SEC Approves Nasdaq Rule Change to Require “Golden Leash” Disclosure

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Summary of the Rule

New Nasdaq Rule 5250(b)(3), effective as of August 1, 2016, will require each Nasdaq-listed company to publicly disclose the parties to, and the material terms of, all agreements or arrangements between any director or director nominee and any person or entity other than the company relating to compensation or other payment in connection with that person’s candidacy or service as a director. The disclosure requirement is not limited to cash payments, but, instead, is intended to be construed broadly; it also encompasses noncash compensation and other forms of payment obligation, such as indemnification and health insurance premiums. Disclosure may be made either on the company’s website (directly or through a hyperlink to another website, provided that the other website is continuously accessible) or in its definitive proxy or information statement for the next 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).

The rule will require each Nasdaq-listed company to disclose all such agreements and arrangements by no later than the date on which the company files its definitive proxy or information statement for the 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). Thereafter, the company must make the disclosure required by the rule at least annually until the earlier of the resignation of the applicable director or one year following the termination of the agreement or arrangement.

Exceptions

The rule provides that a company will not need to make disclosure of agreements and arrangements that:

i. relate to only reimbursement of expenses in connection with candidacy as a director, whether or not such reimbursement arrangement has been publicly disclosed

ii. existed prior to the nominee's candidacy (including as an employee of the other person or entity), where the nominees' relationship with the third party has been publicly disclosed in a definitive proxy or information statement or annual report (such as in the director or nominee's biography)

iii. have been disclosed under Item 5(b) of Schedule 14A of the Securities Exchange Act of 1934, as amended (the Exchange Act), or Item 5.02(d)(2) of Form 8-K in the current fiscal year. However, the applicable agreement or arrangement would still be subject to the continuous disclosure requirements of the rule on an annual basis

Nasdaq provides that an example of an agreement or arrangement falling under the exception in clause (ii) for arrangements that existed prior to the nominee's candidacy is a director or director nominee being employed by a private equity or venture capital fund where employees are expected to serve, and routinely serve, on the boards of the fund's portfolio companies, and their remuneration is not materially affected by such service. However, if such a director or a director nominee's remuneration is materially increased in connection with such person's candidacy or service as a director of the company, the difference between the new and the previous level of compensation needs to be disclosed under the rule.

Deficient Disclosure

The rule states that, if a company discovers an agreement or arrangement that should have been disclosed pursuant to the proposed rule, but was not disclosed, 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, such remedial disclosure, regardless of its timing, would not satisfy the annual disclosure requirements under the rule.

The rule further provides that, if a company undertakes reasonable efforts to identify all such agreements or arrangements, including asking each director or director nominee in a manner designed to allow timely disclosure, and the company makes the required remedial disclosure promptly once it discovers an agreement or arrangement that should have been disclosed, but was not, then the company will not be considered deficient with respect to the rule.

In cases where a company is considered deficient, in order to regain compliance, the company must provide a plan within 45 calendar days that is sufficient to satisfy 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, it will be issued a delisting determination.

Foreign Private Issuers

Nasdaq is also amending Rule 5615(a)(3), which permits foreign private issuers listed on Nasdaq to follow their home-country practice in lieu of certain corporate governance requirements of Nasdaq, provided that the issuer fulfills the conditions set forth in that rule. The required disclosure of third-party payments to directors will be included among the rule provisions where a foreign private issuer would be permitted to follow home-country practice. To meet the conditions of amended Rule 5615(a)(3), a foreign private issuer is required to, among other things, (i) 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 laws and (ii) disclose in its annual filings with the SEC (or, in certain circumstances, on its website) that it does not follow the rule's requirements and briefly state the home-country practice that it follows in lieu of these requirements.

Rationale for the Rule

Nasdaq proposed the rule change due to its concern that investors may not have complete information regarding when third parties compensate directors in connection with that person's candidacy or service as a director. Nasdaq believes 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.

Nasdaq believes that enhancing transparency around third-party board compensation would help address these concerns and would benefit investors by making available information that is potentially relevant to investment and voting decisions. Nasdaq further believes that the disclosure would not create meaningful burdens on directors or those making these payments, nor on the companies required to make the disclosure. Apart from this this rule, Nasdaq noted in its proposal that it is surveying interested parties as to whether these third-party payments should prohibit directors from being considered independent under Nasdaq rules or disqualify these directors from serving on the board altogether. Nasdaq confirmed that no decision regarding whether to propose additional rules has been made at this time.

The SEC found that the rule change is consistent with the requirements of Section 6(b)(5) of the Exchange Act, which requires, among other things, that Nasdaq's rules be designed to prevent fraudulent and manipulative acts and practices; to promote just and equitable principles of trade; to remove impediments to, and perfect the mechanism of, a free and open market and a national market system; and, in general, to protect investors and the public interest, and not be designed to permit, among other things, unfair discrimination between issuers.

The SEC stated that the development, implementation, and enforcement of standards governing the initial and continued listing of securities on an exchange are activities of critical importance to financial markets and the investing public. Listing requirements, among other things, serve as a means for an exchange to provide listed status only to companies that meet certain initial and continued quantitative and qualitative criteria that help to ensure that fair and orderly markets can be maintained once the company is listed. The SEC believes that the corporate governance standards embodied in the listing standards of national securities exchanges, in particular, play an important role in ensuring that exchange-listed companies observe good governance practices, including that listed companies provide adequate disclosure to allow investors to make informed investment and voting decisions. The SEC further stated that it has long encouraged exchanges to adopt and strengthen their corporate governance listing standards in order to, among other things, provide greater transparency into the governance processes of listed issuers and enhance investor confidence in the securities markets.

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