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Legal Update
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US SEC Approves Nasdaq Rule Amendments Requiring Disclosure of "Golden Leash" Arrangements

On July 1, 2016, the Securities and Exchange Commission (SEC) approved amendments to the listing rules of The Nasdaq Stock Market LLC (Nasdaq) that will require listed companies to disclose compensation paid by third parties to directors or nominees for directors, sometimes referred to as "golden leash" arrangements.[1] Golden leash arrangements are often used by shareholder activists in proxy contests to encourage persons to serve as their director nominees but can arise in other situations. These arrangements vary but may include compensating directors based on achieving certain benchmarks important to the third party, such as an increase in share price over a fixed term.

The amendments arise from Nasdaq's belief that these undisclosed arrangements could raise several concerns, including that they "may lead to conflicts of interest among directors and call into question the directors' ability to satisfy their fiduciary duties" and "may also tend to promote a focus on short-term results at the expense of long-term value creation." Nasdaq believes that enhancing transparency around third-party board compensation would help address these concerns.

The rule is effective August 1, 2016.

Required Disclosure

Nasdaq-listed companies will be required by new rule 5250(b)(3) to disclose the parties to and the material terms of all agreements and arrangements between any director or nominee for director and any third party (other than the company) relating to compensation or other payment in connection with such person's candidacy or service as a director of the company, subject to specified exceptions described below. A company can make this disclosure through its web site or by hyperlinking to another web site that must be continuously accessible. If that web site subsequently becomes inaccessible or that hyperlink inoperable, the company must promptly restore it or make other disclosure in accordance with the rule. Alternately, the company can make the disclosure in its proxy or information statement for the next shareholders' meeting at which directors are elected (or, if the company does not file a proxy or information statement, in its Form 10-K or 20-F).

The terms "compensation" and "other payment" are intended to be construed broadly and include agreements and arrangements that provide for cash compensation, non-cash compensation and other payment obligations, such as health insurance premiums or indemnification, made in connection with a person's candidacy or service as a director.

A company listed on Nasdaq at the effective date of the rule or that initially lists thereafter must make the disclosure no later than the date on which the company files or furnishes a definitive proxy or information statement subject to Regulation 14A or 14C under the Securities

Exchange Act of 1934 (Exchange Act) in connection with the company's next shareholders' meeting at which directors are elected (or, if the company does not file proxy or information statements, no later than when the company files its next Form 10-K or 20-F). The company must make the disclosure at least annually thereafter until the earlier of the resignation of the applicable director or one year following the termination of the agreement or arrangement.

Exceptions

Disclosure is not required for the following agreements and arrangements:

- Those that existed before the nominee's candidacy where the nominee's relationship with the third party has been otherwise publicly disclosed. An example of an agreement or arrangement falling under this exception is a director or a nominee for director being employed by a private equity or venture capital firm, or a fund established by such firm, where employees are expected to and routinely serve on the boards of the fund's portfolio companies and their remuneration is not materially affected by such service. If such a director's or nominee's remuneration is materially increased in connection with such person's candidacy or service as a director of the company, however, only the difference between the new and the previous level of compensation needs to be disclosed under the rule.
- Those that relate only to reimbursement of expenses incurred in connection with a nominee's candidacy as a director, whether or not such agreement or arrangement has been publicly disclosed.
- Those for a director or nominee that have been disclosed in the current fiscal year under Item 5(b) of Schedule 14A of the Exchange Act (relating to proxy contests). Such an agreement or arrangement would be subject to the continuous disclosure requirements on an annual basis, however.
- Those entered into in the current fiscal year that have been disclosed under Item 5.02 of Form 8-K, which requires a brief description of any arrangement or understanding between the new director and any other person, pursuant to which such director was selected as a director. Such an agreement or arrangement would be subject to the continuous disclosure requirements on an annual basis, however.

A foreign private issuer may elect to follow its home country practice provided that the issuer complies with the requirements of Rule 5615(a), which include disclosure of such election and a description of the home country practices.

The rule provides that a company will not be considered deficient if it fails to identify all such agreements and arrangements so long as the company (i) has undertaken reasonable efforts to identify all such agreements and arrangements, including asking each director or nominee in a manner designed to allow timely disclosure and (ii) upon discovery of a non-disclosed agreement or arrangement, promptly makes the required disclosure by filing a Form 8-K or 6-K or by issuing a press release. Regardless of timing, the remedial disclosure does not itself satisfy the ongoing annual disclosure requirements of the rule. If a company is considered deficient, it will have 45 calendar days to submit a plan sufficient to satisfy the Nasdaq staff that the company has adopted processes and procedures designed to identify and disclose relevant agreements and arrangements in the future. If the company does not do so, Nasdaq could issue a delisting determination.

Practical Considerations

Nasdaq-listed companies should:

- Review their director and officer questionnaires to determine if questions need

to be modified or new questions added to elicit information with respect to agreements or arrangements with third parties that may need to be disclosed pursuant to the rule.

- Inform their boards of the new disclosure requirement and that they will be asking directors for this information in connection with the next director and officer questionnaire. This will give all directors adequate time to begin preparing for the new disclosure requirement. Companies should consider revising their corporate governance guidelines to require directors to provide this information.
- If they elect to disclose the existence of agreements and arrangements with third parties by hyperlinking from the company's web site to another web site: Revise their disclosure controls and procedures to ensure that the hyperlink is periodically tested to ensure that it is active and the other web site is accessible.
- If they will need to provide the new disclosures: Determine whether they want to do so through their proxy or information statements (or, if they do not file a proxy or information statement, in their annual reports that they file with the SEC) or by adding information to their web sites. In addition, companies should consider mocking up a draft of the disclosure to allow sufficient time for it to be vetted through all proper internal channels before the information is required to be disclosed.
- If they have advance notice bylaws: Review their bylaws to determine whether they currently require this information to be provided and, if not, consider whether to revise their bylaws to gather this information from any third party seeking to nominate directors to their boards.

Disclosure of director compensation arrangements under the new listing standard does not need to be made at the time the arrangement is entered into. Nasdaq only requires that the disclosure be made at the time of the proxy statement or annual report and annually thereafter.

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Endnotes

[1] Nasdaq's SEC filing proposing the amendments can be found at https://www.sec.gov/comments/sr-nasdaq-2016-013/nasdaq2016013-11.pdf. The SEC order approving the rule amendments can be found at https://www.sec.gov/rules/sro/nasdaq/2016/34-78223.pdf.

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