Client Alert

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SEC Approves Nasdaq Rule Requiring Public Disclosure of Payments to Directors by Third Parties

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In March 2016, the Nasdaq Stock Market LLC ("Nasdaq") proposed new rules regarding disclosure of third-party compensation of directors. This third-party compensation, which may not be publicly disclosed, arises when a party other than the issuer, such as an activist investor, compensates a person in connection with that person's candidacy for director or service as a director.

With the goal of enhancing transparency around such third-party compensation of directors, Nasdaq proposed Rule 5250(b)(3), which would require Nasdaq-listed companies to publicly disclose compensation or other payments by third parties to nominees for director or board members. On July 1, 2016, the Securities and Exchange Commission (SEC) approved this rule change, which will become effective on August 1, 2016.

WHAT DISCLOSURE IS REQUIRED?

New Rule 5250(b)(3) requires disclosure of the material terms of all agreements and arrangements between any director or nominee and any person or entity other than the company (a "Third Party") relating to compensation or other payment in connection with a nominee's candidacy for director or for a director's service as a director. At a minimum, the disclosure must identify the parties to the agreement or arrangement, as well as the material terms of the agreement or arrangement. The terms "compensation" and "other payment," as used in new Rule 5250(b)(3), are not intended to be limited to cash payments; rather, those terms are to be construed broadly and will apply to agreements and arrangements that provide for "non-cash compensation and other payment obligations, such as health insurance premiums or indemnification, made in connection with a person's candidacy or service as a director."

Nasdaq's proposal recognized the potential breadth of the new requirement, as well as the significant potential for overlap with existing SEC disclosure requirements (e.g., the disclosure required by Items 401(a) and 402(k) of Regulation S-K, Item 5(b) of Schedule 14A, and Item 5.02(d) of Form 8-K). Accordingly, Nasdaq provided in new Rule 5250(b)(3) that a listed company need not make disclosure of agreements and arrangements that:

- relate only to reimbursement of expenses in connection with candidacy as a director;
- existed prior to the nominee's candidacy (including as an employee of the other person or entity) and the nominee's relationship with the Third Party has been publicly disclosed, such as in the director's or nominee's biography in a definitive proxy or information statement or annual report—in this regard, if the nominee's or director's remuneration is thereafter materially increased in connection with such person's

candidacy or service as a director of the company, the difference between the new and previous levels of compensation must be disclosed; or

- have been disclosed under Item 5(b) of Schedule 14A (i.e., interests of certain persons in connection with a proxy contest) or Item 5.02(d)(2) of Form 8-K (i.e., interests of certain persons in connection with a proxy contest) in the current fiscal year—in this regard, this disclosure will not relieve a listed company of its Rule 5250(b)(3) obligation to make annual disclosure in future years.

WHEN AND WHERE MUST NASDAQ-LISTED COMPANIES MAKE THIS DISCLOSURE?

New Rule 5250(b)(3) will apply to companies that are listed at the time the rule becomes effective or companies that become listed after that effective date. As discussed below, the rule provides for special treatment of listed foreign private issuers.

The disclosure required by the new rule is to be provided either through SEC filings or the listed company's website, as follows (subject to the exceptions for previously disclosed information discussed above):

- *If the disclosure is to be made through SEC filings*—The initial required disclosure must be included in the company's definitive proxy statement or information statement for its next shareholders' meeting at which directors are elected after the effective date (or, if a listed company does not file proxy or information statements, in its next Form 10-K or Form 20-F).
- *If the disclosure is to be made through the listed company's website*—The listed company may provide the required disclosure on its own website or through a website by hyperlinking to another "continuously accessible" website. A company posting the requisite disclosure on or through its website must make the initial required disclosure publicly available no later than the date on which the company files a proxy or information statement in connection with a shareholders' meeting at which directors are to be elected (or, if a listed company does not file proxy or information statements, no later than when the company files its next Form 10-K or Form 20-F).

After the initial disclosure discussed above, a listed company must make this disclosure at least annually until the earlier of (i) the resignation of the director or (ii) one year following termination of the agreement or arrangement. Under the new rule, listed companies are not required to make disclosure upon entry into subject agreements or arrangements; however, the required disclosure must be made for the next shareholders' meeting at which directors are elected.

Remedial Disclosure. Rule 5250(b)(3) further states that if a listed company discovers an agreement or arrangement that should have been disclosed pursuant to the rule but was not, the company must promptly make the required disclosure by filing a Form 8-K or Form 6-K, where required by SEC rules, or by issuing a press release.

Such remedial disclosure, regardless of its timing, will not satisfy the ongoing obligation under the rule to provide annual disclosure. However, a company will not be considered deficient under the rule if it (i) has undertaken reasonable efforts to identify all such agreements or arrangements, including asking each director or nominee in a manner designed to allow timely disclosure, and (ii) makes the required remedial disclosure promptly if it

discovers an agreement or arrangement that should have been disclosed but was not. If a company is determined to be deficient, the company must submit a plan to Nasdaq demonstrating that it "has adopted processes and procedures designed to identify and disclose relevant agreements or arrangements."

HOW DOES THE DISCLOSURE REQUIREMENT APPLY TO LISTED FOREIGN PRIVATE ISSUERS?

The rule also amends Nasdaq Rule 5615(a)(3). This amendment permits foreign private issuers to follow their home country practice in lieu of the requirements of Rule 5250(b)(3), provided that the foreign private issuer (i) submits 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) discloses 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 states the home country practice it follows in lieu of the rule's requirements.

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