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SEC Approves NASDAQ's 'Golden Leash' Disclosure Rule

On July 1, 2016, the Securities and Exchange Commission (SEC) approved changes to the NASDAQ Listing Rules that will now require every NASDAQ-listed company to publicly disclose all agreements made between third parties and directors in connection with service or candidacy on a company's board of directors, also known as "golden leash" agreements. The rulemaking process first began on March 15, 2016, when NASDAQ filed the proposed rule change, which was published for comment in the Federal Register on April 5, 2016. On May 18, 2016, NASDAQ filed Amendment No. 1 to the proposal, which resulted in the Commission extending the time period within which it could approve or disapprove of the proposed rule change. On June 30, 2016, NASDAQ withdrew Amendment No. 1 and filed Amendment No. 2 to replace and supersede the original proposal in its entirety, which was then approved by order by the SEC and will go into effect as of Aug. 1, 2016.

The new rule creates Rule 5250(b)(3), which requires each NASDAQ-listed company to publicly disclose the material terms of all agreements or arrangements between any director or nominee for director on the company's board and any person/entity other than the company relating to compensation or other payment in connection with the person's candidacy or service as a director.

NASDAQ's proposal is based on a view that undisclosed third-party compensation arrangements for directors raise concerns relating to conflicts of interest and a concern that they may create a focus on short-term results as opposed to long-term value. The newly approved rules seek to mitigate these concerns by making these arrangements more transparent. Some opponents of the rule insisted that the SEC rules already require disclosure of similar information and the new rule changes are thus redundant and unnecessary. However, the SEC noted that it is not unusual to adopt disclosure requirements in listing rules that supplement or overlap with other disclosure requirements otherwise imposed under federal securities law to ensure transparency.

The new rules further require disclosure by 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 (Act), in connection with the company's next shareholders' meeting at which directors are elected so that such concerns will be

known to shareholders.

All listed companies will be required to disclose this information either on or through the company's website or in the definitive proxy or information statement for the next shareholders' meeting at which directors are elected. Companies should begin coordinating with web development and information technology teams to prepare their company websites for the required disclosures.

The proposal does, however, carve out exceptions for circumstances when a company does not need to make disclosure of such agreements or arrangements. These situations include circumstances in which the agreements:

- Relate only to reimbursement of expenses in connection with candidacy as a director;
- Existed prior to the nominee's candidacy and the nominee's relationship with the third party has been publicly disclosed in a definitive proxy, information statement or annual report. For example, a director or nominee that is employed by a private equity or venture capital firm, whose employees are expected to, and who routinely, serve on the boards of directors of the firm's portfolio companies and whose remuneration is not materially affected. However, if that director's remuneration is materially increased, then this arrangement must be disclosed;
- Have been disclosed under Item 5(b) of Schedule 14A of the Act or Item 5.02(d)(2) of Form 8-K in the current fiscal year. However, such disclosure, pursuant to the provisions under Schedule 14A and Form 8-K would not relieve a company of its disclosure obligations under the rule.

For situations where disclosure is required, companies must make these disclosures at least annually until the earlier of the resignation of the director or one year following the termination of the agreement or arrangement.

If a company discovers an agreement or arrangement that should have been disclosed but was not, then the company must promptly make the required disclosure by filing a Form 8-K or 6-K, where required by SEC rules, or by issuing a press release. However, this remedial disclosure does not satisfy the annual disclosure requirements under the proposed rule, which the company still must comply with.

The new rules also provide that if a company undertakes reasonable efforts to identify all such agreements or arrangements, including asking each director or nominee in a manner designed to allow timely disclosure, and makes the required remedial disclosure promptly if it discovers an agreement that should have been disclosed, then the company will not be considered deficient with respect to the rule. Companies will now have to determine what constitutes "reasonable efforts" to ensure compliance with the new rules. Accordingly, NASDAQ-listed companies should review their director and officer questionnaires to confirm that the scope of the questions within these questionnaires captures all "golden leash" arrangements that fall under the new rules. Companies that are considered deficient under the new rule will have 45 calendar days to submit a remedial plan to the satisfaction of NASDAQ in order to regain compliance.

Foreign Private Issuers

In addition to the adoption of Rule 5250(b)(3), the proposal also amends NASDAQ Listing Rule 5615 which permits foreign private issuers to follow their home country practice in lieu of certain corporate governance requirements applicable to domestic companies. Under the amended rule, the required disclosure of third-party payments to directors will now be included among the rule provisions where foreign private issuers are permitted to follow home country practice. To meet these conditions, foreign private issuers must submit to NASDAQ a written statement from an independent counsel in its home country certifying that the company's practices are not prohibited by the home country's law. The issuer is then required to disclose in its annual filings with the Commission that it does not follow the proposed rule's requirements and to briefly list the home country practice in lieu of these requirements.

Conclusion

These new NASDAQ rules are intended to provide investors with greater transparency regarding compensation paid or other payments made by third parties to directors or director nominees. The Commission provided a revised date of effectiveness of thirty days after this approval in order to allow all NASDAQ-listed companies time to comply with the new

requirements. Although there has been no official announcement yet, New York Stock Exchange listed companies might find themselves facing similar rule changes in the future.

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