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Al Able, Bert Baker and Charley Cain were long time friends. Able had years of experience in the field of designing and marketing custom computer software as an employee of a large computer company. Able, however, lacked sufficient money to start his own business. His friends Baker and Cain had plenty of money, but relatively little skill in designing and marketing custom computer software, although they were very interested in learning more about both subjects. The three agreed to go into business together by forming the ABC Corporation. The general understanding of the parties was that while Able would initially supply the expertise in marketing and program design, and the other two the necessary additional capital for the business, Able would train Baker and Cain in marketing and programming so that all three could be active in the business. The three men also generally understood that Able was to be President and Chief Executive Officer ("CEO") of the corporation, Baker was to be Senior Vice President and Chief Financial Officer of the corporation and Cain was to be Senior Vice President and Secretary of the corporation. There was, however, no formal agreement made with respect to any of these understandings. ABC's article of incorporation provided for a single class of common stock, a three member board of directors elected by straight voting, and the creation of the aforementioned corporate offices. The articles also provided that election to or removal from any of the offices required unanimous board approval. The single class of common stock was divided among the three with Able receiving forty percent and Baker and Cain receiving thirty percent each. The three unanimously elected themselves to the board, and the board in turn appointed the three to corporate offices in accordance with the understanding described above.

As the years went by, the ABC Corporation became modestly successful. The corporation did not pay any dividends, but the three men were able to prosper because the corporation paid them generous but reasonable salaries in their respective positions. Baker and Cain eventually learned both the programming and marketing aspects of the custom computer programming business.

After Baker and Cain became fully conversant with these aspects, however, they became dissatisfied with the direction in which Able was taking the ABC Corporation. Baker and Cain believed that Able was simply too cautious in terms of the contracts he was willing to accept for the firm. Able, for his part, believed that it was simply too risky for the company to attempt to compete for projects in which it had little experience and in which it could not guarantee the client first-rate results. The disagreement between Able on the one hand, and Baker and Cain on the other, continued to fester for several months. Finally, it came to a head over a contract which the ABC Corporation lost. The contract was for a project in an area in which ABC did not have any special expertise. Able did make pitch for the contract, but Baker and Cain believed that Able's reluctance to enter such a project influenced the potential customer to place the contract elsewhere.

Baker and Cain felt that as long as Able was active in the business as its President and CEO, the ABC Corporation would be at a competitive disadvantage in seeking contracts in new areas because of Able's attitude toward risk. Both of them believed that Able would make sincere efforts to get contracts in new areas, but that his deep-seated belief that the corporation ought to "stick to its knitting" would prevent him from being a persuasive advocate. Baker and Cain formally agreed that in the future they would vote for each other as director and cast their votes in unison for a candidate they agreed upon, but under no conditions were they to vote for Able as a director. At the next shareholder meeting, pursuant to their agreement, Baker and Cain cast their votes for themselves and Don Delta (the person upon whom Baker and Cain agreed). This, of course, resulted in the ouster of Able from the Board.

The new Board (consisting of Baker, Cain and Delta) unanimously voted to oust Able from his position as President and CEO of the Corporation. Able tried to sell his stock in the ABC corporation, but has found no buyers. Able then approached the corporation and asked that it buy back his stock. The corporation correctly pointed out to Able that if it bought back his stock, it would lack the liquid resources needed to expand ABC into new areas, and might even lack sufficient liquid assets to remain a viable competitor in the custom computer program market.

Able has now brought suit against Baker and Cain and against the corporation. In the alternative he seeks (a) dissolution of the corporation or (b) a compelled buy-out of his stock by the corporation.

How should a court rule on Able's suit and why should it rule that way?

N.B. The relevant portion of the jurisdiction's statute on judicial dissolution of corporations is identical to section 34.30 of the Revised Model Business Corporation Act which is set forth on p.6 of the statutory supplement.

Question II

The Truetone Corporation is incorporated in the state of East Virginia. The corporation is engaged in the business of manufacturing hearing aids. The corporation is a publicly held company whose stock is traded on various regional stock exchanges.

The most expensive and crucial parts of hearing aids are the integrated circuits ("ICs") which do the actual amplification in the hearing aids. Traditionally, Truetone had bought ICs from a variety of suppliers, shopping around for the best price for Ics. Now, however, a relatively new competitor in the IC market, Chipco Corp. was proposing a different arrangement between it and Truetone. Chipco Corp. proposed that it enter into a contract with Truetone making Chipco Corp. the exclusive supplier of ICs to Truetone for a period of ten years. Chipco Corp. offered Truetone a very favorable price on ICs, a guaranteed source of supply and freedom from the need to waste time and effort shopping around for a source of ICs. Al Burnside, the President and CEO of Truetone was extremely enthusiastic about the Chipco offer. He personally negotiated an agreement with Chipco making the Chipco Corp. the exclusive supplier of ICs for Truetone for the next five years.

Burnside brought the contract he negotiated with Chipco before Truetone's five member board of directors for approval. The five members of the board were as follows:

(1) Al Burnside, President and CEO of Truetone

(2) Walt Reynolds, a Vice President and Director of Chipco

(3) Ann Welles, an attorney with a lucrative law practice, Ms. Welles was also the daughter of the President and CEO of Chipco, although she received no remuneration from either her father or Chipco.

(4) David Porter, partner in an investment banking firm which did substantial business with Chipco and Truetone, but had no role in the contract between the two firms.

(5) Ollie Howard, owner of an import/export brokerage

business. Howard had absolutely no ties or relationship with Truetone or Chipco other than serving on the board of directors of Truetone.

Burnside made a five minute presentation to the board with respect to the contract. He outlined the advantages of the contract to the board. He then inquired if the board members had any questions. Welles asked how the price for ICs that Truetone would pay under the contract compared to prices currently being charged for the ICs. Burnside accurately replied that the price Chipco would be charging was lower than any price currently being quoted for ICs.

The proposal was put to a vote of the board. (East Virginia has a statute which allows any directors to be counted toward a quorum even if they have an interest in the subject matter under consideration--thus, a quorum was present.) All the directors were aware of all the relationships between the various directors and the Chipco Corp. (including the fact that Ms. Welles was the daughter of the President of Chipco). The final vote was 3 in favor of approving the contract (Howard, Welles and Porter), none opposed, and two abstentions (Burnside and Reynolds).

The contract turned out disastrously for Truetone. First, the Japanese government unexpectedly refused to renew a "voluntary" agreement limiting the number of ICs exported to the United States. This had the effect of dropping the price of ICs substantially below the price which Truetone and Chipco had set in their contract. Even worse, however, Chipco turned out to be a totally undependable supplier. First, Chipco was often late with its shipments of ICs. Second, the ICs Chipco shipped were often of shoddy quality which in turn meant that the hearing aids produced by Truetone were of equally shoddy quality, These two developments resulted in Truetone's earning a reputation for (a) being tardy in delivering promised products, and (b) making poor quality products. Truetone repudiated the contract with Chipco, but it was too late to prevent damage to Truetone's reputation and its profits. Chipco's performance of the contract should have come as no surprise. Chipco even in the relatively short time it had been in the IC market had a widespread reputation in the electronics industry for being a slow deliverer and having problems in the area of quality control. Burnside was aware of Chipco's reputation in this regard, but did not bring it to the attention of Truetone's board none of whom, other than Burnside, had any idea about the ill repute of Chipco.

After suffering losses Truetone was taken by another corporation through a hostile takeover, and a totally new board installed. The new board's first instinct was of course to sue Chipco for breach of contract. However, Chipco is now bankrupt and judgment proof. The new board is considering suing the board members who approved the contract with Chipco for breach of the fiduciary duties. The new board has also discovered, however, that of the original board members only Welles and Porter have resources to pay a monetary judgment.

While East Virginia has a statute identical to section 102(b)(7) of the Delaware Corporation Code, Truetone has not placed any provisions with respect to director liability in its certificate of incorporation. East Virginia also has a statute identical to Delaware Corp. Code section 144 and East Virginia's

Have indicated that they will adhere to the interpretation given that section by the Delaware Supreme Court in Fliegler v. Lawrence, 361 A.2d 218 (Del. 1976). East Virginia courts have also indicated, however, that they will not necessarily follow the lead of Delaware courts on other questions of corporate law.

Discuss the possible liability of Welles and Porter to the corporation, in a suit brought directly by the corporation, for breaches of their fiduciary duties as directors of Truetone.