

When Should the Board Call Separate Counsel?

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By Doug Raymond and Kimberly Rubel

Reports of the increased risk of liability for boards of directors, as well as for individual directors, have become commonplace against the backdrop of ever-increasing regulation and litigation risk. There is intense scrutiny of directors, and some believe the risk of personal liability for serving on a public company board has never been greater.

Commentators have offered a long list of suggestions for how directors should respond in this climate, including hiring separate and independent counsel to advise only the board. They express skepticism about whether the corporation's regular lawyers can adequately advise the board. We think this is an overreaction. Situations arise where directors must turn to independent counsel for advice, but most of the time the board should be able to rely in full confidence on the company's inside general counsel or regular outside counsel.

Under most circumstances, the corporation's counsel is not the lawyer for the CEO or any other individual officer or director, but represents the entity itself – the corporation. As the board of directors ultimately speaks for the corporation, the corporation's lawyers work for, and are answerable to, the board. Therefore, in general, there should not be any inherent conflict, and the board should be able to rely on the company's general counsel, who should have the primary responsibility for advising the board and for designing and implementing the corporation's procedures for legal compliance.

This is true not only for the board's day-to-day business, but in most other circumstances as well, including significant transactions such as acquisitions and securities offerings. Inside and regular outside counsel should work together to provide the board with a sufficient basis to approve the transaction and any related disclosure documents.

Effective regular counsel to the board develops a relationship of trust with the board and can serve as an important source of institutional memory. If the board does not have confidence in the judgment, competence or integrity of the corporation's legal advisors, it should replace those lawyers with counsel on whom the directors can rely.

In an increasing number of companies, the board has separated the roles of chairman and CEO or appointed a lead independent director, not necessarily because of any inherent conflict, but because of a belief that an

independent chairman or lead director can bring a different and useful perspective to the board. Companies also may want the advisors to the board or to a particular committee, such as the audit or compensation committee, to have a perspective that is different and independent from that of management.

Because of the daily interactions that the general counsel, and often regular outside counsel, have with the rest of the management team, it can sometimes be difficult to expect them to have an independent perspective. An independent counsel, with no other ties to the company, can provide that perspective, which in some situations can be useful.

But, when the board separates the roles of CEO and chairman or appoints a lead independent director, it generally keeps both individuals in the boardroom and so retains access to the CEO's experience and knowledge base. A board that turns to unrelated counsel should be careful not to lose the knowledge, experience and judgment of the general counsel and regular outside counsel.

Of course, the board should call on independent counsel if it or the general counsel decides that expertise in a particular area of law is needed or if there is potential for the general counsel's judgment to be, or appear to be, compromised as a result of relationships with management or otherwise. In general, the board should turn to independent counsel to avoid actual or perceived conflicts that can arise when dealing with sensitive issues, such as some executive compensation issues, anti-takeover protections, and affiliate transactions.

Furthermore, if there is any serious question about the integrity of any member of senior management, or if the board or any board committee undertakes an internal investigation, the board should consider engaging independent counsel that has no other relationship with the company. In this situation, the credibility of the investigation depends in part on the perception that the lawyers advising in the investigation are completely independent of any potential wrongdoers.

While there are times when it is appropriate to call separate and independent counsel, we think most of the time the board should be able to rely in full confidence on the company's general counsel or regular outside counsel, who generally know the board and the issues much better than would an unrelated firm.



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