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SEC Adopts New Disclosure Requirements Regarding Nominating Committee Functions and Communications Between Security Holders and Boards of Directors

The Securities and Exchange Commission has adopted disclosure requirements concerning the operation of Board nominating committees and the processes established by companies permitting shareholders to communicate with Board members.[1] The rules, which apply to both operating companies and investment companies, do not mandate any particular policy by a company or its Board with respect to nominations. Companies are required to comply with these disclosure requirements in proxy or information statements sent or given to security holders on or after January 1, 2004 and, in the case of investment companies, in the Form N-CSR for the first reporting period ending after January 1, 2004.

Disclosure Regarding Nominating Committee Processes

The amended disclosure requirements will expand the current proxy statement disclosure regarding a company's nominating processes to include:

- A statement as to whether the company has a standing nominating committee or a committee performing similar functions. If the company does not have such a committee, a statement of the basis for the Board's view that it is appropriate not to have a committee. In addition, whether or not the company has a nominating committee, the company must identify each director who participates in the consideration of director nominees;

- 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 available on the company's website, disclosure of the company's website address. If the nominating committee has a charter and the current copy is not available on the company's website, then the rules require inclusion of a copy of the charter as an appendix to the company's proxy statement at least once every three fiscal years. If the nominating committee does not have a charter, a statement of that fact;

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[1] Release No. 34-48825 (Nov. 24, 2003)("Adopting Release"). As indicated above, theses rules concern disclosure only, and not inclusion of shareholder nominations of directors in issuer proxy statements. On that subject, see Rel. No. IC-26206 (Oct. 14, 2003) and our Client Alert No. 75, dated Nov. 21, 2003.

- In the case of an investment company, disclosure is required as to whether nominating committee members are "interested persons" of the company as defined in Section 2(a)(19) of the Investment Company Act of 1940 ("1940 Act");

- If the nominating committee has a policy with regard to the consideration of director candidates recommended by security holders, a description of the material elements of that policy and a statement as to whether the committee will consider director candidates recommended by security holders. If the nominating committee does not have such a policy, a statement of that fact and the basis for the view of the Board 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 their recommendations;

- A description of any specific, minimum qualifications that the nominating committee believes must be met by a nominating committee-recommended nominee for director, 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;

- 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 third party; and

- If the nominating committee received, within a designated time period, a recommended nominee from a security holder or group of securities holders that beneficially owned in the aggregate, more than 5% of the company's voting common stock 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 disclose whether the nominating committee chose to nominate the candidate. Such identification and disclosure is not required without the written consent of both the security holder or security holder group and the candidate to be so identified.

Disclosure Regarding the Ability of Security Holders to Communicate with Boards of Directors

The new disclosure standards will require a company to provide, in its proxy statement or on the company's website:

- A statement as to whether or not the Board provides a process for security holders to send communications to the Board[2] and, if the

[2] Communications from an employee or agent of the company will be considered as security holder communications for purposes of the disclosure requirement if those communications are made solely in such employee's or agent's capacity as a security holder. Security holder proposals submitted pursuant to Exchange Act Rule 14a-8, and communications made in connection with such proposals, are excluded from the definition of "security holder communications" for purposes of the disclosure requirement.

company does not have such a process, a statement of the basis for the view of the Board of Directors that this is appropriate;

- A description of any process by which security holders can send communications to the Board and, if applicable, to specified individual directors. If every security holder communication is not sent directly to Board members, a description of the company's process for determining which communications will be relayed to Board members; provided, however, that a company need not disclose ministerial activities such as the company's process for collecting and organizing security holder communications, if such process is approved, in the case of a fund, by a majority of the directors who are not "interested persons" of the fund as defined in section 2(a)(19) of the 1940 Act;[3] and

- A description of the company's policy, if any, 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.

In addition, the rules will require companies to report any material change to the procedures for security holder nominations which, in the case of investment companies, would be reported on the Form N-CSR filed for the period in which the material change occurs. Adoption of procedures by which security holders may recommend nominees to a company's Board of Directors, where the company previously disclosed that it did not have in place such procedures, is deemed a material change.

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If you have any questions about the information in this update, please contact one of the attorneys listed below or the Dechert LLP attorney with whom you are in regular contact:

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[3] The SEC said, in the Adopting Release, that commentators had suggested that companies should not need to make extensive disclosure of processes by which company personnel filter shareholder communications because it would imply that the company was "improperly blocking communications from security holders." The Adopting Release noted that filtering processes were thought by commentators to be necessary because "many security holder communications are related to company products and services, are solicitations, or otherwise relate to improper or irrelevant topics." Presumably, the idea behind not requiring detailed disclosure of filtering processes at the ministerial level, if approved by the independent directors, is that the independent directors are comfortable with the filtering process. It may be that the instruction is not entirely workable. In any event, some funds may find that letters addressed to Board members or requests that the letter be forwarded to the Board are infrequent enough that no filter is necessary and all communications can be forwarded.