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QUESTION 1

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The Lease

A partnership (PS) is agreement by two or more persons to carry on together a business for profit. The intent to carry on business together is the key element (Holmes case), however agreements to share in the profits, losses, and control of the business are also evidence of a PS.

Here, the facts show that Joy (J), Mervyn (M), and Greg (G) agreed to go into business together. Presumably this was an intent to go into business together for profit. Since the parties so intended, a PS was formed -- no formal agreement or writing is required to form a PS.

Every partner has authority to bind the PS in the usual course of business, absent some contrary provision in a partnership agreement. There are two rules defining "usual way": the American rule, which is the usual way that particular business is conduced, and the English rule, which is how business of that type are conducted. The English rule is correct.

In this case, J was a partner at the time she made the lease. At that time there was also no PS agreement limiting her authority as a partner, thus she could bind the PS in the usual way a drycleaning company does business. Dry cleaners need space in which to operate, so the making of a lease by J for the PS is valid. Moreover, she indicated to the landlord that she would not be

the sole party responsible for the lease, which is further evidence of her intent to bind the PS, not herself personally. Notwithstanding the fact that only J signed the lease, the PS is liable for the lease.

However, all partners are jointly and severally liable for such PS debts. Thus the PS itself and all partners are liable. M may try to argue that he is a dissociating partner (discussed later) and should not be liable if the PS is unable to pay the lease after he leaves. M's argument will fail, because a partner remains liable on PS debts incurred during PS unless he is released by the creditor and the other partners indemnify him. Absent a release and indemnification, M will remain liable. Further, if M's dissociation is wrongful, then he would be liable to the PS for damages caused by the dissociation, including the PS's inablity to pay its lease, if such inability should occur.

PS Agreement

A PS agreement is any oral or written agreement between the partners as to the affairs and operations of the partnership and as to the relations of the partners to each other.

When J, M, and G held a meeting on January 5, they orally agreed to share profits equally, to contribute equal capital contributions, and to share equally in the losses. This constitutes an oral PS agreement which parallels the statutory default provisions. Thus, the oral PS agreement does

not in any way vary the statutory default provisions.

PS Equipement

Under antiquated common law principles, each partner held an interest in each individual piece of PS property. Such property was held as tenants in common under the aggregate theory of partnership. Upon dissolution of the PS, which would occur with any change in the exact constellation of partners, each partner was entitled to their piece of each item. However, under the modern entity theory of partnerships, partners have only an economic interest in the value of PS property, not in the property itself.

Here it is unclear whether J, M, and G intended to vary the default PS laws by providing that each partner will actually have an interest in the items they actually purchased. Under statutory defaults, J, M, and G would each have an interest in the value of their share of the PS property, but not in the property itself. However, if their decision to take turns buying the necessary equipment does constitute a variance of the default provisions each partner does have the right to take the property purchased upon leaving the PS, since the parties effectively added that provision to their oral PS agreement (supra). It is worth noting that absent contrary provisions in a PS agreement, each partner has an equal share in the PS regardless of capital contribution, so even if one piece of equipment was more costly it would not give that partner an enhanced claim against the PS upon dissociation.

Mervyn's Dissociation

Dissociation marks the time when a partner ceases to be involved in carrying on of the business of the PS. Classically, dissociation of a partner meant the end of the PS, although remaining partners could purchase PS property and join to form a new PS. Modernly, any partner may dissociate without causing dissolution of the PS under the entity theory. The express will of any partner can cause dissociation at any time.

Here, M has communicated to J and G his intent to leave the PS to take a better position with a competitor. This will likely be found to be a dissociation and will trigger certain actions in completing M's affairs with the PS. However, until M's affairs with the PS are concluded, he continues to labor under certain duties, namely fiduciary duties.

Fiduciary Duties

Each partner owes the fiduciary duties of care and loyalty to the PS and to the other partners. The duty of loyalty encompasses an obligation not to compete with the PS prior to conclusion of relationship with PS, not to appropriate PS opportunities, and not to put his/her own interests ahead of the interests of the PS.

The facts show that M remains a partner at the time when he decides to take valuable PS property and a $20K signing bonus and leave the PS. This is likely a breach of M's duty of loyalty. Here, he is taking away PS property necessary to function and profitablility of the PS. M will benefit, but the PS and remining partners will suffer. M is putting his own financial interests ahead of those of the PS and other partners, resulting in a breach of his duty of loyalty to the PS. Further, M is taking a payoff to harm the PS. This is clearly a breach of the duty of loyalty. Further, M is going to work for a competitor, compounding the breach.

Regarding the PS property in question, M may or may not be entitled under the oral PS agreement (supra) to take the conveyor equipment. If the parties did agree to modify the statutory defaults and provide each partner had the right to take the specific equipment they purchased then M does have the right to take the conveyor. However, if there was no such modification M has no right to the specific equipment and is only entitled to a payment in cash of his portion of the value of the PS property.

It is unlikely J and G will be able to prevent M from joining Dan, but they do have a remedy for their damages. M is liable to the PS and remaining partners for the damages they suffered as a result of his breach of the duty of loyalty. This includes lost profit damages if M wrongfully takes the equipment, but such damages will not be available if the PS agreement modified existing partnership laws. If M's dissociation is found to be wrongful, he will be entitled to his proportionate share of the value of the PS in cash (or bond posted with the court), minus the

value of any goodwill and also minus any damages caused by the wrongful dissociation. Since M violated his fiduciary duty by agreeing to compete with the PS while he was still a partner, it is likey his dissociation will be found to be wrongful.

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Rights of Carl

Carl (C) will have a cause of action against the director/shareholders who removed him. Their actions in removing C were improper. There were several improper actions of Abraham (A) and Beverly (B) during their S/H meeting as detailed below. C will have a cause of action against A and B for the actions that impacted him as a director, as well as those that impacted him as a S/H.

Shareholder's Meeting

The first problem is that a special S/Hs meeting may not be called without proper notice (usually at least 10 days) to S/Hs. The notice must be sent to all S/Hs and must describe that issues that S/Hs will be voting on. Notice can be waived by actual attendance at the meeting, but we know from the facts that only A and B attended the S/H meeting. Thus, A and B improperly called the meeting and any actions approved at the meeting will be invalid. It bears mentioning that A and B had a quorum for the meeting, assuming that the corp required a majority for a quorum, because together they owned 55% of the stock. Also, each vote that was taken at the meeting represented all of the shares that attended the meeting, so the vote would have been valid except for the notice requirement violation. There were also fiduciary duty breaches in addition to the notice violations that impacted the validity of the actions (discussed infra).

Vote to remove C from the board:

S/Hs do have the authority to remove directors from the board with or without cause (at common law, directors could only be removed for cause). Thus, if the vote is valid, the S/Hs have the

power to remove C or any other director. However, if the S/Hs wish to remove a director for cause, they must give the director notice and a chance to defend himself, ideally in writing and before the meeting. Here, we know that the notice of the special meeting was not properly given and Carl was given no notice that the S/Hs were intending to vote on his removal. He also had no chance to defend himself ahead of time. Thus, A and B's action in removing Carl will be invalid. C may sue A and B personally (since they breached their fiduciary duties, discussed infra) and the corp if it tries to enforce the action for an injunction against his removal.

Vote to amend the articles to create a new class of "super-stock"

Again, the lack of notice invalidated this action. However, there were other problems with the action. First, it is important to clarify that at this meeting, A and B were acting as S/Hs, not directors. S/Hs do not ordinarily owe a fiduciary duty to other S/Hs. A fiduciary duty, in general, is the highest form of duty at law or equity. The fiduciary must be extremely loyal to the persons to whom the duty is owed. The fiduciary must not compete with the person to whom the duty is owed and cannot profit at his/her expense. While the general rule is that S/Hs owe no fiduciary duty, most jurisdictions recognize that a fiduciary duty is owed by majority S/Hs to the minority S/Hs, especially in a closely held corporation. A closely held corp is one in which there are a small number of S/Hs, typically fewer than 20, the S/Hs are also the managers, and the shares are not easily sold on the open market. Acme fits the definition of a closely held corp; it might also meet the requirements of a statutory close corp, which might result in extra duties owed. While A and B might argue that they are not majority S/Hs since they each have fewer than 50% of the shares, a court would probably hold that they were a "unit" because they were brother and sister.

Thus, A and B are majority S/Hs who owe a fiduciary duty to not act in a way that prejudices the minority holders. This issuance of "super-stock" to officers will be fundamentally unfair to the minority holders who are not officers. That includes Carl, who owns 35% but is not an officer, and the unspecified 10% S/Hs who are presumably also not officers. Thus, Carl and the other 10% S/Hs will have a cause of action against A and B for breach of fiduciary duty to treat the minority S/Hs fairly. They can get specific performance, which would be to invalidate the issuance of the shares. A final point on these super-stock shares is that in some jurisdictions, the court will not allow different voting privileges within the same class of stock. These shares allow 10 votes per share--if there are other stocks that are considered within the same class that have only one vote per share, this would cause validity problems in some jurisdictions, but not all. We do not have facts to support this type of finding.

Vote to issue the stock to themselves (A and B)

When A and B voted to issue these stocks to just themselves, they once again violated their fiduciary duties to the minority holders (see discussion infra). This action is also invalid because of the notice problems mentioned earlier. There are no facts given as to any consideration for the shares. Normally, consideration, such as money, property, etc. is needed for shares to be issued. We also do not know if these shares were authorized, a step that the board must take before shares are issued. If these are some kind of "bonus" for officers, there is a clear conflict of interest that the majority S/Hs are issuing these shares just to themselves. It will also result in everyone else's shares being worth less. The other minority S/Hs, including Carl will have a cause of action against A and B and the corporation to invalidate the action. Carl may also argue

that the dilution of his interest injured his position. If he has preemptive rights (the right to purchase newly issued shares to keep the same percentage of ownership), he'll be able to buy stock himself to keep his ownership at 35%. Most jurisdictions don't allow for preemptive rights unless the bylaws allow for this right.

Carl's exposure for the exploding crates

Carl as a director may be held personally liable if he acts in a way that violates his fiduciary duties to the S/Hs. Note: as a S/H, Carl has limited liability for debts of the corp beyond his capital contribution, so we are now just discussing director's duties. These fiduciary duties include a duty of due care as well as a duty of loyalty. Carl will only be liable for the explosions if he has acted in a way that violates his duty of care or loyalty. Normally, there would be an inquiry as to the actions of the board as a whole. However, individual directors may offer their own defenses for their actions. C should definitely offer his own defense. The actions of his co-directors are so egregious as to warrant a court finding them in breach of duty and therefore liable, especially A. Francine also clearly violated her duty to monitor the corp's officers (discussed infra) when she was uninterested in hearing about the explosions. A court would certainly consider C's actions in light of the board's actions as a whole. However, C has a chance to defend his own actions.

Carl's duty of care

Every director has a duty of care that requires that he use the care that a prudent director would use in carrying out his duties. A director may defend against a charge of breach of the duty of

care by asserting a defense based on the business judgment rule (BJR). This rule gives directors broad discretion in making business judgments. A director may not be held personally liable for a conscious, good faith decision absent illegality, fraud, self-dealing and gross negligence. Thus, C may defend himself against any shareholders who sue him based on the plummeting stock price by invoking the BJR. C can assert that he did not push Abraham to explain about what was bothering him and voted for the bonuses based on the fact that he made an informed business judgment that was rational. This defense may work for any business judgment C made regarding the bonuses. However, Carl does not seem to have done much to inform himself, which takes him outside the scope of defense for the BJR, which only applies to "conscious" decisions. He also does not seem to mind when B does not document his question--the S/Hs might argue that this was gross negligence, although it probably was not.

Carl's duty to monitor

Carl had a duty to monitor the conduct of the company's employees, including officers such as Abraham. While courts do not require that boards undertake extensive "corporate espionage to ferret out wrongdoing," a board must take reasonable steps to be informed of possible illegal or other problematic conduct. We know that Acme's products are potentially dangerous and could injure scores of people at one time. It seems that the board as a whole should have taken some steps to find out more about the stability of the fireworks. Perhaps there could be a system of quality control or accident reporting from line employees. The S/Hs who wish to find Carl personally liable may argue that he should have done more specifically when he "sensed A was uneasy." An uneasy president is cause for more inquiry for a reasonable director. While C will

argue that he's not responsible for A's consciously misleading behavior, he will not be successful with this argument. C seems to have been asleep at the switch.

The S/Hs will also argue that C should have brought in experts in stability of fireworks if the board was not sure of itself in making decisions about safety. After all, we have no facts to indicate there are any explosives experts on the board. The ornithologist would be particularly unhelpful in this area. Carl Castle works as a newscaster at NPR (if this is the same Carl Castle). All the rest of the board members seem chosen because they were related to someone else on the board A board is entitled to rely on expert reports in making decisions. Consulting an expert could have help establish that the board was fulfilling its fiduciary duties by getting more advice in the areas in which it was weak.