Assessing the Independence of the Compensation Committee's Outside Advisors

MUCH HAS BEEN WRITTEN ABOUT THE NEED FOR BOARDS AND COMPENSATION COMMITTEES TO SEEK ADVICE FROM OUTSIDE ADVISORS WHO ARE INDEPENDENT OF MANAGEMENT. For example, the NACD Blue Ribbon Commission on Executive Compensation and the Role of the Compensation Committee suggests that Compensation Committees consider engaging an independent compensation consultant who is hired by and who reports directly to the Compensation Committee and who has not been retained by the Company in any other capacity. The failure to use outside advisors was cited in both the Cendant and Disney complaints as further evidence of the Compensation Committee's failing.

As these guidelines suggest, Compensation Committees that consider engaging outside advisors should assess not only the advisor's experience and expertise but also the advisor's independence. This is no small matter. It is the rare advisor who is willing to tell the emperor that he has no clothes – or in the corporate world of today, that the CEO's pay package is too high or being compared to an inappropriate set of companies. The controversy over Mr. Grasso's pay is a case in point.

Advisors may be reluctant to risk management's displeasure by challenging the executive pay program.

The fees that executive compensation advisors receive often represent a small portion of the overall fees received by the advisor from the company. As might be expected, these advisors may be reluctant to risk management's displeasure by challenging the executive pay program. As a result, Compensation Committees should periodically assess their advisor's independence. In the case of compensation advisors, Richard Breeden suggests in his MCI Report that this should occur in conjunction with the Compensation Committee's review of the advisor's performance.

The following is an example of a checklist that can be used to assess an outside advisor's independence:

> The advisor should be free of any relationship with the Company or its management that may impair, or appear to impair, its ability to provide independent advice to the Compensation Committee. In addition:
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> - No officer or shareholder of the advisor should be a current or former (within the prior three years) employee or more than 1% shareholder of the Company or any affiliate of the Company.

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- No officer or director of the Company should be a current or former (within the prior three years) officer or shareholder of the advisor.
- No officer or shareholder of the advisor should have a familial relationship with any executive officer or director of the Company.
- The advisor should not receive remuneration from the Company, directly or indirectly, other than for advisory services rendered to, or at the direction of, the Board or Compensation Committee. ♦

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