GENERAL FACTS
(unless otherwise noted below, these facts apply to all the questions that follow)

The Endpork Corp., incorporated in Delaware, is a publicly held corporation with operations in the oil pipeline and fiber optic cable business. The oil pipeline business consists mainly of transporting oil through pipelines owned and leased by Endpork; the fiber optic cable business consists of selling transmission ‘space’ on fiber optic cables owned or leased by Endpork to high volume users such as AOL. Endpork has been involved in both businesses since 1990. Endpork has been listed on the New York and Singapore stock exchanges since 1994.

Endpork’s articles of incorporation establish a 5 person board. This board is currently composed of two inside directors: (1) Porkey Pigge, who also serves as Endpork’s chief executive officer and president, (2) Crowne Roasta Pigge, Porkey’s daughter, who also serves as chief financial officer of Endpork. The other directors are outside directors: (1) Beefy Chunks, Porkey’s college roommate and currently the chief executive officer of Swindle Brothers, an investment banking firm that considers Endpork as one of its principal clients, (2) Vegetaria Stalk, the dean of the Penn State Dickinson Law School, and (3) Fish Fry, a wealthy socialite who is reported to be the best friend of highly placed politicians, but who has never worked a day in his life.

Though Endpork’s shares are publicly traded, Porkey owns 40% of the outstanding stock, and Crowne Roasta owns an additional 15% of the stock. The rest of the stock is owned by the public, with no other person owning more than 1% of the outstanding shares.

Haggis MacDuff, Porkey’s best friend and Crowne Roasta’s husband, has served as the chief operating officer and secretary of Endpork since the company’s founding. However, Haggis does not serve on the board of Endpork. As part of his duties, Haggis was charged with creating a comprehensive monitoring system for Endpork’s operations in 1994. Haggis understood that the purpose of this monitoring system was to make it harder for any employee to divert Endpork’s products for their personal gain. Haggis created a monitoring system that proved to be the industry standard; indeed, this system was featured in “Business Today” magazine as a model of its kind. It is based on a system of reports generated at all levels of Endpork and delivered to Haggis, who then summarizes the data and reports his findings to the board. As a result of the system, the company has been able to reduce the occurrence of misconduct that might affect the company’s performance.
Porky trusts Haggis. So does Crowne Roasta. So do the rest of the members of the board of directors. That is very sad indeed, because Haggis is not trustworthy at all. Haggis needs money to support a very expensive habit – dining on endangered species – a habit he has hidden from Porkey and Crowne Roasta for many years. To feed this habit, Haggis began, almost immediately after creating the monitoring system, to divert gas from Endpork’s pipelines, for sale to third parties, pocketing the money from the sales. He avoided detection by destroying all reports of irregularities reaching his desk, and then using Crowne’s passwords to alter the company’s books so that it appeared that Endpork had sold the diverted gas, and obtained payment for these sales.

All went well for a number of years until 2001 when, in response to a perceived energy crisis, the federal government ordered all energy companies to conduct a special audit of their books. During the course of the audit, the discrepancies were revealed. As a result, Endpork will likely have to restate their financial statements for the years 1994-2000, reducing aggregate reported income by $200,000,000.

As a result of these disclosures, the stock price of Endpork’s shares has decreased from $90 per share to less than $1.00 per share. This fall in stock prices has triggered the default provisions of all of Endpork’s bank debt. The banks have informed Porkey that they want to meet to discuss declaring all the debt to be in default.

**QUESTION 1**
(suggested time 30 minutes; 30 points)

Haggis entered into a five year employment contract with Endpork in 1999. It obligated the board of directors of Endpork to retain Haggis as an officer of the corporation with the title of Chief Operating Officer and secretary of the corporation at an annual salary of $1,000,000 plus a series of bonuses. The agreement also provides that Haggis may only be terminated for ‘cause.’ ‘Cause’ is defined as conviction of a felony after the time for all appeal has passed.

The day after the board of directors was informed of the financial statement discrepancies, the board voted, 3-2 (with Porkey and Crowne Roasta voting no) to terminate Haggis immediately and to immediately remove him as corporate secretary.

The bylaws of Endpork specify that any member of the board of directors may call a special shareholder meeting on 10 days written notice, if such notice specifies the purpose of the meeting. At the conclusion of the shareholder meeting at which Haggis was fired, Porkey tells the rest of the board that he will call a special shareholders meeting to be held eleven days after notice is sent out for the purpose of voting on a resolution demanding the reinstatement of Haggis. The board adopts a resolution (by a 3-2 vote) forbidding all corporate officers from arranging for the meeting on pain of immediate termination.
Three days later, (1) Haggis files an action in state court for reinstatement as Chief Operating Officer and Secretary (effectively seeking the specific performance of his employment agreement) and (2) Porkey files an action in the same court seeking an order to compel the company to permit the calling of the special shareholders meeting.

YOU ARE AN ASSOCIATE AT THE FIRM REPRESENTING ENDPORK. THE PARTNER YOU WORK FOR WANTS TO KNOW (1) WHAT LIABILITY ENDPORK MAY HAVE UNDER THE HAGGIS EMPLOYMENT CONTRACT AND (2) WHETHER A COURT WOULD COMPEL ENDPORK TO CALL THE SHAREHOLDERS MEETING. WRITE THE MEMO TO THE PARTNER EXPLAINING YOUR REASONING.

QUESTION 2
(suggested time 30 minutes; 30 points)

Three days prior to the discovery of Haggis’ theft, the board of directors had declared a dividend of $10.00 per share for 2001. The equity section of Endpork’s financial statements (as of December 31, 2000) looked like this at the time the dividend was declared:

| Capital * | 100,000,000 |
| Surplus | 9,000,000 |
| Retained Earnings (from operations) | 190,000,000 |
| **299,000,000** |

* $100 par value shares, 1,000,000 shares authorized, issued and outstanding

After the special audit, and as a result of the required restatement of the financial statements of Endpork, Endpork’s equity accounts (as of December 31, 2000) looked like this:

| Capital * | 100,000,000 |
| Surplus | 0 |
| Retained Earnings (from operations) | (1,000,000)** |
| **99,000,000** |

* $100 par value shares, 1,000,000 shares authorized, issued and outstanding.

** (n) designates an amount owed or negative balance in the account, where n = the amount of the negative balance

Assume that Endpork will post profits (after payment of expenses and taxes) of $9,000,000 for the year ending December 31, 2001. Assume further that as restated after the audit, Endpork’s total assets were $500,000,000 and its total liabilities were
$401,000,000.

A. MAY THE ENDPORK BOARD OF DIRECTORS DECLARE AND PAY THE $10 PER SHARE DIVIDEND UNDER DELAWARE BOARD? CAN THEY DECLARE AND PAY A DIVIDEND OF $1.00 PER SHARE INSTEAD?

B. IF THE RMBCA APPLIED, AND THE BOARD WANTED TO DECLARE A $1.00 PER SHARE DIVIDEND, WOULD THE RESULT BE DIFFERENT?

EXPLAIN EACH ANSWER FULLY.

Question 3
(suggested time 30 minutes; 30 points)

At the meeting with the banks, Porkey was told that he needed to raise cash quickly. The banks agreed not to declare a default on their loans to Endpork if the fiber optic cable business was sold and the proceeds used to pay down Endpork’s debt. After some negotiation, Swine, Inc. agreed purchase the fiber optic cable division of Endpork, by purchasing the assets and assuming the liabilities of that division.

Over the past 5 years:

A. the fiber optic cable division constitutes no less than 20% and no more than 70% of the value of Endpork’s property plant and equipment. Currently, the division accounts for 45% of PP&E.

B. the fiber optic cable division has employed no less than 20% and no more than 60% of Endpork’s employees. Currently the division employees 50% of the employees.

C. The fiber optic cable division has contributed no less than 5% and no more than 55% of the income of Endpork. Currently, the division contributes 40% of Endpork income.

Crowne Roasta has told Porkey that she is opposed to the sale of the division and will vote against it. Porkey believes that a large portion of the public shareholders will also vote against the transaction, but is not sure whether the opposition can muster more than 48% of the vote. Porkey wants to avoid a shareholder vote on the transaction if at all possible. Assume that the sale involves no breach of any fiduciary duty on the part of any of the members of the Endpork board.

A. ASSUMING DELAWARE LAW APPLIES, IS A VOTE OF ENDPORK’S
SHAREHOLDERS REQUIRED TO APPROVE THE SALE OF ENDPORK’S FIBER OPTIC CABLE DIVISION?

B. HOW WOULD YOUR ANSWER BE DIFFERENT IF THE CURRENT VERSION OF THE RMBCA APPLIED?

Question 4
(suggested time 30 minutes; 30 points)

Immediately after the revelations of the facts set forth in the General Facts section, above, all of the directors of Endpork were sued for breach of the fiduciary duty of care. You represent the directors in the suit, who have decided to stand together on the issue of liability. You have had a meeting with the directors in which the following facts were made known to you (in addition to those described in the General Facts section):

1. Prior to the time Haggis was given the assignment to set up the monitoring system, the board had spent 6 months discussing the issue of workplace monitoring, had read all the available literature on the topic and had attended a seminar, put on by the ABA at its annual convention, on corporate monitoring. Haggis was given this information.

2. Fish Fry was the sole director voting against giving Haggis the authority to set up AND control the monitoring system. Fish suggested that the two functions be split up – that Haggis set up the system, but that the board retain full control of the monitoring itself. This approach was rejected by the board on Porkey’s recommendation.

3. Once the monitoring system was put in place, Haggis was required to report twice a year on the monitoring system. He prepared a 10 minute summary of findings, and made the raw data available. He answered questions after the presentation, which lasted anywhere from 15 minutes to three hours. The board never reviewed the raw data.

4. At one point during a board of directors meeting in 1997, after Haggis had delivered his report and left, Fish Fry suggested that it might be a good idea to evaluate the effectiveness of administration of the monitoring system. However, Fish could not articulate any reason to suspect that Haggis was engaged in bad conduct. Fish, however, thought it odd that Endpork was drawing so heavily on its bank loans. Porkey suggested his suspicions were unfounded, that Haggis had Porkey’s full confidence, and that Fish had no expertise from which to make any assessments of the financial condition of Endpork.
5. In 1998, a consulting firm hired to help the board of directors decide whether to reorganize the corporation, opined that they thought it better, as a general rule, that the board periodically retain an outside firm to audit the monitoring system. The board concluded, with Fish dissenting, that such an audit would be a waste of money.

**PLEASE PREPARE A MEMO TO THE BOARD OF DIRECTORS EXPLAINING TO THEM WHETHER OR TO WHAT EXTENT THE BOARD MAY BE LIABLE FOR BREACH OF THE DUTY OF CARE. EXPLAIN YOUR ANALYSIS FULLY.**

**Question 5**  
*(suggested time 30 minutes; 30 points)*

Tomay Toe and Quu Cumber, wealthy investors, each own 100 shares of Endpork. They believe that they can profit from Endpork’s distress. They would like to form a corporation for the purpose of buying Endpork’s oil pipeline business. To that end, they propose to establish a corporation, Salad, Inc. Tomay wants nothing to do with the running of the day to day business, but she wants to make sure that no significant corporate action is taken without her consent. Quu has extensive experience in the oil pipeline business. Both want to share equally in the profits of the business, but Tomay doesn’t want Quu to take advantage of her by setting a huge salary for herself to the detriment of Tomay. To memorialize their understanding, Tomay and Quu want to incorporate the following terms into any corporation they form:

**Articles of Incorporation:**

1. The Board of directors shall consist of 3 people elected by the holders of Class A common stock. No action of the board of directors or any officer thereof, with a value of $10,000 or more, at shall be valid unless and until the action is approved, by the affirmative vote of 75% of the outstanding shares entitled to vote, at a special meeting called for the purpose of approving such action.

2. The corporation shall authorize the issuance of 100 shares of two classes of shares – Class A and Class B common stock. Class A common stock shall possess full voting rights, shall be fully participating as to income and assets. Class B common stock shall possess full voting rights, except that Class B shares shall have no right to participate in the election of directors, and otherwise shall be fully participating as to income and assets.

You have been asked to analyze these provisions by the senior partner who represents Tomay Toe. **PREPARE A MEMO TO THE PARTNER DISCUSSING FULLY THE LEGALITY OF THE PROVISIONS AND THE EXTENT TO WHICH THE**
Tomay and Quu ultimately form Salad, Inc. The company is incorporated in Virginia, a state that has adopted the RMBCA. In addition to the provisions described in Question 5, above, the shareholders agreement (to which the company was a party) provided that:

In the event of deadlock, the board of directors may, by resolution, cause the corporation to purchase the shares of any shareholder for the fair value of the shares, and the shareholders shall be bound by such determination.

Salad, Inc., purchased the pipeline business of Endpork for an excellent price. Within a year of the purchase, Tomay and Quu began to argue about the future of the company. Tomay wanted greater investment in East coast markets. Quu became more and interested in expanding into Canada and Mexico. The arguments over the future direction of the company became increasingly heated.

By the end of the second year of operations, Tomay and Quu had ceased speaking to each other except through their legal counsel. Because Quu controlled the board, she kept developing plans for expansion of the business into Canada and Mexico – including negotiating agreements for the expansion. Because Tomay has approval rights as shareholder, the shareholders consistently disapproved every attempt to expand the business into those countries. As a result, the business of Salad, Inc. effectively came to a standstill. At the beginning of year three of operations the banks sent formal notice to the company that they might declare the company’s debt in default under the terms of the loan agreements of the company failed to adopt and implement a policy of expansion.

Tomay has demanded that Quu sell her interest to Tomay. Immediately thereafter, the directors participated in a meeting of board at which they resolved to require Tomay to sell her interest to Quu. However, because the value of this transaction exceeded $10,000, this action was blocked by a shareholder vote in which Tomay voted all her shares against the action. Quu has filed an action in state court seeking to compel Tomay to sell her shares to the corporation.

YOU REPRESENT QUU. PREPARE A MEMO FOR QUU EXPLAINING WHETHER QUU CAN SUCCESSFULLY COMPEL TOMAY TO SELL HER SHARES IN ACCORDANCE WITH THE TERMS OF THE SHAREHOLDER AGREEMENT, AND ANY ALTERNATIVES IF TOMAY CANNOT BE COMPELLED TO SELL.