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## NASDAQ Adopts Rule Requiring Disclosure of Golden-Leash Arrangements

By [Brian R. Rosenau](#)

On July 1, 2016, the Securities and Exchange Commission (SEC) approved a change to the NASDAQ Stock Market LLC's (NASDAQ's) Listing Rules that will now require NASDAQ-listed companies to publicly disclose so-called golden-leash arrangements. Golden-leash arrangements generally are defined as agreements or arrangements made by activist shareholders to pay a director or director nominee in connection with his or her service on, or candidacy for, a company's board of directors, usually in connection with a proxy fight. In a typical arrangement, a director or nominee is entitled to receive certain compensation directly from the relevant activist shareholder if the company's stock price performs in a certain manner over a specific time period. The final rule relating to this change became effective August 1, 2016, and may be found [here](#).

In recent years, golden-leash arrangements have generated significant debate among U.S. market participants. Activists that utilize this type of compensation arrangement argue that it is necessary to attract high-quality director candidates and that it aligns the relevant director's interests with those of shareholders. Opponents of this type of arrangement argue that it

may lead to conflicts of interest among directors, that it casts doubt on a director's ability to satisfy his or her fiduciary duties, and that it leads to a focus on short-term results as opposed to long-term value creation. Some public company opponents have even revised their bylaws to include provisions prohibiting their directors from receiving certain types of compensation from third parties.

In light of the public debate regarding this issue and the impact that this type of compensation arrangement may have on public-company boards, NASDAQ determined that it was "appropriate and timely to consider issues raised by third party payments to directors for board service," and that it would be beneficial to implement a rule requiring public disclosure of this type of compensation arrangement. In enacting such a rule, NASDAQ believes that the enhanced transparency around this type of arrangement will both alleviate some of the concerns that opponents may have and also benefit investors by making available information that may be relevant for purposes of their investment and voting decisions.

The final rule that was approved by the SEC requires NASDAQ-listed companies to publicly disclose on their website or in

their definitive proxy or information statement for any shareholders' meeting at which directors are elected (or, if they do not file proxy or information statements, their Annual Report on Form 10-K or 20-F) the material terms of, and the parties to, all agreements and arrangements between any director or nominee for director and any person or entity (other than the listed company) relating to compensation or other payment in connection with that person's candidacy or service as a director. A company may make the required disclosure through its website by hyperlinking to another website, so long as that other website is continuously accessible. If that other website becomes inaccessible, or the hyperlink thereto becomes inoperable, the company must either promptly restore it or make other disclosure in accordance with the final rule.

The terms "compensation" and "other payment" as used in the final rule are meant to be construed broadly and, accordingly, apply to noncash compensation and other payment obligations, such as health insurance premiums and indemnification obligations. The final rule applies to agreements or arrangements irrespective of whether the right to nominate the applicable director or

nominee legally belongs to the third party making the payment.

A company that was listed on NASDAQ on August 1, 2016, or that initially lists on NASDAQ thereafter is required to disclose all agreements and arrangements in accordance with the final rule by no later than the date on which it files a definitive proxy or information statement in connection with its next shareholders' meeting at which directors are elected (or, if it does not file proxy or information statements, no later than when it files its next Annual Report on Form 10-K or 20-F). Thereafter, the company must make the required disclosures at least annually until the earlier of the resignation of the applicable director or one year following the termination of the agreement or arrangement.

There are a number of exceptions to the final rule. Specifically:

- Agreements or arrangements that existed before the nominee's candidacy (including as a result of an employment relationship) where the nominee's relationship with the applicable third party has been publicly disclosed in a definitive proxy or information statement or annual report (for example, in a director's biographical summary) need not be disclosed. NASDAQ specifically provided an example of an agreement or arrangement that would fall under this exception as a director or nominee that is employed by a private equity or venture capital firm, or fund established by that firm, whose employees are expected to, and who routinely, serve on the boards of directors of the firm's or fund's portfolio companies and whose remuneration is not materially affected by that service. However, if that director's or nominee's remuneration is materially increased in connection with that person's candidacy or service as a director, the difference between the new and previous level of compensation must be disclosed under the final rule.
- Agreements or arrangements that relate only to the reimbursement of expenses

incurred in connection with candidacy as a director need not be disclosed, regardless of whether that reimbursement arrangement has otherwise been publicly disclosed.

- SEC rules subject persons soliciting proxies in opposition to a company's proxy solicitation to certain disclosure requirements. Where an agreement or arrangement for a director or nominee is disclosed pursuant to those disclosure requirements, a company is relieved from the initial disclosure requirements of the final rule, but thereafter remains subject to the final rule's annual disclosure requirements.
- If a company provides disclosure under the requirement in Item 5.02(d)(2) of Form 8-K to provide "a brief description of any arrangement or understanding between [a] new director and any other persons, naming such persons, pursuant to which such director was selected as a director," it is not required to satisfy the initial disclosure requirements under the final rule. However, the applicable agreement or arrangement remains subject to the annual disclosure requirements of the final rule.
- If certain conditions are met, a foreign private issuer may elect to follow its home country practice in lieu of the requirements of the final rule.

It will not be a violation of the final rule if a NASDAQ-listed company fails to make a particular required disclosure, so long as the company undertakes 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 promptly makes any required disclosures that it discovers should have been made by filing a Form 8-K or 6-K, where required by SEC rules, or by issuing a press release. However, such remedial disclosure, regardless of its timing, will not satisfy the ongoing annual disclosure requirements under the rule. If a listed company is deemed deficient with respect to the disclosure obliga-

tions under the final rule, it has 45 days to submit a plan to regain compliance sufficient to satisfy NASDAQ's staff that it has adopted processes and procedures designed to identify and disclose relevant agreements and arrangements in the future. If the listed company does not do so, it will be issued a delisting determination.

The final rule is not without its critics. For example, both the Business Council of New York State and the Securities Regulation Committee of the Association of the Bar of the City of New York wrote comment letters to the SEC opposing the rule. In both instances, these organizations argued: (a) that federal securities laws already require disclosure of this type of agreement or arrangement; (b) even if disclosure of this type of agreement or arrangement is not sufficiently covered by existing regulations, it is more appropriate for the SEC, as opposed to NASDAQ, to address that issue through its rulemaking; and (c) the rule provides shareholders of NASDAQ-listed companies with different information than shareholders of New York Stock Exchange-listed companies receive. NASDAQ responded that the concerns raised by these two organizations did not warrant disapproval of the rule and noted specifically that the final rule addresses potential duplicative disclosure issues and that, although certain current disclosure regulations promulgated by the SEC may require disclosure of third-party director payments in certain circumstances, "the nature, scope and timing of these required disclosures may not in all cases be the same as the disclosure mandated by [the NASDAQ rule], including for example ongoing annual and remedial disclosure." Ultimately, the SEC agreed with NASDAQ and approved the rule.

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