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SEC Adopts New Disclosure Requirements Regarding Nominating Committees and Shareholder-Director Communications

The Securities and Exchange Commission has adopted amendments to existing disclosure requirements relating to board nominating committees and new disclosure requirements concerning the means by which shareholders may communicate with directors. The final rules were adopted to provide shareholders with a better understanding of board operations, nominating committees, the nomination process and communication between a company's board and its shareholders. The rules represent the SEC's latest effort to provide shareholders with specific information upon which to evaluate the boards of directors and nominating committees of the companies in which they invest.

Disclosure Requirements Relating to Nominating Committees

The final rules expand the current disclosure requirements relating to nominating committees in a company's annual proxy statement to include a discussion of the following items:

- A statement as to whether the company has a standing nominating committee (or committee performing a similar function) and, if not, a statement of the basis for the view of the board of directors as to why the company does not have such a committee.
- The identification of each director who participates in the consideration of director nominees.
- A statement as to whether or not the nominating committee has a charter and, if so, whether a copy of the charter is available on the company's website along with the company's website address. If the nominating committee has a charter which is not available on the company's website, a copy of the charter must be included as an appendix to the company's proxy statement at least once every three fiscal years. In the years in which the charter is not attached to the proxy statement as an appendix, the company must identify the year that the charter was an appendix to the proxy statement. It is important to note that NYSE's recently revised listing standards require that a company's nominating committee charter be available on the company's website.
- Disclosure as to whether the members of the nominating committee are independent, as independence is defined in the listing standards applicable to the issuer. Both NYSE and Nasdaq have adopted, and the American Stock Exchange has proposed, revised listing standards that require listed companies to have independent nominating committees.¹
- A statement as to whether the nominating committee has a policy relating to consideration of director candidates recommended by shareholders and, if not, a statement of the basis for the view of the board of directors that it is appropriate that the company does not have such a policy.

¹ If the company is not listed on a national securities exchange or in an automated inter-dealer quotation system of a national securities association, then the company must use a definition of independence of a national securities exchange or in an automated inter-dealer quotation system of a national securities association that has been approved by the SEC, state which definition the company used and disclose whether the members of the nominating committee are independent.

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- A description of the material elements of such policy regarding shareholder recommendations and the procedures followed by shareholders in submitting recommendations for directors to the nominating committee.
- A description of any minimum qualifications, specific qualities or skills that the nominating committee believes must be met by a nominating committee-recommended nominee for director.
- A description of the nominating committee's process for identifying and evaluating all director candidates (including shareholder recommended candidates) and any differences in the evaluation process for nominees recommended by shareholders.
- For each nominee approved by the nominating committee for inclusion on the company's proxy card (excluding nominees who are executive officers or directors standing for re-election), a statement regarding the "category" of persons or entities who recommended each nominee (i.e., shareholder, non-management director, the CEO, other executive officers, third-party search firm or other specified source). In disclosing the category of persons or entities that recommended a candidate to the nominating committee, companies should ensure that they also identify any person or entity that caused a particular person to be recommended (e.g., if the CEO asks a third party to evaluate a particular candidate and the third party recommends the candidate, both the CEO and third party should be identified).
- A statement as to whether the company pays any third party a fee to assist in identifying or evaluating potential nominees and, if so, a description of the function performed by the third party.
- A statement as to whether the nominating committee chose to nominate any candidate for director recommended by a shareholder or group of shareholders who beneficially owned more than 5% of the company's stock for at least one year at the time of the recommendation and, if so, the names of the recommending shareholder(s) and the candidate(s). No such disclosure is required without the written consent of the shareholder or group of shareholders and the candidate to be identified.²

The enhanced disclosure requirements are intended to increase the shareholders' understanding of the nomination process, board accountability, board responsiveness and the company's corporate governance policies.³ The SEC is currently considering additional proposed rules relating to nominations by shareholders and direct access to proxy statements by shareholders for their nominees.

Disclosure Requirements Relating to Shareholder Communications with Boards of Directors

The final rules also require new disclosure with regard to shareholder communications with board members in a company's proxy statement. The new disclosure will need to include a discussion of the following items:

- A statement as to whether or not the board of directors has a process for shareholders to send communications to the board and, if not, a statement of the basis for the view of the board of directors that it is appropriate that the company does not have such a process.
- If the company does have such a process to send communications to the board:
 - a description of the manner in which shareholders can send communications to the board, and, if applicable, to specified individual directors; and

² Disclosure must be provided only if the recommendation was received by the nominating committee by a date not later than the 120th calendar day before the date of the company's proxy statement released to shareholders in connection with the previous year's annual meeting.

³ NYSE listed companies should take these new rules into consideration as they formalize or update their corporate governance guidelines required under recently revised listing standards.

- if such process has not been approved by a majority of the independent directors, a description of the company's process for determining which communications will be relayed to the board if not all shareholder communications are sent directly to the board.
- A statement as to whether the company has a policy with regard to board members' attendance at annual shareholders meetings and a statement of the number of board members who attended the prior year's annual meeting.

With the exception of the statement of whether or not the board has a process for sending shareholder communications to the board, the company may place such information on the company's website, instead of having the disclosure in the proxy statement. If a company relies on the website, it must disclose in its proxy statement the website address and where such information may be found.

Shareholder proposals submitted pursuant to Rule 14a-8 of the Securities Exchange Act of 1934 and related communications have been expressly excluded by the SEC for the purposes of the new disclosure standard.

Effectiveness

The final rule will become effective on January 1, 2004. Companies must comply with the new disclosure requirements in proxy statements or information statements that are first sent or given to security holders on or after January 1, 2004 and must provide disclosure of any material changes in procedures for shareholder recommendations for director candidates, as necessary, in periodic reports beginning in the first reporting period ending after January 1, 2004.

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