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## MEMORANDUM

TO: Our Clients and Friends

FROM: Godfrey & Kahn, S.C.

DATE: August 22, 2003

RE: SEC Proposals Relating to Nominating Committee Functions and Shareholder Communications

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*The SEC recently proposed new rules that would increase disclosure in proxy statements concerning the nomination and election of new directors and require disclosure of procedures for shareholder communications with directors. These rule proposals are the first in what we expect to be a series of rule proposals on this subject. This memorandum is intended to provide a summary of the proposed rules. The rules are subject to a comment period ending September 15, 2003, after which the SEC will issue final rules.*

### **I. Enhanced Nominating Committee Disclosure**

The stated intention of the SEC's proposed rules regarding enhanced nominating committee disclosure is to provide shareholders with specific information upon which to evaluate the boards of directors and nominating committees of the companies in which they invest, and to make the nominating process more understandable to shareholders.

The proposed rules would expand current proxy statement disclosure to require a statement as to whether the company has a standing nominating committee. Any company that does not have a standing nominating committee must provide a statement as to why its board of directors views it appropriate for the company not to have such a committee, as well as the names of those directors who participate in the consideration of director nominees. In addition, the proposed rules would require each company with a standing nominating committee to provide the following information in its proxy statement:

- a statement as to whether the nominating committee has a charter and, if so, a description of the material terms of the charter and where the charter is available for review (which could be the company's website);
- for each company with securities listed on a national securities exchange or quoted on The Nasdaq National Market, 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 the company is listed or quoted;
- for each company that is not a listed issuer, disclosure as to whether each member of the nominating committee meets the definition of independence of a national securities exchange or of The Nasdaq National Market, and a statement as to which definition the company used (the definition used must be the same for all members of the nominating committee and must be the same definition the company used for determining the independence of its audit committee members);
- a description of the material terms of any nominating committee policy regarding the consideration of any director candidates recommended by shareholders, including a statement as to whether the committee will consider candidates recommended by shareholders and a description of the procedures to be followed by shareholders in submitting such recommendations, or, if the nominating committee does not have such a policy, a statement to that effect;
- a description of any specific minimum qualifications that the nominating committee believes must be met by director candidates recommended by the nominating committee, any specific qualities or skills that the committee believes are necessary for 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 any differences in the manner in which the nominating committee evaluates nominees for director based on whether the nominee was recommended by a shareholder;
- a statement of the specific source, such as the name of an executive officer, director or other person, 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;
- a description of the function performed by any third-party paid by the company to assist in identifying or evaluating potential nominees; and
- if the nominating committee has rejected a candidate put forward by certain large, long-term shareholders (defined as a shareholder or a group of shareholders who beneficially own more than 3% of the company's voting stock for at least one year),

information about the shareholder who recommended the candidate and the specific reason(s) for rejecting the candidate must be provided.

The foregoing rule proposals would apply to the proxy statements of operating companies and investment companies (i.e., mutual funds) alike. The only difference in the rule proposals as they relate to operating companies versus mutual funds is that instead of disclosing whether the members of a mutual fund's nominating committee are independent, the fund would be required to disclose whether such persons are "interested persons" of the fund, as defined in Section 2(a)(19) of the Investment Company Act.

## **II. Disclosure Regarding the Ability of Shareholders to Communicate with the Board of Directors**

In addition to the proposed rules regarding enhanced nominating committee disclosure, the SEC has proposed a number of specific and detailed disclosure requirements regarding communications by shareholders with the board of directors. The stated reason for these rule proposals is the SEC's belief that the requirements are necessary to give shareholders a better understanding of the manner in which they can engage in such communications.

The proposed rules would require that, where action is to be taken with respect to the election of directors, companies include a statement in their proxy materials as to whether the company's board of directors provides a process for shareholders to communicate with the board of directors and, if not, a statement as to why not. If a company has a process for shareholders to send communications to the board of directors, the company must include the following information in its proxy statement:

- a description of the manner in which shareholders can send such communications to the board;
- identification of those board members to whom shareholders can send communications;
- if shareholder communications are not to be sent directly to board members, a description of the company's process for determining which communications will be relayed to the board, including disclosure of the department or other group within the company that is responsible for making such a determination; and
- a description of any material action taken by the board during the proceeding fiscal year as a result of communications from shareholders.

As with the rule proposals regarding enhanced nominating committee disclosure, these rule proposals would apply to operating companies and mutual funds alike.

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We will continue to monitor the SEC's activities for new developments and will keep you apprised of them as they occur. In the meantime, please do not hesitate to contact us if you have any questions.

Godfrey & Kahn Securities Team

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