Empire College School of Law
Professor Robert Rutherfurd
Business Organizations – Midterm
Tuesday, December 13, 2016

Student ID#_______________

QUESTION 1

In December 2015, Jason and Ruth, who are both certified public accountants, agreed to form a limited liability partnership—J & R, LLP. Jason completed Articles of Registration and sent them to the Secretary of State, but he failed to sign them. When the Secretary of State returned the Articles without filing them, Jason tossed them on his “To Do” stack and forgot about them.

Meanwhile, Ruth talked to a real estate agent, Joe, about the availability of office space. Ruth and Joe visited a trendy new building together. Ruth told the Landlord that she loved the office but that she needed to consult with her partner—who the Landlord mistakenly assumed was Joe; since Joe (as both the Landlord and Ruth knew) was also a CPA. When Ruth stepped out to take a phone call, the Landlord offered to hire Joe as the exclusive leasing agent for another large office complex the Landlord was building and pay him an additional 1% above the standard real estate commission if Joe agreed to lease the office. Joe said, “Sure.” He signed the lease the Landlord pulled out of his back pocket as “Joe, agent for J & R, LLP.

When Ruth ended her call and returned to the meeting, Joe and the Landlord told her that they had reached a deal. Stunned, Ruth said only that the rent sounded good. Joe and the Landlord did not tell her that the lease obligated J & R, LLP to rent the space for 15 years--a long time for an office lease.

Then, Ruth’s phone rang. It was Jason. “We’re finished,” he said. “I’ve been helping the executives of a major company ‘cook’ the books. The shareholders just filed a class-action lawsuit against you, me, and J &R, LLP.”

Shocked, and concerned about protecting a sizeable inheritance she received a few years ago, Ruth asks you to analyze her potential rights and liabilities arising from these circumstances. Please do so.

QUESTION 2

Joni, Bob, and Van are the controlling shareholders of Lightning, Inc., a Delaware corporation qualified to conduct business in California ("Lightning"). Lightning owns a successful nightclub in Los Angeles. Lightning has approximately twenty-five other shareholders, and Lightning's stock is not publically traded. Lightning's Articles of Incorporation state that the liability of directors and officers for damages is eliminated to the fullest extent allowed by law.

Joni, Bob, and Van pool their votes to elect themselves as Lightning's three directors, and as directors, they hire themselves to manage the club. Each year, they retain a consulting firm specializing in executive compensation to recommend how much Lightning should pay them for their management services. Bob's wife, Clara, owns the consulting firm. The salary proposals Clara submits to the board are always based on the highest amounts paid in the nightclub industry without considering that other, less-famous clubs in cities lacking the vibrant entertainment culture of L.A. demand much more from their management teams than Lightning does. Thrilled with the six-figure salaries Clara recommends that Lightning pay them, Joni, Bob, and Van, acting as the directors of Lightning, sign written consents each year adopting Clara's salary recommendations. They never meet with Clara to discuss her methodology, but Joni and Bob sometimes call two or three other salary consultants who usually opine that Clara's recommendations, while generous, are not unreasonable, given how successful the club has been.

A group of disgruntled Lightning shareholders allege that Joni, Bob, and Van breached their fiduciary duty to Lightning by paying themselves exorbitant salaries, and they filed a lawsuit to recover damages from Joni, Bob, and Van.

Joni, Bob, and Van have asked that you represent them. Please assess the potential liability of the three directors concerning their salaries and what defenses to liability they may assert.

QUESTION 3

In 2012, Patty, Rose, and Emily formed Concinnity Software, Inc. , a Delaware corporation ("Concinnity"). The Articles of Incorporation for Concinnity authorized the corporation to issue up to 300 shares of common stock with a par value of $1.00 per share. The Articles also state that the liability of the directors and officers for monetary damages is eliminated to the fullest extent allowed by law. Patty, Rose, and Emily each contributed $100 for 100 shares of Concinnity stock. In addition, Emily loaned $500,000 to Concinnity. She received a note that allowed her to demand payment in full at any time.

Concinnity grew at a meteoric pace, hiring software designers and engineers by the dozen and occupying a beautiful (and pricey) corporate campus. With all the start up costs, Concinnity posted modest profits at best, amassing only $100,000 in retained earnings during its first three years of existence. But analysts familiar with the software industry valued the corporation at $20 million or more.

The three shareholders served as Concinnity's officers and directors. At a meeting of the directors in 2016, Patty and Rose voted to distribute $600,000 in dividends. Emily objected, claiming that such a large distribution would leave Concinnity in a precarious financial situation. Patty and Rose ignored her.

Patty and Rose then decided to sell all of their Concinnity stock to Gordon Gecko, who was famous for pillaging small firms like Concinnity. True to form, Gecko looted Concinnity. His puppet directors sold Concinnity's IP to other firms controlled by Gecko for a fraction of its value, fired the employees, and closed the campus. Concinnity filed bankruptcy. Closure of the campus hit the neighborhood hard, as crime and unemployment rates in the area soared.

Emily asks for advice about what remedies she might pursue against Patty, Rose, Gecko, and his puppet directors. She thinks Concinnity has some assets left, and if so, she wants to file a claim in bankruptcy to recover under her note. Emily also wonders if she can force Patty, Rose, or Gecko to do something for the blighted neighborhood Concinnity once called home.