

# Client Alert

A report  
for clients  
and friends  
of the firm

December 2003

## The SEC Has Adopted Rules, Effective January 1, 2004, Requiring Disclosure in Proxy Statements of Nominating Committee Functions and Procedures for Communications between Security Holders and Boards of Directors

On November 19, 2003, the Securities and Exchange Commission ("SEC") adopted rules requiring specific detailed disclosure by domestic companies in their proxy statements about nominating committee functions and procedures for security holders to communicate with boards of directors. See Rel. 33-8340 (November 24, 2003). These requirements do not apply to foreign private issuers or to domestic companies that are not required to file proxy statements. The application of these rules to registered investment companies is not addressed in this client alert.

### Effective Dates:

- Disclosure in proxy statements
  - January 1, 2004
- Disclosure in Forms 10-Q, 10-QSB, 10-K or 10-KSB of any material changes in the procedures by which security holders may recommend nominees for the company's board of directors
  - Any such periodic report filed after the company provided disclosure about such procedures in a proxy statement

The SEC staff has indicated that, for the next two years, it will monitor carefully the newly required dis-

closures. Accordingly, companies should avoid boilerplate responses to these requirements.

### Disclosure about Nominating Committee Functions

The following disclosure is required by Items 7(d)(1) and (2) of Schedule 14A to the SEC's proxy rules:

- A statement as to whether the company has a standing nominating committee or a committee performing similar functions (which could be the majority of independent directors, as permitted under Nasdaq listing standards, or the entire board of directors) and, if it does not have a standing nominating committee or committee performing similar functions, a statement of the basis for the view of the board of directors that it is appropriate for the company not to have such a committee and identification of each director who participates in the consideration of director nominees;

The following information regarding the company's director nomination process:

- If the nominating committee has a charter, disclosure of whether a current copy of the charter is available on the company's website, and if so, disclosure of the company's website address. If the nominating committee has a charter and a current copy of the charter is not available on the company's website, inclusion of a copy of the charter as an appendix to the company's proxy statement at least once every three fiscal years. If a current copy of the charter is not available on the company's website, and is not included as an appendix to the company's proxy statement, identification of the prior fiscal year in which the charter was so included;
- If the nominating committee does not have a charter, a statement of that fact;
- If the company's securities are listed on a national securities exchange that has independence requirements for nominating committee members or are admitted to Nasdaq, disclosure as to whether the members of the nominating com-

mittee are independent, as independence for nominating committee members is defined in the listing standards applicable to the listed issuer;

- If the company is not a listed issuer, disclosure as to 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 Nasdaq that has been approved by the SEC and state which definition it used. Whatever definition the company chooses, it must apply that definition consistently to all members of the nominating committee and use the independence standards of the same national securities exchange or Nasdaq for purposes of this nominating committee disclosure and the audit committee disclosure required under Item 7(d)(3)(iv) of Schedule 14A;
- If the nominating committee has a policy with regard to the consideration of any director candidates recommended by security holders, a description of the material elements of that policy, which must include, but need not be limited to, a statement as to whether the committee will consider director candidates recommended by security holders;
- If the nominating committee does not have a policy with regard to the consideration of any director candidates recommended by security holders, a statement of that fact and a statement of the basis for the view of the board of directors that it is appropriate for the company not to have such a policy;
- If the nominating committee will consider candidates recommended by security holders, a description of the procedures to be followed by security holders in submitting such recommendations;
- A description of any specific, minimum qualifications that the nominating committee believes must be met by a nominating committee-recommended nominee for a position on the company's board of directors, and a description of any specific qualities or skills that the nominating committee believes are necessary for one or more of the company's directors to possess;
- A description of the nominating committee's process for identifying and evaluating nominees for director, including nominees recommended by security holders, and any differences in the manner in which the nominating committee evaluates nominees for director based on whether the nominee is recommended by a security holder;
- With regard to each nominee approved by the nominating committee for inclusion on the company's proxy card (other than nominees who are executive officers or who are directors standing for re-election), a statement as to which one or more of the following categories of persons or entities recommended that nominee: security holder, non-management director, chief executive officer,

other executive officer, third-party search firm, or other, specified source;

- If the company pays a fee to any third party or parties to identify or evaluate or assist in identifying or evaluating potential nominees, disclosure of the function performed by each such third party; and
- If the company's nominating committee received, by a date not later than the 120th calendar day before the date of the company's proxy statement released to security holders in connection with the previous year's annual meeting, a recommended nominee from a security holder that beneficially owned more than 5% of the company's voting common stock (as determined by the company's most recent periodic report) for at least one year as of the date the recommendation was made, or from a group of security holders that beneficially owned, in the aggregate, more than 5% of the company's voting common stock, with each of the securities used to calculate that ownership held for at least one year as of the date the recommendation was made, identification of the candidate and the security holder or security holder group that recommended the candidate and disclosure as to whether the nominating committee chose to nominate the candidate. (No such identification or disclosure is required without the written consent of both the security holder or security holder group and the candidate to be so identified.) If the date of the annual meeting has been changed more than 30 days the previous year's meeting, the letter must be received a reasonable time before the company begins to print and mail its proxy material. For these purposes, the percentage of securities held by a recommending security holder, as well as the holding period of those securities, may be determined by the company if the security holder is the registered holder of the securities. If the security holder is not the registered owner of the securities, the security holder can submit one of the following to the company to evidence the required ownership percentage and holding period:
  - A written statement from the "record" holder of the securities (usually a broker or bank) verifying that, at the time the security holder made the recommendation, he or she had held the required securities for at least one year; or
  - If the security holder has filed a Schedule 13D, Schedule 13G, Form 3, Form 4, or Form 5 or amendments to those documents or updated forms, reflecting ownership of the securities as of or before the date of the recommendation, a copy of the schedule or form, and any subsequent amendments reporting a change in ownership level, as well as a written statement that the security holder continuously held the securities for the one-year period as of the date of the recommendation.

For purposes of the company's obligation to provide the required disclosure specified, the security holder or group must have provided to the company, at the time of the rec-

ommendation, the written consent of all parties to be identified and, where the security holder or group members are not registered holders, proof that the security holder or group satisfied the required ownership percentage and holding period as of the date of the recommendation.

The use of a more than 5% beneficial ownership threshold to trigger this disclosure obligation means that recommendations generally will be made by security holders or groups that have a reporting obligation under Act Regulation 13D-G. Recommending security holders, like other beneficial owners, will continue to report on 13G or Schedule 13D based on their purpose or effect in acquiring or holding the company's securities.

In addition, the SEC anticipates that security holders may communicate with each other in an effort to aggregate more than 5% of a company's securities before submitting a recommended candidate to a company's nominating committee. The determination as to what communications may be deemed solicitations, either subject to or exempt from the proxy rules, is based on facts and circumstances and is not intended to be affected by the adoption of this new disclosure obligation.

### **Disclosure about Material Changes in Procedures for Security Holder Nomination of Directors**

Disclosure of material changes in procedures for security holder nominations of directors since the last disclosure of those procedures in a company's proxy statement are required to be disclosed in Forms 10-Q (Item 5(b)), 10-QSB (Item 501(b)), 10-K (Item 10) or 10-KSB (Item 9) and Items 401(j) of Regulation S-K or 401(g) of Regulation S-B.

### **Disclosure about Procedures for Security Holder Communications With Boards of Directors**

The following disclosure is required by Item 7(h) of Schedule 14A to the SEC's proxy rules:

- A statement as to whether or not the company's board of directors provides a process for security holders to send communications to the board of directors and, if the company does not have such a process for security holders to send communications to the board of directors, a statement of the basis for the view of the board of directors that it is appropriate for the company not to have such a process; (In Exchange Act Release No. 34-48745 (November 4, 2003), the SEC approved a new NYSE listing standard that addresses security holder communications with board members. This standard provides that: "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." This method could be analogous to the method in the NYSE listing

standards required by Exchange Act Rule 10A-3 regarding audit committees. Exchange Act Rule 10A-3(b)(2) requires listing standards relating to audit committees to require that "[e]ach audit committee ... establish procedures for the receipt, retention and treatment of complaints regarding accounting, internal accounting controls or auditing matters, including procedures for the confidential, anonymous submission by employees of the issuer of concerns regarding questionable accounting or auditing matters.");

- If the company has a process for security holders to send communications to the board of directors:

A description of the manner in which security holders can send communications to the board and, if applicable, to specified individual directors; and

If all security holder communications are not sent directly to board members, a description of the company's process for determining which communications will be relayed to board members, unless that process is approved by a majority of the independent directors; and

- A description of the company's policy, if any, with regard to board members' attendance at annual meetings and a statement of the number of board members who attended the prior year's annual meeting.

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