominee to be recommended for a position on the board, any specific qualities or skills that the committee or board believes are necessary for one or more director to possess, and any specific standards for the overall board structure and composition;
- The process for identifying and evaluating director nominees, including nominees recommended by shareholders, and any differences in how nominees recommended by a shareholder are evaluated;

¹ For the purpose of all of these bullet points, “nominating committee” or “committee” refers not only to the nominating committee and any other committee performing similar functions, but also to groups fulfilling the role of a nominating committee, including the board of directors.

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- The specific source, such as the name of an executive officer, director or other individual, of each director nominee (other than nominees who are executive officers or directors standing for reelection) approved for inclusion on the company's proxy card;
 - The function performed by any third party that is paid a fee to identify or assist in identifying or evaluating potential nominees; and

 - If the committee (or board performing nominating functions) receives a director nominee recommendation from a shareholder or group of shareholders that beneficially own more than 3% of the company's voting common stock for at least one year as of the date of the recommendation, and decides not to nominate that candidate, disclose:

The name or names of the shareholders who recommended the candidate; and

The specific reasons for the determination not to include the candidate as a nominee.

What is the SEC hoping to accomplish with the proposed new disclosures?

The SEC believes that shareholders require more insight into the workings of the nominating process at public companies, and that detailed disclosure requirements are the only way to elicit that information.

New Disclosure About Shareholder Communications With Board Members

What other disclosures about shareholder communications with board members did the SEC propose?

The SEC proposed that public companies include the following information in their proxy statements whenever action is to be taken with respect to election of directors:

- A statement of whether or not the company's board provides a process for shareholders to send communications to the board² and, if not, the specific basis for the board's view that it is appropriate for the company not to have such a process;

- If the company does have a process for shareholders to send communications to the board:

A description of the manner in which shareholders can send such communications;

Identification of the board members to whom security holders can send communications;

² On a related note, the SEC has published a NYSE listing standard proposal that states: "In order that interested parties may be able to make their concerns known to non-management directors, a company must disclose a method for such parties to communicate directly and confidentially with the presiding director (of the non-management directors) or with non-management directors as a group."

If shareholder communications are not all sent directly to board members, a description of the company's process for determining which communications will be relayed to board members, including the department or group within the company that is responsible for making this determination; and

A description of any material action taken by the board during the preceding fiscal year as a result of communications from security holders.

When are comments on the proposed rules due?

These rule proposals are on a fast track—the proposing release requires that the SEC receive comments on all topics covered by September 15, 2003.

How do I find the full text of the rule proposal?

The rule proposal is available at [<http://www.sec.gov/rules/proposed/34-48301.htm>]

What if I have more questions?

If you have any questions about these new rules, please contact any member of your Fenwick & West team. You may also contact Laird Simons (lsimons@fenwick.com) or Horace Nash (hnash@fenwick.com), each of whom contributed to this update.

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