

## SECURITIES ALERT

### DISCLOSURE REGARDING NOMINATING COMMITTEE FUNCTIONS AND COMMUNICATIONS BETWEEN SECURITY HOLDERS AND BOARDS OF DIRECTORS



#### OVERVIEW

Effective January 1, 2004, the Securities and Exchange Commission (SEC) adopted final rules that require additional disclosures on proxy rules and information statements. The new rules further the goal of providing the transparency that is necessary for security holders to understand the nomination process and the process by which they may communicate with board members of the companies in which they invest. Specifically, the SEC is requiring companies to disclose —

- a company's determination whether to have a nominating committee
- the nominating committee's charter, if any
- the nominating committee's processes for identifying and evaluating candidates
- the minimum qualifications for a nominating committee-recommended nominee and any qualities and skills that the nominating committee believes are necessary or desirable for board members to possess
- the means, if any, by which security holders may communicate with directors.

These rules require disclosure but do not mandate any particular action by a company or its board of directors; rather, the new disclosure requirements are intended to make more transparent to security holders the operation of the boards of directors of the companies in which they invest.

With the objective of (i) generally enhancing transparency of boards of directors, (ii) providing security holders with a better understanding of the process by which directors of the companies in which they invest are selected and (iii) clarifying the means, if any, by which security holders may communicate with directors, the SEC issued final rules that will require additional disclosures on proxy rules and information statements. The rules became effective on January 1, 2004. The rules are not mandatory for foreign private issuers.

### **DISCLOSURES REQUIRED WITH RESPECT TO THE PROCESS FOR NOMINATING CANDIDATES FOR ELECTION AS DIRECTORS**

The SEC adopted rules that require domestic companies, as well as investment companies, to make the following disclosures in their proxy statements with respect to the process for nominating candidates for election as directors:

- The company must prepare a statement as to whether the company has a nominating committee or a committee performing similar functions and, if the company does not have such a committee, a statement of the basis for its board of directors not to have such a committee and the identification of each director who participates in the consideration.
- The following disclosures are required regarding the nominating process:
  - If the nominating committee has a charter, it must disclose whether a current copy of the charter is available to security holders on the company's Web site and the company's Web site address. If the nominating committee has a charter and a current copy of the charter is not available to security holders on the company's Web site, a copy of the charter as an appendix to the company's proxy statement must be included at least once every three fiscal years. If a current copy of the charter is not available to security holders on the company's Web site, and is not included as an appendix to the company's proxy statement, the nominating committee must identify the prior fiscal year in which the charter was so included.
  - If the nominating committee does not have a charter, it must provide a statement of that fact.
  - If the company is a listed issuer whose securities are listed on a national securities exchange or in an automated inter-dealer quotation system, the company must disclose whether the members of the nominating committee 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, it must disclose whether each member 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 state which definition it used. Whatever definition the company chooses, it should apply that definition consistently to all members of the nominating committee and use the independence standards of the same national securities exchange or national securities association.
  - If the nominating committee has a policy with regard to the consideration of any director candidates recommended by security holders, the committee must provide a description of the material elements of that policy, which shall include 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, the committee must provide 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 must be provided of the procedures to be followed by security holders in submitting such recommendations.
- A description must be provided of any specific, minimum qualifications that the nominating committee believes must be met by a nominee for a position on the company's board of directors, and a description must be provided 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 must be provided 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 must be made as to which 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 to assist in identifying or evaluating potential nominees, the company must disclose the function performed by each such third party.
- 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 percent of the company's voting common stock 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 percent 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, the company must identify the candidate and the security holder or security holder group that recommended the candidate and must disclose whether the nominating committee chose to nominate the candidate. Such identification or disclosure requires the written consent of both the security holder or security holder group and the candidate to be so identified.

In a footnote to the Rule, the SEC stated that recommending security holders would continue to report their beneficial ownership under Schedule 13G or Schedule 13D based on the purpose or effect in acquiring or holding the company's securities. Accordingly, the making of recommendations pursuant to this Rule is not intended to affect the scope of beneficial owners' reporting obligations.

## DISCLOSURES REQUIRED WITH RESPECT TO THE ABILITY OF SECURITY HOLDERS TO COMMUNICATE EFFECTIVELY WITH THE BOARD OF DIRECTORS

The SEC adopted rules that require domestic U.S. companies and investment companies to make the following disclosures in their proxy statements with respect to the ability of security holders to communicate effectively with the board of directors:

- The company must prepare a statement as to whether the company's board of directors provides a process for security holders to send communications to the board of directors; if the company does not have such a process, it must prepare a statement of the basis why.
- If the company has a process for security holders to send communications to the board of directors, the company must provide —
  - a description of the manner in which security holders can send such 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.
- The company must provide a description of its 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.

\* \* \*

The corporate and securities practice of Akin Gump includes six major areas: mergers and acquisitions, corporate finance and securities, international transactions, investment fund management, private equity and corporate restructuring. Our lawyers manage every aspect of sophisticated corporate transactions as well as provide day-to-day advice to clients on general corporate matters. For other corporate and securities-related Alerts, please visit our Web site at <http://www.akingump.com/publication.cfm>.

### CONTACT INFORMATION

If you have any questions or would like to learn more about this topic, please contact the partner who normally represents you, or:

Dawn M. Gertz  
Director of Client Service  
[dgertz@akingump.com](mailto:dgertz@akingump.com)  
1.866.AKINLAW

Albany Austin Brussels Chicago Dallas Houston London Los Angeles Moscow New York  
Northern Virginia Philadelphia Riverside/Inland Empire Riyadh (Affiliate) San Antonio San Francisco Washington, D.C.