

August 15, 2003

## SEC Proposes New Disclosure Requirements Regarding Nominating Committee Functions and Shareholder Communications With Boards of Directors

In an effort to improve the transparency of the operation of boards of directors, the SEC has proposed enhancements to existing disclosure requirements regarding the operation of board nominating committees and a new disclosure requirement concerning the means, if any, by which security holders may communicate with members of the boards of directors. These proposals were put forth by the SEC in response to an apparent growing concern among security holders that they lack sufficient input into decisions made by the boards of directors of the companies in which they invest.

The proposed disclosure requirements would oblige an issuer to provide its security holders with detailed and specific information regarding its nominating committee, if it has one, and the process involved in nominating an individual for election as a member of the board of directors. The proposals would also require an issuer to disclose in its proxy materials whether and how a security holder may communicate with the board of directors. Both sets of proposals are discussed below in greater detail.

### I. Enhanced Nominating Committee Disclosure

Companies currently must disclose in their proxy materials whether they have a nominating committee and, if so, whether the committee considers nominees recommended by security holders and how any such recommendations may be submitted. The SEC has grown concerned that the existing disclosure requirements have resulted in mere boilerplate disclosure and, as such, have not provided investors with the information necessary to understand the nominating process at the companies in which they invest. Accordingly, it has proposed to expand disclosure in company proxy statements regarding the nominating committee and the nominating process. This enhanced disclosure is intended to provide security holders with additional, specific information upon which to evaluate the boards of directors and nominating committees of the companies in which they invest.

Specifically, the proposed amendments would require a statement in an issuer's proxy statement as to whether or not the company has a standing nominating committee or a committee performing similar functions. If the company does not have a nominating committee, it would be required to state why the board of directors believed it appropriate for the company not to have such a committee and the names of those directors who participate in the consideration of director nominees.

The following disclosure regarding the nominating process would also be required to be included in the company's proxy statement:

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(86-10) 6505-6822

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- A statement whether or not the nominating committee has a charter and, if it does have a charter, a description of the material terms of the nominating committee charter and disclosure as to where the nominating committee charter is available, which can be the company's website;
- If the company's securities are listed on a national securities exchange or quoted on Nasdaq, 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 they are listed or quoted (except where a non-independent director is relying on a specific exclusion from the relevant market's independence requirements);
- If the company is not a listed issuer, 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 Nasdaq that has been approved by the SEC, and state which definition it used. Whatever definition the company chooses, it would have to 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 Exchange Act Rule 10A-3;
- A statement as to whether the nominating committee has a policy with regard to the consideration of any director candidates recommended by security holders, and if it does have such a policy, a description of the material elements of that policy, including 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, any specific qualities or skills that the nominating committee believes are necessary for one or more of the company's 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 security holders, and any differences in the manner in which the nominating committee evaluates nominees for director based on whether or not the nominee is recommended by a security holder;
- A statement of the specific source, such as the name of an executive officer, director, or other individual, of each nominee (other than nominees who are executive officers or directors standing for re-election) approved by the nominating committee for inclusion on the company's proxy card;
- If the company pays a fee to any third party or parties to identify or assist in identifying or evaluating potential nominees, disclosure of the function performed by each such third party; and
- If the nominating committee (a) receives a recommended nominee from a security holder or group of security holders who individually, or in the aggregate, beneficially owned greater than 3% of the company's voting common stock for at least one year as of the date of the recommendation, and (b) the nominating committee decides not to nominate that candidate, disclosure of:
  - the name or names of the security holders who recommended the candidate; and

- the specific reasons for the nominating committee's determination not to include the candidate as a nominee (though disclosure of a rejected candidate's name would not be required).

The SEC's Division of Corporation Finance has separately recommended new rules to require enhanced security holder access to the nomination process. The appropriate ownership threshold, if any, for any such enhanced access is being treated by the SEC as a separate issue from the proposed 3% ownership threshold relating to disclosure of the rejection of candidates nominated by significant security holders.

The New York Stock Exchange and Nasdaq have proposed revised listing standards that would require listed companies to have independent nominating committees. While these proposed listing standard changes demonstrate the importance of the nominating process and the nominating committee, and represent a strengthening of the role and independence of the nominating committee, they would not require nominating committees to consider security holder nominees or companies to make the disclosures described above. The SEC intends its proposed disclosure requirements to operate in conjunction with any proposed listing standards regarding nominating committees that are adopted by the NYSE and Nasdaq.

## **II. Disclosure Regarding the Ability of Security Holders to Communicate With the Board of Directors**

The SEC considers the existence of a process for security holders to communicate directly with the board of directors to be a potential consideration for investors making investment decisions. Providing security holders with disclosure about such a process would, believes the SEC, improve the transparency of board operations, as well as security holder understanding of the companies in which they invest.

The SEC has proposed that companies include a statement in their proxy materials where action is to be taken with respect to the election of directors as to whether or not the company's board of directors provides a process for security holders to send communications to the board and, if the company does not have a process for security holders to send communications to the board, a statement as to why the board of directors believes it appropriate for the company not to have a such a process. If the company does have a process for security holders to send communications to the board of directors, the proposals would require companies to also include the following information in their proxy materials:

- a description of the manner in which security holders can send such communications to the board;
- identification of those board members to whom security holders can send communications;
- 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, including disclosure of the department or other group within the company that is responsible for making this determination; and
- a description of any material action taken by the board during the preceding fiscal year as a result of communications from security holders.

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This memorandum is not intended to provide or constitute legal advice, and no legal or business decision should be based on its contents.

Any questions concerning the foregoing should be addressed to members of the Paul Weiss Securities Group (see below). In addition, memoranda on related topics may be accessed under Securities Group publications on our web site ([www.paulweiss.com](http://www.paulweiss.com)).

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