

PUBLICATION

SEC Approves NASDAQ's Rule Requiring Annual Disclosure of Golden Leashes – Effective August 1, 2016

July 11, 2016

On July 1, 2016, the Securities and Exchange Commission (SEC) issued a release which requires NASDAQ-listed companies to disclose certain compensation or payments made by third parties to directors or director nominees.

The rule change was approved by the SEC on an "accelerated basis," and will become operative August 1, 2016. (Release No. 34-78223, approving NASDAQ's proposed Rule 5250(b)(3)) The rule change is intended to address NASDAQ's concerns regarding golden leash payments that might interfere with a director's independence. "Golden leashes" are payment arrangements made by parties outside of a company (often activist investors seeking to influence director elections) to pay director nominees for their service as a director once elected. The specific terms of golden leashes vary, but often include requirements that the company meet certain profitability or share price milestones before the director receives payment.

Under current NASDAQ rules (and NYSE rules, as discussed below), golden leashes need not be disclosed annually, or in a company's proxy or information statement filings with the SEC. In its amended proposal (the SEC rejected NASDAQ's first proposal on this topic), NASDAQ stated its concerns that "these undisclosed compensation arrangements potentially 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. These arrangements may also tend to promote a focus on short-term results at the expense of long-term value creation."

The new NASDAQ Rule 5250(b)(3) reflects NASDAQ's intention to remedy the foregoing concerns with increased transparency in relation to golden leashes, by requiring NASDAQ-listed companies to publicly disclose the material terms of all agreements and arrangements between any director or nominee and any person or entity (other than the company itself) relating to compensation or other payment in connection with the director or nominee's candidacy or service as a director.

Under the new rule, the required public disclosure of golden leash arrangements may be made on or through the company's website or in the company's proxy statement or information statement for any shareholders' meeting at which directors are elected (or, if the company does not file proxy or information statements, on its Form 10-K or 20-F). A company can make this disclosure available on its own website or by hyperlinking to another website, which must be continuously accessible. If the website becomes inaccessible or the hyperlink inoperable, the company must promptly restore it or make other disclosure in accordance with the rule change. By allowing the required disclosure to be made on a company's website, NASDAQ states its intention to make the burdens of compliance with the new Rule 5250(b)(3) relatively light. In further pursuit of such burden minimization, the new rule also provides means to remedy failures to make a particular required disclosure, as long as the company undertakes reasonable efforts to identify all relevant golden leash arrangements, including by asking each director or nominee in a manner designed to allow timely disclosure and by issuing a press release, 8-K or 6-K under applicable SEC rules that contains any missing disclosure.

The rule change will require companies listed at the time the rule change takes effect, or initially listed thereafter, to disclose all agreements and arrangements by no later than the date on which the company files

or furnishes a proxy or information statements in connection with the company's next shareholders' meeting at which directors are elected (or, if it does not file proxy or information statements, no later than when the company files its next Form 10-K or Form 20-F).

Exceptions to the New Rule

Pursuant to new Rule 5250(b)(3)(E), foreign private issuers may be exempted from these golden leash disclosure requirements in lieu of the use of such issuers' home country practices by utilizing the process set out in new Rule 5615(a)(3).

For both domestic and foreign issuers, the rule change does not separately require the initial disclosure of newly entered into agreements or arrangements, as long as the disclosure is made for the next shareholder meeting at which directors are elected. The new rule also does not require disclosure in instances where:

payment arrangements only relate to reimbursement of expenses incurred in connection with candidacy as a director;

the payment arrangement existed before the nominee's candidacy for director and was publicly disclosed. The definition of such pre-existing arrangements includes payments made to nominees that are employees of the third party; or

the payment arrangement was already disclosed under Item 5(b) of Schedule 14A or Item 5.02(d)(2) of Form 8-K in the current year. However, items disclosed on Schedule 14A or Form 8-K must subsequently be reported annually (at least until the applicable director resigns or one year after the payment arrangement's agreement terminates) under the requirements of the new rule. Companies that provide proxy access rights should also note that this exemption does not extend to disclosures made on Schedule 14N, filed by nominating shareholders.

Overlap with Existing Securities Laws

In its approving release, the SEC recognizes that the NASDAQ's new rule has some overlap with existing securities laws beyond the Form 8-K and Schedule 14A items that are expressly recognized in the new NASDAQ rule (as discussed above), such as: Items 401(a) and 402(k) of Regulation S-K; Section 6(b)(5) of the Securities Exchange Act of 1934, as amended; and Rules 10b-5, 14a-9 and 14c-6 under the Securities Exchange Act of 1934, as amended.

In supporting its position that the new NASDAQ rule is allowable because it could require disclosure in scenarios that would not otherwise require disclosure under certain SEC rules, the SEC reiterated its policy of allowing national exchanges to broaden or supplement the SEC rules, and stated the SEC's belief that the new NASDAQ rule provides "investors and market participants additional information to make informed investment and voting decisions."

New York Stock Exchange Corollary

In 2013, both NASDAQ and the New York Stock Exchange (NYSE) adopted new listing standards (as required by under the Dodd-Frank Wall Street Reform and Consumer Protection Act and SEC Rule 10C-1 under the Securities Exchange Act of 1934, as amended) that were designed to promote the independence of certain board members, such as compensation committee members. Commentary to NYSE's proposal relating to

such 2013 rule changes advised public companies' boards to consider "compensation from any person or entity that would impair [a director's] ability to make independent judgments about the listed company's executive compensation."

Despite the receipt of such commentary, the NYSE has not adopted a similar rule relating to golden leash disclosure to date. Of course, we will provide updates if the NYSE reacts to the NASDAQ's new rule.

Conclusion

The new NASDAQ rule is a reminder to all companies, not just those listed on the NASDAQ, that rigorous procedures must be implemented to disclose all forms of director compensation, to ensure fair and fulsome information to the public. For example, all public companies should ensure that their officers and directors complete annual questionnaires covering such topics as the golden leash disclosures required by the NASDAQ's new rule. NASDAQ-listed companies in particular should also coordinate with the parties responsible for their websites in order to implement systems for posting required disclosures pursuant to the new rule. By timely inquiring into golden leash-like compensatory arrangements, public companies may anticipatorily protect themselves from potential future litigation for failure to disclose such information.

The new rule is also a cautionary reminder for any person or entity outside of a company planning to enter into arrangements with directors or director nominees to be very careful in structuring and disclosing golden leashes, so that such director's companies are not harmed, or even delisted, as a result of a failure to disclose golden leash compensatory arrangements.

For more information on how this may affect your business or related matters, contact any member of the Firm's Corporate Finance and Securities Group.