

SEC Proposes Disclosure Requirements Related to the Director Nomination Process and Shareholder Communications with Directors

The SEC has proposed rule changes that would strengthen disclosure requirements relating to (i) the nomination of company directors and (ii) shareholder communications with directors. The proposals follow recommendations made by the Division of Corporation Finance to the SEC in its July 15 “Staff Report: Review of the Proxy Process Regarding the Nomination and Election of Directors”¹ and represent the first step of the implementation of the Staff Report. The SEC anticipates considering further rule proposals later this fall regarding enhanced shareholder access to a company’s proxy statement and form of proxy for nomination of directors.

The proposed rules may be found on the SEC’s website at <http://www.sec.gov/rules/proposed/34-48301.htm>, and any comments on the proposals must be received by September 15, 2003.

Proposed Rules Requiring Additional Disclosure of Nominating Committee Processes

Companies are currently required to disclose in their proxy statements whether they have a nominating committee, whether the committee considers nominees recommended by shareholders, and, if so, how such recommendations should be submitted. The SEC’s proposed rules would require the following additional disclosure in a company’s proxy materials:

- whether it has a nominating or similar committee², and if not,
 - the reasons why it is appropriate for the company not to have a committee, and
 - the names of the directors who determine nominees for directors in the absence of such a committee;
- the material terms of the nominating committee charter, if any, and where it is available to shareholders;
 - if the nominating committee does not have a charter, a statement to that effect;

¹ This Staff Report may be found at <http://www.sec.gov/news/studies.shtml>.

² NYSE and Nasdaq proposed listing standards would required listed companies to have nominating committees, with charters, consisting solely of independent directors.

- if the company is listed on an exchange or quoted on the Nasdaq Stock market, disclosure of any instance during the last fiscal year where any member of the nominating committee did not satisfy the definition of independence in the listing standards of the market on which it is listed or quoted;
 - if the company is not listed, disclosure of whether each of the members of the nominating committee is independent.
- in determining whether a member is independent, the company must use a definition of independence of a national securities exchange or a national securities association that has been approved by the SEC, and identify the definition used. Whatever definition the company chooses, it must apply that definition consistently to all members of the nominating committee and use the same independence standards for purposes of nominating committee disclosure under this requirement and audit committee disclosure under '34 Act Rule 10A-3;
- a description of the material elements of any policy regarding consideration of director candidates recommended by shareholders, including a description of the procedures to be followed by shareholders in submitting recommendations;
- if the nominating committee does not have any such policy, disclosure of that fact;
- a description of
 - any specific minimum qualifications that the nominating committee believes are required for committee-recommended nominees,
 - any specific qualities or skills that the nominating committee believes are necessary for one or more of its directors to possess, and
 - any specific standards for the overall structure and composition of the company's board of directors;
- a description of the nominating committee's process for identifying and evaluating nominees for director, including nominees recommended by shareholders, and any differences in the manner in which the nominating committee evaluates shareholder and board-recommended nominees;
- a statement of the specific source (e.g., name of executive officer, director, or other individual) of each nominee approved by the nominating committee for inclusion on the company's proxy card;
 - the proposed rules provide an exception for nominees who are executive officers or are directors standing for re-election;
- if the company pays a fee to any third party to identify or assist in identifying potential nominees, disclosure of the function played by each such third party; and
- if the nomination committee receives a nominee from a shareholder or a group of shareholders that beneficially own either individually or in the aggregate over 3% of the company's common stock for

at least one year as of the date of the recommendation, and the nominating committee decides not to nominate that candidate, disclosure of

- the name or names of the shareholders who recommended the candidate, and
- the specific reasons for the nominating committee's determination not to include the candidate as a nominee (although there is no requirement to identify the rejected candidate by name).

Proposed Rules Requiring Disclosure Regarding the Ability of Shareholders to Communicate with Board of Directors

The proposed rules also call for the disclosure in the company's proxy statement, when action is to be taken with respect to the election of directors, of information regarding shareholder communications with the board of directors.³ Such disclosure includes the following:

- whether or not the company has a process for shareholders to send communications to directors and, if not, the reasons why it is appropriate for the company not to have such a process;
- if the company has a process for shareholders to send communications to the board of directors, a description of the manner by which shareholders can send such communications and the identification of those board members to whom shareholders can send communications;
- if all shareholder communications are not sent directly to board members, a description of the company's process for determining which communications are relayed to board members, including a description of the department within the company responsible for making such determination; and
- a description of any material action taken by the board in the preceding fiscal year as a result of communications with shareholders.

Registered Investment Companies

All of these proposals apply to proxy statements of registered investment companies in the same manner that they apply to other companies, although the proposals require disclosure as to whether or not the members of the fund's nominating committee are "interested persons" rather than independent under the listing standards as is the case for operating companies.

Contact Information

If you have any questions or would like to learn more about these rules, please contact your usual legal advisor at Ropes & Gray.

³ NYSE proposed listing standards would require listed companies to disclose a method for interested parties to communicate directly and confidentially with the presiding director or the non-management directors as a group.