



H.S. Grace & Company, Inc.

## Defining the Difference # 61 – October 2012

### Codes of Ethics

Codes of Ethics are frequently at the center of litigation involving issues such as breach of fiduciary duties and securities fraud actions against directors and officers. Boards and shareholders are paying increasing attention to the provisions in Codes of Ethics and to both enforcement and waivers of these provisions, particularly in light of new SEC whistleblower regulations and increased Foreign Corrupt Practices Act (FCPA) enforcement. H.S. Grace & Company, Inc.'s team of experienced former executive officers and board members has extensive experience in drafting, review and enforcement of Codes of Ethics, which they can bring to bear in situations involving alleged violations of Codes of Ethics.

### New York Stock Exchange (NYSE) Rule 303.10 Code of Business Conduct and Ethics

Post Sarbanes –Oxley, NYSE Rules have required that listed companies have a Code of Business Conduct and Ethics for directors, officers, and employees and that the Code must be available on or through the company website. The Code serves to “focus the board and management on areas of ethical risk, provide guidance to personnel to help them recognize and deal with ethical issues, provide mechanisms to report unethical conduct, and help to foster a culture of honesty and accountability.” NYSE Rule 303.10 requires that waivers of Code provisions for executive officers and directors may only be made by the board or a designated board committee and must be promptly disclosed to shareholders. Further, the Code must contain compliance standards and procedures to ensure prompt and consistent action against Code violations.

While recognizing that different companies may address corporate governance responsibilities differently depending on the company's unique organization and circumstances, the NYSE Rule does set out specific, important topics that should be covered in the Codes of listed companies. These include:

- Conflicts of interest
- Usurping corporate opportunities and improper use of company property
- Maintaining confidentiality of company and customer information
- Fair dealing
- Protection and proper use of company assets
- Compliance with laws, rules and regulations, including specifically insider trading requirements
- Encouraging the reporting of illegal or unethical behavior

Provisions of the Code of Ethics and enforcement or lack of enforcement of those provisions can play an important role in litigation involving director and officer duties and responsibilities as shown in a recent HSG case involving the rights and responsibilities of a CEO under his employment contract.

### **HSG Analysis of Code of Ethics and Customary Business Practices**

In this case, the CEO's Employment Agreement appeared to contain very favorable terms to the CEO that allowed him to retain full employment benefits post-severance unless he had been fired for cause. "Cause" was limited to a situation in which the CEO had intentionally engaged in illegal conduct that materially injured the company - which the CEO asserted he had not. In fact, the CEO asserted he had been terminated or forced to leave for reasons unrelated to his employment as CEO. HSG's analysis, however, showed that the CEO during his tenure had committed multiple violations of specific provisions of the Company's Code of Ethics, including conflicts of interest provisions, misappropriation of company property provisions, and provisions requiring employees, executives and directors to refrain from engaging in any unlawful acts or even engaging in any acts which appeared to be unlawful. The CEO had, in HSG's opinion, improperly certified that he had complied with the Code of Ethics. The Code provided that violation of the Code was grounds for suspension or dismissal. This analysis was helpful to the company in achieving a very favorable settlement, significantly below the claimed and reserved amounts.

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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

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