



JONES DAY
COMMENTARY

HAVE YOU ASSESSED THE INDEPENDENCE OF YOUR COMPENSATION COMMITTEE ADVISERS?

As you are likely aware, beginning July 1, the compensation committees of NYSE- and Nasdaq-listed companies are required to conduct an independence assessment of individuals who are compensation consultants, legal counsel, and other advisers (subject to some exceptions, including for in-house counsel) before selecting, or receiving advice from, such advisers under Exchange Act Rule 10C-1, as implemented by the listing requirements of the NYSE and Nasdaq.

For current advisers, the independence assessment must be conducted before the adviser next provides advice to the committee on or after July 1. For new advisers selected or providing advice on or after July 1, the independence assessment must be conducted before the earlier of the committee retaining or hiring the adviser or the adviser first providing advice. Thereafter, the independence assessment should be conducted on at least an annual basis.

The new listing standards are clear that a compensation committee, in exercising its business judgment, is free to select or receive advice from any compensation adviser it prefers, after considering the six independence factors set forth below and any other factors the committee deems relevant. The new standards do not require a compensation committee to select or obtain advice from only an “independent” compensation adviser.

The six factors required to be considered by a compensation committee when considering the independence of each adviser are as follows:

1. The provision of other services to the company;
2. The amount of fees received from the company, as a percentage of the total revenue of the firm;
3. The policies and procedures of the firm designed to prevent conflicts of interest;
4. Any business or personal relationship of the adviser with a member of the compensation committee;

5. Any stock of the company owned by the adviser; and
6. Any business or personal relationship of the adviser or his/her firm with an executive officer of the company.

Much has been discussed and written about how this assessment should be done, and for which advisers the assessment should be made—for example, whether the committee should consider the independence of indirect advisers and what it means for an adviser to provide “advice” to a compensation committee or for a compensation committee to “receive” advice from an adviser.

Our sense is that, as in most areas of corporate governance, a one-size-fits-all approach is unwise. Instead, each company should tailor its approach to its unique circumstances. In addition, the SEC Staff has informally indicated that the issue does not lend itself to a “bright line” test and that in-house legal counsel are in the best position to exercise judgment in order to determine, based on the relevant facts and circumstances, whether an adviser is providing advice to the compensation committee and thus should be subject to an independence assessment (in other words, what types of advice should trigger the independence assessment).

So now, what should in-house counsel do in light of these requirements? Our suggestions are:

- It is imperative that the committee minutes reflect that the compensation committee assessed the independence of its advisers at the appropriate times, in a more thorough way than normal practice.
- In-house counsel should be practical in deciding whether an independence assessment is needed, particularly when the adviser does not participate in the committee’s discussions. The SEC Staff has informally indicated that if in-house counsel acts as a conduit for advice provided to him or her by outside counsel, then such outside counsel may be indirectly providing advice and may need to be vetted for independence. Having said this, other inputs

do not necessarily trigger an independence review. For example, in our view, outside counsel’s review and comment on disclosure documents for compliance purposes should not by itself require an independence assessment.

- Finally, counsel should be aware of situations that may fall in a gray area. In our view, having outside counsel implement executive compensation matters—for example, drafting management contracts and benefit plans—does not, without more, require an independence assessment. If outside counsel participated in the consideration of the terms or design of those contracts or plans, however, a different conclusion may be warranted.

LAWYER CONTACTS

We welcome the opportunity to discuss issues that may arise in light of these new listing requirements. For further information, please contact your principal Firm representative or one of the lawyers listed below. General email messages may be sent using our “Contact Us” form, which can be found at www.jonesday.com.

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