

## SEC's adoption of NASDAQ "Golden Leash" rule goes into effect



| Friday, August 12, 2016

### What is a "Golden Leash"?

The term "Golden Leash" comes from a perceived insurgence of payments made by third-party activist shareholders to board nominees and directors as remuneration for their voice and agenda being represented on the board. According to the Securities and Exchange Commission (SEC), the increasing popularity of these arrangements has given rise to criticism and concern that these relationships will cause directors to compromise fiduciary duties to the company and promote short-term results over long-term company value. Thus, the SEC chose to approve NASDAQ's proposed rule.

### When does the SEC/NASDAQ Golden Leash rule become effective?

On August 1, the SEC's adoption of the NASDAQ "Golden Leash" rule became effective. The rule requires listed companies to disclose third-party compensation of any nominee or director (i.e., companies must disclose their "Golden Leash" arrangements).

### What does the rule require?

The New Listing Rule 5250(b)(3) requires any listed company to disclose any compensatory arrangement between one of its nominees or directors and a third party in connection with that person's candidacy or service as a director. The rule takes a broad view on what is considered a compensatory arrangement and includes cash payments, equity arrangements, indemnification coverage and payments, and benefit premium payments. If such an arrangement exists, the company is required to disclose its existence and all material terms. The company is required to disclose this information either on its website, in its proxy or shareholder meeting information statement, or in a Form 10-K or 20-F if the company does not file a proxy statement. If the information is provided on the company's website it must be continually accessible. The disclosure must be made no later than the date the company furnishes its proxy or information statement in preparation for its next shareholders' meeting. The rule also provides exceptions where disclosure of a Golden Leash arrangement is not required, including: agreements to reimburse the nominee or director for expenses in connection with his or her candidacy; where there is a pre-existing relationship disclosed, pre-dating the director nominee's candidacy; and where the arrangement has been disclosed under the company's proxy or 8-K filings during the current fiscal year. The exception for pre-existing relationships is designed to protect directors and nominee directors employed by private equity and venture capital firms, and funds set up by those firms, which routinely have employees serve on the boards of their portfolio companies. The disclosure of an ongoing third-party compensation relationship must continue on an annual basis until the earlier of the resignation of the director or one year after the termination of the arrangement.

### What happens if a company fails to disclose a Golden Leash relationship?

If a company discovers a third party arrangement that should have been disclosed but was not, the company must promptly make the disclosure via an 8-K or 6-K SEC

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filing, or issue a press release. If the company has undertaken reasonable efforts to identify all Golden Leash arrangements, which includes asking each director and giving him or her enough time to disclose, the company will not be deemed deficient. Any remedial disclosure will need to be made in addition to the yearly disclosure requirement. If the company is found to be deficient, the rule requires it to submit a plan to reestablish compliance within 45 calendar days. If the company fails to provide such a plan, NASDAQ will issue a Staff Delisting Determination, which can be appealed to a hearings panel.

### **What should companies do to comply with the new rule?**

Companies should ensure to update their Director and Officer Questionnaire to confirm that the questions appropriately capture potential Golden Leash arrangements. In addition, companies should consider how they will incorporate these disclosures into their regular reporting routines, whether by including these annually in proxy statements, on an ad hoc basis on Form 8-Ks, or continually updating their website.