

THE
BEST
OFFERS

Nomination of Directors:

SEC changes the process

. . .

In July 2003, the staff of the Securities and Exchange Commission delivered a report to the Commission recommending changes related to the nomination and election of public company directors. The report suggested:

- increased disclosure related to director nominating committee functions and shareholder communications with boards of directors; and
- increased shareholder access to the proxy process for the nomination of directors.

In response, on August 8, 2003 and October 14, 2003, respectively, the Commission proposed rules in these two areas. On November 19, 2003, it adopted the rule changes addressing the first topic.

More Disclosure Related to Director Nominating Committee Functions

Currently, the SEC's proxy rules under the Securities Exchange Act (the "Exchange Act") require public companies subject to the proxy rules under the Exchange Act to disclose in their proxy materials whether or not the company has a nominating committee and, if so, whether or not the committee considers nominees recommended to the nominating committee by shareholders. Current rules also require disclosure regarding how such recommendations should be submitted to the nominating committee.

On November 19, 2003, the SEC adopted changes to Item 7 of Schedule I4A under the Exchange Act. These changes apply to all Exchange Act reporting companies subject to the proxy rules (and therefore, do not apply to foreign private issuers). The changes are **effective for proxy statements mailed after January 1, 2004**, and significantly expand the amount of disclosure required.

Specifically, companies will be required to provide:

- A statement as to whether or not 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 reasons why it does not have a nominating committee and the names of the directors who participate in the consideration of the director nominees;
- Disclosure regarding the nominating process, including:
 - If the nominating committee has a charter, disclosure of whether it is available on the company's website, and if on the website, then disclosure of the website address. If the disclosure is not on the website, then include a copy in the appendix to the company's proxy statement at least once every three fiscal years, and if not available on the website and not included with the current proxy statement, then identification of the prior fiscal year in which the charter was included;
 - If the nominating committee does not have a charter, a statement indicating this;
 - If the company is listed on a market, which has independence requirements for nominating committee members, disclosure as to whether members are independent;

CLIENT ALERT

- If the company is not listed on a market, disclosure of whether each of the members of the nominating committee is independent;
- If the nominating committee has a policy with regard to the consideration of director candidates recommended by shareholders, a description of the material elements of that policy, including a statement as to whether or not the committee will consider shareholder-recommended candidates;
- If the nominating committee does not have a policy with regard to the consideration of director candidates recommended by shareholders, a statement indicating this and a statement of the reasons why the board considers it appropriate for the company not to have such a policy;
- If the nominating committee will consider candidates recommended by shareholders, a description of the process shareholders should follow in making such recommendations;
- A description of any specific, minimum qualifications that the nominating committee believes must be met by a candidate for a position on the company's board of directors, and any specific qualities or skills that the committee believes are necessary for one or more of the company's directors to have;
- A description of the nominating committee's process for identifying and evaluating nominees for director, including those recommended by shareholders, and any differences in the manner in which the committee evaluates nominees for director based on whether or not the nominee is recommended by a shareholder;
- A statement as to which category of entities or persons recommended the nominee approved by the nominating committee for inclusion on the company's proxy card; *i.e.*, (i) shareholder, (ii) non-management director, (iii) chief executive officer, (iv) other executive officer, (v) third-party search firm, or other, specified source;
- If the company pays a fee to a third party to identify or assist in identifying or evaluating potential nominees, disclosure of the function performed by that third party; and
- If the nominating committee receives, by a date no later than the 120th day before the date that the company's proxy statement is released to shareholders in connection with the previous year's annual meeting, a recommendation from a shareholder or group of shareholders who individually or collectively have owned greater than 5% of the company's voting common stock for at least one year as of the date of the recommendation, then it must disclose: the name of the nominated candidate; the name or names of the shareholders who recommended the candidate; and whether the nominating committee chose to nominate the candidate. However, no identification is required without the consent of those to be identified.

The new rules also require that when proxy materials for election of directors are distributed, they include the following information:

- A statement as to whether or not the company's board of directors provides a procedure for shareholders to send communications to the board of directors and, if the company does not have such a procedure, a statement of the reason why it is appropriate for the company not to have such a procedure;
- If the company has a procedure for shareholders to send their communications to the board:
 - A description of the procedure by which shareholders can send communications to the board;
 - If applicable, identification of the board members to whom shareholders can send their communications;
 - If all shareholder communications are not sent directly to board members, a description of the company's procedure for determining which communications will be directed to board members; and
- A description of the company's policy, if it has one, with regard to annual meeting attendance by board members, and a statement of the number of board members who attended the previous year's annual meeting.

Shareholder Access to the Proxy Process

The second rule change, proposed in October 2003, but not yet adopted,

would require that, under certain circumstances, public companies include in the company proxy materials the names of shareholder nominees for election as director. The SEC stated that its purpose in proposing the rule was to increase the ability of shareholders to participate meaningfully in the proxy process for the nomination and election of directors.

Currently, unless they are prepared to incur the significant cost of waging a proxy fight, shareholders are only given the opportunity to vote on candidates nominated by the board of directors. A dissatisfied shareholder or group of shareholders must go through a proxy contest in order to get alternative nominees before the shareholders for a vote. Significantly, the shareholder waging a proxy contest must in most cases bear the costs of waging the proxy contest, which can be very high. In contrast, the expenses incurred by incumbent management in the proxy contest normally are paid by the corporation.

The proposed rule would require a company to include in the company's proxy materials information regarding a shareholder's nominee for election to the board of directors when certain conditions are satisfied.

Proposed Rule 14a-11 would apply to all companies subject to the Exchange Act's proxy rules (thus it also does not apply to foreign private issuers), unless prohibited by state law. However, the SEC is considering having this rule initially apply only to companies that are "accelerated filers" (i.e., those with a market capitalization held by non-insiders of over \$75 million) and applying it to smaller companies at a later date.

Triggering Events

A company would be required to include a shareholder nominee

only after at least one of the following triggering events occurs:

(i) at least one of the board nominees receives "withhold" votes from more than 35% of the votes cast at an annual meeting of shareholders held after January 1, 2004; or

(ii) a shareholder proposal submitted under existing Rule 14a-8 providing that the company become subject to the shareholder nomination procedure in the proposed new Rule 14a-11:

(a) was submitted to shareholders at an annual meeting of shareholders held after January 1, 2004, by a shareholder (or group of shareholders) that held more than 1% of the company's shares entitled to vote on the proposal for one year as of the date the proposal was submitted, and

(b) that proposal received more than 50% of the votes cast on that proposal at the annual meeting.

Once a triggering event occurs, it would then remain operative for any meeting, annual or special, held during the remainder of the calendar year in which the triggering event occurs, the following calendar

year, and the portion of the second calendar year following the calendar year in which the triggering event occurs.

The proposing release indicated that the SEC is considering a third triggering event:

(i) a 1%/one year shareholder (or group of shareholders) submitted a proposal at a prior meeting, pursuant to Rule 14a-8, other than a proposal to become subject to Rule 14a-11;

(ii) the proposal received more than 50% of the votes at that meeting, and

(iii) the board of directors failed to implement the proposal by the 120th day prior to the date that the company mails its proxy materials for the current annual meeting.

Notice Requirements

If there has been a triggering event, then the company

must give shareholders notice of that fact by disclosing the shareholder vote in either the Form 10-Q or, if the vote occurred in the fourth quarter, in the Form 10-K.

The SEC proposes that shareholders wishing to have a nominee on the ballot be required to give the company notice of that fact no later than 80 days before the anniversary of the date the company mailed its proxy materials for the prior year's annual meeting, or if the date of the annual meeting has changed more than 30 days from the prior year, then within a reasonable time before the company mails its proxy materials. The nominating shareholder would also be required to file notice of its intention with the SEC.

Eligibility Requirements

In order to submit a nomination under proposed Rule 14a-11, a shareholder (or group of shareholders) would be required to:

- Own, either individually or collectively, more than 5% of the company's shares that are eligible to vote for the election of directors at the next annual meeting, with each of the shares used for purposes of calculating that ownership having been held continuously for at least two years;
- Intend to continue to own those shares through the date of that annual or special meeting;
- Be eligible to report beneficial ownership of company securities on Schedule I3G, rather than Schedule I3D (i.e., a passive or institutional investor not be seeking to take control of the company); and
- Have filed a Schedule I3G reporting such ownership before the date of the submission of the nomination to the company. The Schedule I3G must include a certification that the shareholder (or group of shareholders) has held their interest for at least two years.

After the Company Receives Notice ...

If the company determines that the shareholder complied with the above procedures, the company would then have to include information regarding the shareholder nominee or nominees in its proxy materials. A company would be required to include one shareholder nominee if the board consists of eight or fewer directors, two shareholder nominees if the board consists of between eight and twenty directors, and three nominees if the board consists of twenty or more directors. If the company has a staggered board and a shareholder nominee has already been elected whose term will continue beyond the meeting, then the company does not have to include shareholder nominees that could result in the total number of shareholder nominees (including the continuing director[s]) being greater than the numbers described above.

Responses The SEC accepted comments on the proposed rule through December 22, 2003. Institutional and individual investors have largely applauded the proposals, although a number of large institutional investors have argued that the holding period for the shareholder making a nomination is too long and the percentage of ownership too high. Companies argue that giving shareholders access to company proxy materials would turn elections of directors into disruptive and costly contests and may discourage qualified board candidates from appearing on the company's slate of board nominees.

For more information, please contact your Brown Rudnick attorney or one of the following attorneys:

IN BOSTON

Philip J. Flink
617.856.8555
pflink@brbilaw.com

Steven R. London
617.856.8313
slondon@brbilaw.com

David H. Murphree
617.856.8362
dmurphree@brbilaw.com

IN PROVIDENCE

Jayne Donegan
401.276.2612
jdonegan@brbilaw.com

IN HARTFORD

David E. Golden
860.509.6579
dgolden@brbilaw.com

IN NEW YORK

Steven F. Wasserman
212.209.4999
swasserman@brbilaw.com

Kenneth S. Goodwin
212.209.4862
kgoodwin@brbilaw.com

IN LONDON

Lawrence M. Levy
+44.20.7851.6000
llevy@brbilaw.com

IN DUBLIN

Mark A. Dorff
+353.1.664.1738
mdorff@brbilaw.com

BR
BI
BROWN
RUDNICK
BERLACK
ISRAELS LLP

Boston
Dublin
Hartford
London
New York
Providence

Brown Rudnick
Berlack Israels LLP
is a full-service inter-
national law firm
with offices in the
United States and
Europe. We have 200
attorneys who provide
advice across key areas
of the law: Corporate
& Securities,

Intellectual Property, Bankruptcy &
Corporate Restructuring, Complex
Litigation, Finance, Government Law &
Strategies and Real Estate.

www.brownrudnick.com