Empire College School of Law
Professor Rutherfurd
Business Organizations – Midterm
Tuesday, December 18, 2018

Student ID#_______________

QUESTION 1
(One Hour)

Martha worked as the executive travel director for Planes and Rockets, Inc. a Delaware corporation (Planes) that built jet fighters. Martha made business travel arrangements for the engineers and officers of Planes.

At a travel industry convention, Martha met Phillip, the owner of International Travel, a sole proprietorship, Impressed by the volume of Plane's travel business, Phillip told Martha that he would pay her one-half (50%) of the profits he made on flights and lodging she booked through his office.

Martha began using International exclusively when making travel arrangements for Planes, even though the cost of booking through International was higher than the rates she could obtain from other agencies. True to his word, Phillip paid Martha one half (50%) of the profits from the business she placed through his agency. Martha made a lot of money from her relationship with Phillip

But Martha worried about the quality of Phillip's work and about his ability to meet the demands of a client as large as Planes. She demanded that Phillip give her remote access to his computer so she could check on how things were going at International. She also insisted that Phillip change International's bank accounts to require that Martha sign all checks over $100. And Martha wanted Phillip closer to Plane's headquarters to expedite processing of all the business Martha referred to him. Martha agreed that she would pay one-half of the rent, so Phillip went ahead and signed a five - year lease for an office across the street from Plane's facility. The lease identified Phillip and Martha as the tenants. Phillip signed the lease on Martha's behalf.

Martha contacted you because her relationship with Phillip has taken a bad turn. Phillip recently confessed to making a number of bogus hotel reservations that earned him extra commissions—some of which he had shared with Martha. The hotel had figured out the scam faster than Phillip had expected and was demanding its money back. Phillip has disappeared. Meanwhile, the audit committee at Planes has scheduled a meeting with Martha to discuss why travel costs have increased so dramatically.

Martha asks that you advise her about whether these business dealings with Phillip create any potential liability exposure for her. Please do so.

QUESTION 2
(One Hour)

Delicious Wine, Inc. (Delicious) is a duly formed Delaware Corporation with 500 shares of common stock issued and outstanding. Lilly owns 200 shares. Owen owns 100 shares, and Penny owns 200 shares. Delicious owns and operates a winery in California, and all three shareholders, live in California, sit on the Board of Directors, and work at Delicious. The shareholders and Delicious have made an election to be taxed as an "S" corporation.

The business relationships among the shareholders become contentious in 2017. At the meeting of shareholders held in January, 2018, Penny announced that she intended to vote her shares cumulatively. Lilly and Owen objected and refused to recognize her request, pointing out (correctly) that neither the Articles nor the Bylaws of Delicious provide for cumulative voting. In response, Penny argued that California law applied and mandated cumulative voting. Lilly and Owen proceeded with the shareholders' meeting. They voted together and elected themselves and their friend, Gus, to fill the three seats on the board, out voting Penney 300 to 200 on each seat..

Lilly and Owen then voted to adjourn the meeting of shareholders. After written notice to the directors, a board meeting was convened five days later. Lilly, Owen, and Gus all were present. Citing a decline in sales, the directors voted to fire Penny, even though she worked in the accounting department and had nothing to do with marketing.

Delicious had sold some of its prime vineyard land in 2017, pocketing a hefty profit and triggering a significant amount of taxable income that shareholders had to include on their personal tax returns. The balance sheet for Delicious showed over $1 million in earned surplus (also called retained earnings) and that the assets of Delicious exceeded its liabilities plus stated capital by more than $2 million. Penny wrote to the board and demanded that it declare a dividend, but the board rejected her request. The board, did, however, approve payment of a $400,000 bonus to Lilly and a $200,000 bonus to Owen.

On behalf of Penney, please discuss the legal issues pertaining to the election of directors and whether the actions by the directors breached their fiduciary duty to Penney. What remedies might Penney pursue?