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Public Company Advisor

Practical Insights for Public Company Counsel

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King & Spalding's Public Company Practice Group periodically publishes the Public Company Advisor *to provide practical insights into current corporate governance, securities compliance and other topics of interest to public company counsel.*

Compensation Committees May Need to Consider the Independence of Outside Legal Counsel to the Company

Under new NYSE and Nasdaq listing standards that take effect on July 1, 2013, a compensation committee may receive advice from legal counsel, as well as compensation consultants and other advisors, only after considering six independence factors. In the February edition of the *Public Company Advisor*, we provided an overview of the new NYSE and Nasdaq listing standards.[1]

Where outside legal counsel is directly engaged by a compensation committee, or is providing advice directly to a compensation committee, it is clear that the compensation committee must consider the independence of such counsel prior to receiving the advice.

However, it has not been clear under the new listing standards whether the consideration of outside counsel's independence is required where the outside counsel is engaged by the company (vs. the compensation committee), regularly works with the general counsel and other in-house legal staff and provides advice to the general counsel or other in-house legal staff that may indirectly be provided to the compensation committee by the general counsel or other in-house legal staff.

In this edition of the *Public Company Advisor*, we address the analysis to be undertaken by in-house counsel in order to determine whether a compensation committee must consider the independence of outside counsel that is engaged by the company. We also provide practical advice for in-house counsel in requesting information from outside counsel necessary for consideration by the compensation committee.

SEC Staff Indicates that a "Facts and Circumstances" Analysis Should be Undertaken by In-House Counsel to Determine if Outside Legal Counsel is Indirectly Providing Advice to the Compensation Committee

As adopted, the listing standards did not address the specific circumstances under which outside legal counsel would be considered to be "providing advice" to the compensation committee such that a consideration of its independence would be required. While the listing standards are rules of the NYSE and Nasdaq, the listing standards were mandated by

[1] The February edition of the *Public Company Advisor* is available at the following link: http://www.kslaw.com/library/publication/PublicCompanyAdvisor-February2013.pdf

regulations promulgated by the Securities and Exchange Commission (the “SEC”) pursuant to the Dodd-Frank Act, and the specific content of the listing standards was approved by the SEC. Therefore, the SEC staff’s guidance (even informal guidance) carries significant weight.

At several recent informal meetings between industry groups and the staff of the SEC, the SEC staff responded to questions about how to analyze whether outside counsel may indirectly be providing advice to the compensation committee. The SEC staff declined to provide a bright line test, but did offer thoughts on two hypothetical scenarios.

The SEC staff discussed a scenario in which a member of the compensation committee asks a question of the general counsel. If the general counsel steps out of the meeting, calls outside legal counsel to get an answer, and comes back into the meeting and repeats the answer, the SEC staff would view the outside legal counsel as having indirectly provided advice to the compensation committee. In this scenario, the compensation committee should have considered the independence of outside legal counsel prior to receiving the advice.

The SEC staff also discussed a scenario in which a general counsel discusses a legal issue with several outside advisors, considers the advice received and formulates his or her own conclusion. If the general counsel subsequently is asked a question by a member of the compensation committee and responds to the question based on the previous analysis, then the SEC staff would not view the outside legal counsel as having indirectly provided advice to the compensation committee.

Per the SEC staff, in-house counsel should undertake the facts and circumstances analysis to determine whether outside counsel may indirectly provide advice to the compensation committee.

Action Items for In-House Counsel

Based on this informal guidance, in-house counsel will need to consider whether to broaden the scope of the compensation committee’s advisor independence consideration to include its outside counsel. Factors for in-house counsel to consider in determining whether outside counsel may be indirectly providing advice to the compensation committee include whether outside counsel:

- is primarily responsible for preparing the CD&A that is recommended by the compensation committee for inclusion in a company’s proxy statement,
- is involved in the design or drafting of executive employment agreements or executive compensation plans or arrangements that are presented to the compensation committee for approval, or
- advises on compensation-related tax matters, including the treatment of compensatory arrangements under Sections 280G and 162(m) of the Internal Revenue Code, that are reviewed or approved by the compensation committee.

If outside counsel is expected to provide advice to the compensation committee after July 1, 2013, whether directly or indirectly, in-house counsel should coordinate with the outside counsel to obtain the information necessary for the compensation committee to consider the independence of the outside counsel prior to the time the committee receives the advice.

We expect that, upon receipt of a request from a public company, law firms will provide the compensation committee with information regarding the factual basis for the committee’s consideration. The information provided by the law firm should address the following factors with respect to the firm as an entity and/or the attorneys actually providing advice to the compensation committee (the "matter attorneys"), as applicable:

- Other services provided to the company by the law firm.
- The amount of fees paid by the company to the law firm, as a percentage of the firm's total revenue for the most recent fiscal year.
- The policies and procedures of the law firm that are designed to prevent conflicts of interest.
- Any business or personal relationship between the matter attorneys and a compensation committee member.
- Any company stock owned by the matter attorneys or their immediate family members.
- Any business or personal relationship between the matter attorneys and/or the law firm and an executive officer of the company.

The compensation committee will need to consider the independence of outside counsel in light of the information disclosed. While the listing standards do not require that the compensation committee make a determination that outside counsel is independent, the committee must take into consideration the relevant factors as part of the decision to receive advice from outside counsel.

We recommend that compensation committees conduct any necessary consideration of the independence of outside counsel at their next committee meeting. Given the typical compensation and annual meeting schedule for calendar year-end companies, we expect many companies will not currently have a compensation committee meeting scheduled prior to the effectiveness of the new listing standards on July 1, 2013. These companies can satisfy the listing standards by having the compensation committee conduct the independence consideration at its next regularly scheduled meeting after July 1, 2013, so long as it is prior to the time the committee receives advice from outside counsel.

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King & Spalding's Public Company Practice Group is a leader in advising public companies and their boards of directors in all aspects of corporate governance, securities offerings, mergers and acquisitions and regulatory compliance and disclosure.

About King & Spalding

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