

Empire College of Law

Fall Semester 2012

Business Organizations

Midterm Examination

Professor: Rob Rutherford

Three Essay Questions

Time to Complete Examination: 3 hours

Instructions

This examination consists of 3 essay questions. Your answers to each question will be weighted equally when determining your grade. You have three (3) hours in which to complete the exam. The recommended time for each question is one (1) hour. Please budget your time so you can adequately answer each question.

Before starting to write, you should read each question carefully and spend some time organizing your answer. Your goal should be to identify the issues, recite applicable law and then apply and analyze the facts. Strive for precision and brevity and avoid getting stuck on one issue or topic.

Good Luck and Happy Holidays!

Empire College of the Law
Business Organizations - Rutherford
Midterm Fall 2012

Question 1

Teri decided to open a retail furniture store. But Teri did not have any money, so she borrowed \$50,000 from her Mom. Teri promised to pay Mom back when the store was sold. In the meantime, Teri agreed to pay Mom 15% of the profits generated by the business. Mom insisted that she have the right to inspect the financial records of the business at any time. Teri agreed, but stipulated that Mom could not interfere with the day-to-day operation of the store.

Teri signed a lease for showroom space in the local mall and rented a truck to use for furniture deliveries. She also opened accounts with a number of furniture suppliers. Teri had a bad credit history and was worried that her applications would be denied, so she listed Mom as the owner of the business on all these contracts and signed them as Mom's agent.

One day, a customer recommended to Teri that she sell carpet in addition to furniture. The customer said that her husband, Jim, was a carpet installer with lots of contacts in that industry. Teri called Jim, and they soon agreed on terms. Teri would take carpet orders at the store, and Jim would do the installation work. They shared the profits 50-50. Teri kept the operation and all of the income from the carpet business separate from the furniture store and did not include it when calculating Mom's share of the furniture business profits.

Preoccupied with the more lucrative carpet business, Teri stopped paying attention to the furniture business. Losses mounted and she was forced to close the furniture store. The landlord, delivery truck owner and furniture suppliers all are looking for their money. Mom has asked for your advice as to whether or not she has any liability to these parties. She is also angry about Teri diverting her attention to the carpet business and wonders what rights she may have regarding that. Please discuss Mom's rights and potential liabilities.

Empire College of Law
Business Organizations - Rutherford
Midterm Fall 2012

Question 2

Anna owned all 100 shares of the authorized, issued and outstanding common stock of a beverage distribution business called Fizzy Drinks, Inc. (“Fizzy”), a California corporation. Fizzy is a sub chapter “S” corporation for income tax purposes. Anna ran the business and has been its sole director since the company was formed in 2000. In December 2011, Anna decided that she wanted to quit the business and go to art school, so she gifted 30 shares of her Fizzy stock to her daughter, Rosa, and 30 shares to her son, Nick. Anna, Rosa and Nick then signed a Shareholders Agreement saying that the three of them would serve as directors of Fizzy and that all actions by the Board of Directors required their unanimous consent. The Shareholders Agreement also provided that Rosa and Nick would receive annual salaries of \$100,000 each for serving as the officers and running the business, and it required that Fizzy would distribute at least 50% of its annual earnings to the shareholders

Anna leased a warehouse to Fizzy on a month-to-month tenancy. In 2012, Fizzy’s income declined, and Rosa and Nick asked Anna to reduce the warehouse rent. Anna said that she needed the full amount she was receiving to pay her bills. Though a real estate appraiser told them the warehouse rent was reasonable, Rosa and Nick responded by signing a Written Action by Shareholders removing Anna as a director without cause. Rosa and Nick then convened a Directors’ Meeting during which they voted to terminate the warehouse lease. The next day they sent a lease termination notice to Anna. They also sent her an email saying that all corporate distributions would be discontinued immediately.

Please discuss what rights and remedies Anna may have against Rosa, Nick and Fizzy.

Empire College of Law
Business Organizations - Rutherford
Midterm Fall 2012

Question 3

Rick, Mark and Lisa started a winery business called RML Wines (“RML”). Lisa insisted that they incorporate the business in Delaware. She prepared Articles of Incorporation for RML and mailed them to the Delaware Secretary of State on July 15. The Articles stated that RML had a single class of stock and was authorized to issue up to 100,000 shares with par value of \$10 each.

Rick, Mark and Lisa held an organizational meeting on August 1. Lisa began by telling Rick and Mark that the Articles had been filed. The three of them agreed to serve as RML's directors, and they appointed Rick as President, Mark as Treasurer, and Lisa as Secretary. Next, they approved the sale of 10,000 shares of stock to each of them for \$5,000. Mark deposited the proceeds from the stock sales in a separate account he opened in his own name. Lisa never issued stock certificates to the shareholders and did not prepare minutes of the meeting.

On August 5, Rick bought \$250,000 of winery equipment for RML from Bill. Rick signed the contract: Rick, President, RML, Inc. The contract called for RML to pay for the equipment over the next 5 years.

On August 7, Lisa received a notice from the Delaware Secretary of State informing her that RML's Articles of Incorporation had not been filed because she had not included the filing fees. She immediately sent the fees by overnight delivery. Lisa was greatly relieved when she received a copy of the Articles showing that they had been filed on August 10.

Mark went to interview a wine maker on September 20. On the way back to the office, Mark ran through a stop sign and struck a bicyclist, severely injuring her.

On October 21 an earthquake destroyed RML's facility and all the equipment. Bill is demanding payment in full, and the bicyclist has sued RML and Rick, Mark and Lisa. RML did not have earthquake insurance. It did buy liability insurance, but unfortunately, the injuries to the bicyclist will exceed the policy limits. Rick, Mark and Lisa feel RML will not survive these events and have asked you to advise them whether or not they face any personal liability for the claims asserted by Bill and the bicyclist. Please do so.