July 8, 2016

SEC Approves Nasdaq's Disclosure Rule on "Golden Leashes"

On July 1, 2016, the Securities and Exchange Commission approved, on an accelerated basis, Nasdaq's proposal to require listed companies to publicly disclose compensation or other payments by third parties to director and director nominees in connection with that person's candidacy or service as a director (so-called "golden leash" arrangements). In a typical golden leash arrangement, an activist stockholder would compensate its nominee(s) for service on the board based on certain company or stock performance criteria.

New Nasdaq Rule 5250(b)(3) will require listed companies to publicly disclose, at least annually, the parties to, and the material terms of, all agreements and arrangements between any director or nominee and any person or entity, other than the company, relating to compensation or other payments in connection with candidacy or service as a director. A company may make this disclosure on its website (or through it by hyperlinking to another website) or in its 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, in its Form 10-K or Form 20-F). Disclosure made available via a website must be continuously accessible.

Through this new disclosure rule, Nasdaq intends to address concerns arising from these (potentially) undisclosed golden leash arrangements, including that such arrangements may lead to conflicts of interest or could promote "short-termism" at the expense of long-term value creation. The new rule does not prohibit such arrangements.

The rule also does not require the disclosure of any agreements and arrangements that:

- relate only to reimbursement of expenses in connection with candidacy as a director (whether or not such reimbursement arrangement has been publicly disclosed);
- existed prior to the nominee's candidacy (including as an employee of the other person or entity), and where the nominee's relationship with the third party has been publicly disclosed in a proxy or information statement or annual report (such as in the director or nominee's biography); or
- have been disclosed under Item 5(b) of Schedule 14A of the Securities Exchange Act or Item 5.02(d)(2) of Form 8-K in the current fiscal year (such disclosure pursuant to SEC rules, however, will not relieve a company of its ongoing, annual disclosure obligation).

Safe Harbor, Deficiencies and Remedial Disclosures

The rule provides that a company will not be considered deficient with the new requirements if the company has taken reasonable efforts to identify all relevant agreements and arrangements, including by asking each director or nominee in a manner designed to allow timely disclosure, and, upon discovery of an undisclosed agreement or arrangement, promptly makes the required remedial disclosure. Accordingly, listed companies should review their director and officer questionnaires to confirm that the scope of the questions asked captures golden leash arrangements.

In the event that a company discovers an agreement or arrangement that should have been disclosed under the rule, the company must promptly disclose the material terms of the previously undisclosed agreement or arrangement by filing a Form 8-K or Form 6-K or by issuing a press release. The rule does not appear to permit remedial disclosures to be made through a company's website.

If a company is considered deficient, in order to regain compliance, the company must submit a plan to the Nasdaq staff that demonstrates that it has adopted processes and procedures designed to identify and disclose relevant agreements and arrangements in the future.

Foreign Private Issuers

A foreign private issuer that is listed on the Nasdaq would be permitted to follow its home country practice in lieu of the new requirements so long as the foreign private issuer complies with the conditions set forth in Nasdaq Rule 5615. To meet the conditions of Rule 5615, a foreign private issuer is required to (i) submit a written statement to Nasdaq from independent counsel in its home country certifying that the company's practices are not prohibited by the home country's laws, and (ii) disclose in its annual SEC filings (e.g., on Form 20-F or 40-F) or, in certain circumstances, on its website that it does not follow the new requirements and briefly state the home country practice it follows in lieu of such requirements.

Implications for Listed Companies with Proxy Access or Advance Notice Bylaws

A listed company that has adopted a bylaw providing its shareholders with a "proxy access" right should be aware that the new rule does not technically relieve the company from disclosing relevant third-party compensation agreements or arrangements even if they have been disclosed in a Schedule 14N filed by the nominating shareholder (or nominating shareholder group). While the new rule provides an exception for information regarding such arrangements disclosed in a Schedule 14A by persons soliciting proxies in opposition to a company's proxy solicitation, the rule does not contain an exception for similar information that has been disclosed in a Schedule 14N. As a result, the absence of such an exception might result in an incremental reporting burden for listed companies but should not present a significant compliance obstacle for them so long as the proxy access bylaws require comprehensive information for proxy access nominees (including, for example, the completion of a director's questionnaire) that should enable them to make the required disclosure for any relevant third-party compensation agreements or arrangements.

A typical advance notice bylaw also generally will require information for director nominees similar to the requirements for proxy access nominees. A listed company with an advance notice bylaw, however, will be able to benefit from the above-described exception in Nasdaq's disclosure rule.

Timing and Effectiveness

The new rule will become effective on August 1, 2016. Listed companies (and companies that are initially listed after the rule's effective date) must initially disclose all agreements and arrangements in accordance with the new rule by no later than the date on which the company files or furnishes a proxy or information statement subject to Regulation 14A or 14C under the 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 Form 20-F). Thereafter, a listed company is required to annually disclose this information until the earlier of the resignation of the director or one year following the termination of the compensation agreement or arrangement.

Practice Tips

Review D&O questionnaires to confirm that the scope of the questions asked captures golden leash arrangements and coordinate with web development teams to prepare corporate websites for required disclosures.

If you have any questions or would like to learn more about this rule, please contact your usual legal advisor at Ropes & Gray.