

D & O Review Problems

1. Hilda was the president and a minority shareholder of Scrooge, Inc., but not a director. She was elected president at the beginning of 2007 for a term of one year. She also has a written employment contract that lasts until the end of 2008; it provides that she can only be discharged for good cause. Nevertheless, on March 1, 2007, the board of directors held a meeting at which the board unanimously adopted a resolution providing that Hilda be removed as president and her employment terminated, “without cause,” effective immediately. The board’s resolution was promptly communicated to Hilda. The corporation paid her salary through the day of dismissal, but no further. Although the corporation has always generated plentiful excess cash not needed in operations, the board also resolved to discontinue payment of quarterly dividends until such time that Hilda divests herself of her shares of stock in the corporation. All of the other shareholders of the corporation are directors and (generously) salaried employees of the corporation. Hilda asks you the following questions. Explain your answers.

a. Is Hilda still president or not?

b. Does Hilda have a valid claim for breach of contract against the corporation?

2. Wareco is a corporation that operates a small commercial storage warehouse. Pres is the president of Wareco and Sec is the secretary of Wareco. Both Pres and Sec regularly attend board meetings, although neither of them is a director or shareholder of Wareco. At a January 1 board meeting, the Wareco board of directors passed a resolution stating that the president of the corporation may not enter into any contract for over \$1 million without the express prior approval of the board of directors.

On February 1, Pres signed a contract as president of Wareco providing that Wareco would purchase a fleet of 50 trucks from Able, Wareco’s usual supplier of trucks. The purchase price specified in the contract was \$20 million. Able was unaware that the board of directors of Wareco had never approved this transaction, but he did know that Wareco had never owned more than five trucks at any one time. On February 2, the board learned of the contract with Able and immediately repudiated it.

On March 1, Pres proposed to the board of directors of Wareco that the corporation purchase a forklift from Beta. Forklifts are essential to Wareco’s business, and it owns several of them. Because the board did not believe Wareco needed an additional forklift, it refused Pres’s request by passing a resolution disapproving the proposed purchase. In contravention of this resolution, and without the board’s knowledge, on March 5, Pres signed a contract as president of Wareco to purchase a forklift from Beta for \$2000. Beta had no knowledge of the board’s disapproval. On March 6, the board learned of the contract with Beta and immediately repudiated it.

- a. **Is Wareco bound by the contract with Able? Is Pres bound personally on that contract? Suppose the board had not passed the resolution requiring express prior board approval of contracts in excess of \$1 million. Same answers?**
- b. **Is Wareco bound by the contract with Beta? Suppose that Pres had said nothing to the board of directors in advance about the forklift purchase (and the board had thus not passed the resolution disapproving the purchase). Same answer? How, if at all, would your analysis change if a majority of the shareholders of Wareco had signed a written resolution overriding the board resolution and allowing the president of the corporation to buy the forklift from Beta? What if all of the shareholders had signed the resolution?**
- c. **Suppose the board had not passed its resolution disapproving the forklift purchase, and Cathy, a shareholder owning 25% of the Wareco stock, had signed a contract on behalf of Wareco to purchase a forklift from Beta. Would Wareco be bound on this contract? Would it make a difference if Cathy owned 75% of the Wareco stock? What if Cathy were also a director of Wareco?**
- d. **If the shareholders of Wareco are unhappy with Pres's constant disregard for the board's directions, can they vote to remove her from office? Can the board remove Pres from office?**
- e. **Assuming Wareco is bound on the contract with Beta, if Wareco fails to fulfill this obligation and declares bankruptcy, can Beta enforce this contract against the shareholders of Wareco? Against the directors?**