



H.S. Grace & Company, Inc.

Defining the Difference # 63 – January 2013

Compensation Issues in Partnerships, LLC's, Professional Associations and Small Corporations

Compensation issues arise frequently in professional associations, partnerships, LLC's and small corporations – not just in Fortune 500 companies. Analyzing the business issues behind compensation plans and decisions can be critical in understanding why the decisions were made and in determining the duties, rights and obligations among the parties considering normal and customary business practices. H.S. Grace & Company, Inc.'s (HSG) real-world experience in actually making these business and financial decisions – we've been there and done it – helps attorneys quickly and efficiently get to the issues in litigation and arbitration involving compensation. The following HSG case demonstrates the types of business and financial issues that are important in resolving these types of cases.

Allegations

Plaintiff, an older member of a professional association, sued defendants and the professional association (HSG Clients) asserting that they owed him a six-figure sum in deferred compensation they had agreed to pay him when he retired under the specific terms of the shareholder employment agreement entered into between plaintiff, the association, and the younger defendants several years earlier when defendants had become shareholders in the association. Plaintiff managed the association until his retirement. The deferred compensation plan was basically unfunded at plaintiff's retirement. Defendants counterclaimed against plaintiff asserting Texas securities fraud, fraud and fraudulent inducement, breach of fiduciary duty and negligent misrepresentation, among other claims.

HSG Analysis

The HSG team evaluated the detailed actions and business decisions of plaintiff over several years. HSG's analysis showed that plaintiff's conduct did not conform to normal and customary business standards and practices for a managing member of an association and in several instances was self-serving. Specifically, HSG's analysis showed that plaintiff acted inconsistently with his duties and obligations to the association and other defendant shareholders in the following respects:

- Plaintiff signed his own employment agreement both for himself and the association without consultation with other shareholders.
- Plaintiff's deferred compensation provided for in the Employment Agreement was based on revenues rather than profitability. Recognizing the benefit to himself as he neared retirement age, plaintiff entered into agreements with other entities which increased revenues for the association but provided little in the way of profits, increasing his own deferred compensation benefit – and leaving the other shareholders and the association with no way to pay it.
- Plaintiff, as the managing member of the association, made no provision for funding the deferred compensation liability, leaving the association value represented to the entering defendant

shareholders significantly lower than plaintiff claimed. Plaintiff did not disclose this potential unfunded liability in dealing with outside valuation experts, resulting in business valuations which he provided to the other junior members of the association that misrepresented the actual value of the association.

- Prior to creating the association, plaintiff was in a partnership where the partners had put in place a well-structured, fully funded retirement plan based on partnership profits rather than revenues.
- Plaintiff did not devote his full-time and attention to the association as required by his Employment Agreement to the detriment of the association and the other shareholders.

Results

The case, which had initially appeared to be a simple contract dispute from plaintiff's perspective, was resolved quickly at a very favorable sum for defendants after analyzing plaintiff's apparently self-serving business and financial decisions.

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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.

Representative Issues Examined

- Lender Liability
- D&O
- Corporate Split-off
- Family Trust
- Health Care
- Professional Services
- Intellectual Property
- International Structured Finance Transaction
- Fraud
- Pension Fund Investments
- SEC White Collar Defense
- Stock Option Backdating
- Oil & Gas
- Real Estate
- Fiduciary Issues
- Contract Dispute
- Fund Management
- Market Timing Allegations
- Financial Derivatives
- Portfolio Management
- Special Purpose Corporation

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>