



FENWICK & WEST LLP

Corporate and Securities Law Update

SEC Issues New Rules on Board Nomination Processes and Stockholder Communications With Directors (Effective January 1, 2004)

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Newly-adopted SEC rules require proxy statement disclosures from public companies about their director nomination process and their process for communications from security holders to the board of directors. The text of the rules, which are effective for proxy statements filed after January 1, 2004, can be found at <http://www.sec.gov/rules/final/33-8340.htm>. These new rules are distinct from proposed rules, still under consideration by the SEC, that would require companies to include security holder nominees in their proxy statements upon the occurrence of specific triggering events.

What nominating committee disclosure rules currently apply?

Public companies are already required to disclose whether or not they have a nominating committee and, if they do, whether the committee will consider nominees recommended by security holders and the process for submitting recommendations. The SEC recently approved new NASDAQ and NYSE listing requirements that will require listed companies to have a nominating committee, or have nominating committee functions performed by independent directors. The NASDAQ and NYSE listing requirements did not mandate disclosures, but these new SEC rules do require specific new disclosures.

What are we now required to disclose about our director nominating process?

Companies still must disclose whether they have a nominating committee. However, companies that do not have such a committee will now be required to include in their proxy statement the board of directors' view as to why it is appropriate not to have such a committee, and to identify each director who participates in the consideration of director nominees.

The new rules require companies to provide more specific, detailed disclosure about their director nomination process. The following information is required in the proxy statement:

- Provide the nominating committee charter, or a reference to the website where it is posted, or state that the committee has no charter.
- Disclose whether the nominating committee members are independent under the applicable NASDAQ or NYSE listing standards.
- Disclose the material elements of any nominating committee policy regarding consideration of director candidates recommended by security holders, and the procedures security holders must follow to submit such recommendations, or state the basis for the board's view that it is appropriate not to have such a policy if that is the case.
- Describe any specific minimum qualifications that the nominating committee believes must be met for the committee to recommend a nominee, and any qualities or skills the committee believes are necessary for one or more of the company's directors to possess.
- Describe the nominating committee's process for identifying and evaluating nominees, including nominations from security holders, and note any differences in the manner in which the nominating committee evaluates security holder nominees.
- For each nominee who is not a director standing for reelection and not a company executive, state which of several categories of persons recommended the nominee (security holder, non-management director, CEO, other executive officer, a third party search firm, or other specified source).
- If the company pays a third party search firm to assist it in evaluating potential nominees, disclose the function performed by the third party.
- Disclose (i) nominees recommended in a timely manner by any five percent stockholder (or stockholder group) that has held that amount of shares for at least one year and (ii) the stockholder that made the nomination, if the holder and the nominee consent, and disclose whether the nominating committee decided to nominate the candidate.

Do we have to update this disclosure more often than once a year?

Yes. Companies will be required to report any material changes to their nominating procedures. The information will be included in the Form 10-Q or Form 10-K for the period in which the change occurs. The only guidance in the new rule about what might be a “material” change is an instruction to the effect that if a company adopts procedures that allow security holders to recommend nominees to a company’s board of directors and the company had previously disclosed that it did not have such procedures, that will constitute a material change.

What new disclosures are required about security holder communications with the board of directors?

Companies will also be required to provide proxy statement disclosures about their process for security holder communications with board members. These communications do not apply to communications from directors or officers of the company, or to security holder proposals sent in accordance with Rule 14a-8. They also do not apply to communications submitted by security holders who are employees or agents of the company unless made solely in that person’s capacity as a security holder.

As with the nominations process disclosures, the board communications process disclosure mandates are specific and detailed. The following information is required in the proxy statement:

- State whether or not the board of directors has a process in place for security holders to communicate with the board, and state the basis for the view of the board that it is appropriate not to have such a process if that is the case.
- If the company has a process for security holders to send communications to the board, describe the manner in which they can do so.
- If all security holder communications intended for the board are not sent directly to the boardmembers, describe the process for determining which communications are forwarded to the board. However, if a company simply maintains a process for collecting and organizing security holder communications (as well as similar or related activities), this process need not be disclosed if approved by a majority of independent directors.
- Lastly, the company must describe its policy, if any, with regard to board members attending its annual meeting

of stockholders and the number of board members that attended the prior year’s annual meeting.

All of these disclosure requirements may be satisfied by referencing the company website address where this information appears instead of providing the information in its proxy statement.

When are these new rules effective?

The rules apply to all proxy statements first sent to security holders on or after January 1, 2004, and to Forms 10-Q and 10-K for the first reporting period ending after January 1, 2004. The first companies most likely to be affected by these rules are those with fiscal years ended September 30, 2003, many of which would typically send their proxy materials in January 2004.

Where are these new disclosure requirements located?

The obligation to disclose nominating committee functions is located in restated Item 7(d)(2) of Regulation 14A. The requirement to disclose the process for security holder communication with directors is found in new Item 7(h) of Regulation 14A. The obligation to update nomination provisions is included in new Item 401(j) of Regulation S-K, which is referred to in Form 10-K and Form 10-Q.

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 Dan Winnike (dwinnike@fenwick.com) or Horace Nash (hnash@fenwick.com), each of whom contributed to this update.

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