Should Your Board Retain Independent Counsel?

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All too often boards and board committees find their actions and decisions intensely scrutinized. Directors need to be aware of when and why they should consult with independent counsel as part of their decision-making process. While historically, consideration of independent counsel has arisen in "special situations" such as in the context of a shareholder derivative litigation, in connection with management led buyouts of a corporation and in connection with the conduct of internal investigations, the heightened awareness of director actions, and of committee actions in particular in the post-Enron/Sarbanes-Oxley era, has opened the door for a broader and possibly continuing need for independent counsel at the board (for outside directors) or board committee level.

While Enron and other corporations in the news were vast public companies and while in substantial measure Sarbanes-Oxley applies only to public companies, there has been a "trickle down" impact on privately-held and closely-held companies. The scandals which triggered the reactions that resulted in the passage of Sarbanes-Oxley in 2002 (and the corresponding changes in the rules of the Securities and Exchange Commission and the various stock exchanges) have affected the way lenders, venture capital and angel investors, transaction partners and directors’ and officers’ insurance carriers view the corporate governance procedures of their business and transaction partners and their expectations of what are "best practices." Privately-held and family-owned businesses are no longer immune from these influences.

General advice to board members and board committees regarding their duties and obligations has traditionally been provided by a company’s counsel. Company counsel in some instances is in-house and thus a member of management, or, as is more typical in the middle market, privately-held or family-owned business, the outside law firm or attorney who counsels the company generally. The role of boards and board committees has shifted from a team supportive of senior management to one in which the non-management directors have significant oversight responsibility. They must be able to point to the challenges made to management agendas to demonstrate how they are protecting the shareholders’ interests. This does not have to be viewed negatively: aren’t the best results often achieved by parties (here, management and the independent directors) who are equally prepared and briefed on the issues and options before them?

As a practical matter the advantage to outside directors or a board committee of retaining separate counsel is that it provides them with the opportunity for unbiased counsel and clear understanding of the conflict of interest that is inherent in an increasing number of situations for corporate counsel (whether as part of the management team or a de facto member of management albeit with an outside firm). Counsel for the independent directors or a committee is not beholden in any way to management but to the committee and the shareholder interests they are charged with protecting.

Why should the independent directors or a board committee seek independent counsel?
Board decisions are and have been protected by the "business judgment rule." Directors’ decisions are protected if, in making them, the directors have availed themselves of all information material to the decision that is reasonably available to them (duty of care) and have acted in good faith in making the decision (duty of loyalty). This rule has not been changed by any corporate scandal or implementation of Sarbanes-Oxley. It stood before and it stands today. The question for the outside directors or a committee is: in the context of our particular company, are we in a position to make the decision(s) we are charged with making and be protected by the business judgment rule without the input and counsel of an independent advisor? Is the issue before us one for which we may be personally exposed (like executive compensation issues, i.e., Disney/Ovitz, NYSE/Grasso)? The best defense against liability is a good offense, which includes preparation.

**What should the independent directors or a board committee look for in independent counsel?**

If the board or a committee concludes that independent counsel makes sense (and this will not universally be the case) what should they seek in an independent counsel? A firm that is well versed in the corporate law of your jurisdiction, which has worked with companies and boards and committees in both transactional contexts as well as outside general counsel to companies, someone who is aware of what investors, lenders, business partners, investors, and insurers will expect or demand when doing business with your organization. The key to making the independent counsel role work on a regular basis is identifying a firm that can apply its legal knowledge and work with the committee to assert their position in a thoughtful and diplomatic way to achieve the desired end: the best results for the shareholders.

**How should independent counsel be engaged?**

Independent counsel for the board or a committee is best engaged as special counsel to the committee though compensated by the company since it permits the committee the desired autonomy from the company yet protects communications *vis a vis* "true" third parties between independent counsel and the company under the "common interest" principal.

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