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Spotlight on 'Golden Leash' Pay, Perks

By Amanda Gerut July 25, 2016

Nasdaq's new "golden leash" disclosure rule is intended to elicit additional details of compensation paid to activist-nominated directors who serve on boards, including whether they are paid with golf club memberships, car allowances and tickets to the opera — compensation commonly classified as perquisites. Experts say such arrangements are rare, and that therefore a torrent of information about previously unheard-of arrangements is unlikely.

According to the rule, Nasdaq-listed companies must disclose the material terms and arrangements between a director or director nominee and any person or entity other than the company relating to compensation or other payment in connection with the director's candidacy or board service. Nasdaq says that the disclosure requirement also pertains to non-cash compensation and is meant to be "construed broadly." The exchange listed examples such as health insurance premiums and indemnification in addition to cash and equity as payments that qualify.

Third-party compensation arrangements, while scarce, are highly controversial and draw strong opinions from proponents and opponents alike. Even the colloquial term "golden leash," which implies that a director with such an arrangement in place is tethered to the shareholder that nominated the director via compensation, can raise eyebrows. Golden leash payments have been the subject of articles, panel discussions and debates in recent years as more shareholder activists have sought to nominate directors to serve on boards. Many companies have settled with activists after being targeted, which has led to a rise in the number of directors who haven't traveled the typical route of joining a board.

Activist Campaigns With Golden Leash Payments Are Rare

Year	Company	Activist
2008	CNET Networks	Jana Partners, Sandell Asset Management, Spark Capital Partners LLC, Velocity Interactive Management, Alex Interactive Media
2012	Forest Laboratories	Carl Icahn
2012	Office Depot	Starboard Value LP
2013	Hess Corporation	Elliott Management
2013	Hess Corporation	Relational Investors LLC
2014	The Dow Chemical Company	Third Point LLC
2015	General Motors	Harry Wilson, Appaloosa Management, Taconic Capital Advisors, Hayman Capital Management, HG Vora

Source: FactSet

Nasdaq's rule formalizes the requirement of disclosure of third-party compensation arrangements for companies listed on the exchange, and clarifies where such disclosures will appear. Governance observers say the disclosure rule will help quell at least some of the speculation and uncertainty that exists regarding the extent and scope of such arrangements.

"I think there was a feeling that people might not have appreciated that these things needed to be disclosed," explains **Doug Chia**, executive director of the governance center at **The Conference Board**. "Some companies didn't know what was going on in terms of whether these directors were being paid extra or not."

Practically speaking, the new rule means that directors of both Nasdaq- and **NYSE**-listed companies are likely to see one or more additional questions on the topic in D&O questionnaires this year. The rule requires that companies undertake good-faith efforts to identify all third-party arrangements. The disclosure must be included in the company proxy or on the company's website. Nasdaq's rule was approved by the SEC on July 1 and takes effect next month.

Defining 'Golden Leash'

According to **FactSet**, there have only been eight arrangements from 2012 to 2016 that the data firm considers to be golden leash payments in place among U.S.-based companies. All eight arrangements involve activist campaigns that have been highly publicized, including those between **Hess** and **Elliott Management**; **General Motors** and **Harry Wilson**; and **CNET Networks** and **Jana Partners** and other investors.

Adding a layer of complexity to the golden leash debate is the fact that different constituencies have differing definitions of what constitutes a golden leash arrangement. For instance, well-known activist **Carl Icahn** targeted **AIG** and settled with the company in February. Two directors, **Courtney Mather** and **Samuel Merksamer**, joined the AIG board as part of the settlement. Merksamer and Mather are employees of Icahn Capital, and while neither receives special compensation in connection with proxy solicitation, both are entitled to one-time lump sum payments at the end of the term of their respective employment agreements. The payments are equal to between 0.625% and 1.0% of the net profits generated by a portfolio of investment positions, which includes AIG, according to a Feb. 1 disclosure. Given that Mather and Merksamer earn compensation for serving on the board on behalf of **Icahn**

Capital on top of what they earn as board members, some governance observers consider the lump sum payments to be golden leashes.

However, FactSet doesn't classify such payments as golden leashes, and the payments are unlikely to be classified as such under Nasdaq's rule. Additionally, as an NYSE-listed company, AIG isn't subject to Nasdaq's listing requirements. NYSE did not comment on whether a similar disclosure on third-party compensation arrangements would be forthcoming.

"A 'golden leash' is one of those terms that's easy to throw around, but a lot of this is in the eye of the beholder," says **Steve Quinlivan**, a partner with **Stinson Leonard Street** who has written about the topic.

Michael Levin, an advisor to activist investors who writes frequently on the topic and is a director on the board of **Comarco**, says he is only aware of cash and equity compensation for independent directors who are compensated by investors. Most investors also indemnify director candidates until they join a board, he says. Levin also says he isn't aware of any investors that provide perks to independent directors, although he estimates that "a few" directors might start to disclose receipt of perks. He adds that employees of investors also typically receive perks such as health insurance or a car allowance, for example.

Levin says he believes it will become more common in the future for investors to compensate directors despite the disclosure requirement for Nasdaq-listed companies. However, he doesn't see it becoming a standard practice.

"Only the most advanced activist shareholders, with a big enough investment in a troubled enough company, will use these deals to recruit directors," says Levin in an e-mail response to questions. "Investors will pay directors when it makes good sense — for tough companies, or to recruit a hot director."

Is Nasdaq Done With Golden Leashes?

When the rule was first proposed, Nasdaq also announced it was surveying market participants as to whether it should seek to prohibit such arrangements outright, or to clarify that directors who received such payments might not be considered independent under Nasdaq's rules.

However, **David Strandberg,** chief counsel of listing qualifications at Nasdaq, says there are "no current plans to proceed with additional rulemaking or additional proposals along those lines," although the exchange is always seeking to improve its listing standards.

"Part of our thinking was informed by the responses we received from our survey as well as the fact that under our rules currently, a board is obligated to affirmatively consider whether a director is independent," Strandberg says. "We felt comfortable with that requirement."

Indeed, **Cydney Posner**, special counsel with law firm **Cooley**, noted this spring that a footnote in Nasdaq's original and resubmitted rule filings seemed to highlight boards' considerations. "Even if Nasdaq elects not to seek to enhance the definition of independence in this regard, directors may already be obligated to consider this type of third-party payment when assessing director independence."

Strandberg says the rule has generated a lot of attention from governance observers and bloggers. Nasdaq has already begun receiving queries from market participants about how to understand and comply with the rule.

Observers point out that the rule and the attention it has received has also further enhanced Nasdaq's influence in the realm of corporate governance. Following Sarbanes-Oxley, Nasdaq and NYSE made numerous updates to listing standards, but Nasdaq was often referred to after NYSE in corporate governance circles. The golden leash disclosure rule further underscores the shift.

Observers say time — and disclosures — will tell whether the debate over third-party compensation arrangements will continue.

Governance Loopholes

Levin notes in his blog post on the rule approval that there are loopholes that investors who really wanted to avoid disclosure of payments to directors "could drive at least a mid-sized sedan" through. For example, the rule asks for disclosure of "material terms" without defining "material," writes Levin.

"What is material to an individual director, say in terms of the amount of compensation, is probably less material to a shareholder," he writes. "Directors and investors can probably interpret this concept liberally."

As another possibility, he writes that because the disclosure is annual, a shareholder and a director could make a deal the day after an annual meeting and disclose it a year later, for example. Or shareholder-nominated candidates in contested elections could take advantage of the fact that Nasdaq can delist companies that don't comply with the rule, but doesn't have the same reach when it comes to shareholders.

Ultimately, however, Levin writes, there isn't much of a need for activists and director nominees to keep golden leashes under wraps.

"Instead of hiding it, letting other investors know this investment matters enough to do this is worth the effort."

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