



H.S. Grace & Company, Inc.

Corporate Governance: Macro vs. Micro ***Part II – Executive Compensation***

The macro elements of corporate governance continue to be the focus of articles, books, seminars, and other professional development oriented offerings. Guidebooks for directors, addressing the organization and operation of audit committees, compensation committee issues, and executive vs. non-executive board chairs are only a sample of the offerings being made available.

Micro elements of corporate governance, on the other hand, are almost always the critical elements in securities litigation. The combination of experienced legal and business advice is required to identify and examine the relevant micro elements of the matter at hand.

Recent experience of H.S. Grace & Company, Inc. (HSG) in several cases has evidenced the value of being able to offer experienced business advice based on the thoughtful analysis of the facts and circumstances involved in the matter. The HSG team members understand that business investment decisions involve risk, and are able to assist in examining whether and how parties may have addressed the risks associated with the business decisions being questioned in the litigation.

As an example, HSG was hired by the directors and officers of a failed startup firm. There were questions of inappropriate actions within the zone of insolvency, waste of corporate assets, excessive compensation, and other issues. HSG examined the organization and operation of the entity, as well as the performance of its primary competitors. A critical factor was the availability of venture capital over the lifespan of this failed enterprise. Our findings established that the startup firm failed because its business model simply did not work. This finding was supported by the difficulties and failures of the firm's primary competitors. Further compounding the problems of all these firms was the disappearance of the venture capital required to sustain these firms for a lengthy startup period. Our findings established that the D&O's actions in the zone of insolvency were normal and customary, there was no wasting of corporate assets and, instead of receiving excessive compensation, literally all of the senior executives had taken compensation cuts when they joined the startup, their hope being that the value of their options would more than offset their stepped down compensation. (A favorable settlement was achieved.)

The business investment decision risk micro element arose again when HSG was hired on behalf of the D&O defendants in litigation arising from the short tenure of a senior executive, who received considerable compensation at the time of his/her departure. HSG set out the business investment decision risks facing firms when they acquire other firms, when they make major systems development investments, when they undertake new/startup ventures, as well as when they hire senior executives. Our work included detailing a number of senior level executive investment decisions that had failed. Further, our work developed a comparative analysis which demonstrated the D&O defendants had continued to observe

their firm's compensation culture and other standards in negotiating the executive's contract. (A total victory for the defendants was achieved at trial.)

Properly identifying and analyzing these micro elements of corporate governance and introducing them into the overarching legal framework can positively contribute to the resolution of securities litigation.

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.

Houston: 4615 Southwest Freeway, Suite 625, Houston, TX 77027
(713) 572-6800 • FAX (713) 572-6806

New York: 300 E. 57th Street, #18A, New York, NY 10022
(212) 644-8620 • FAX (212) 813-1779

Email: hsgraceco@hsgraceco.com
Visit us at: <http://www.hsgraceco.com>