



H.S. Grace & Company, Inc.

Bankruptcy Trustee v. D&Os Breach of Fiduciary Duty Claims

Legal Issues

1. Fiduciary Duties of Officers and Directors.
2. SEC Reg. 10(b)(5) Violations.
3. Duty of Care and Duty of Loyalty of Officers and Directors.
4. Corporate Waste.
5. Gross Negligence and Mismanagement.

Allegations

Certain of the officers of a bankrupt company had caused the bankruptcy. In addition, the officers were accused of corporate waste, entrenchment, unjust enrichment, misuse of corporate funds through use of speculative interest rate swaps (derivatives) and other waste, as well as negligent misrepresentation of the true nature of the firm's financial condition.

Potential Liability

The Company had been liquidated in Bankruptcy and the creditors were damaged. Potentially, the Directors and Officers could be faced with a liability in the amount of \$1.2 billion.

Analysis

The Company had indeed gone bankrupt for a second time, the officers and directors had remained in control after the initial bankruptcy seven years earlier, the Company had spent large sums on a computer system that was not generating sufficient sales to make the investment pay off, and a significant "call" on the interest rate swaps was the trigger which caused the Company to file for bankruptcy protection. In a nutshell, the defendants appeared to be in a dire situation.

H.S. Grace & Company, Inc. was able to demonstrate:

1. The bankruptcy had been caused by factors outside of the control of the Company.
2. That the derivative program was not a speculative program, but a prudent investment aimed at converting floating rate interest income to fixed rate income.
3. That management had made the appropriate disclosures to the independent directors and the public as to the financial position of the Company.
4. That while the Company had experienced difficulties in the development and implementation of the computer system, neither the time delay nor the 10% cost overrun was unusual in the development of a new computer system.

Result

The facts were presented at mediation, and a favorable settlement was negotiated.

H.S. Grace & Company, Inc. is a team of senior executives who diagnose and resolve critical corporate problems in business governance, operations, finance and control. With more than 1,000 years of experience, our goal is to help companies enhance shareholder value, protect reputation and their long-term ability to succeed, avoid and manage litigation, and navigate major changes such as mergers and acquisitions or bankruptcies. We often serve as consulting and testifying experts, identifying and analyzing critical business issues.

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