1) 90

======== Start of Answer #1 (959 words) ========

Moms potential liability would arise under two situations either through a potential partnership or through an agency relationship.

PARTNERSHIP

Mom's potential liability through a partnership is based on whether or not mom was in a partnership with Teri or not. A partnership is an association of two or more people engaged in business for profit. Now, it is obvious that Mom gave teri a loan for the business. A creditor of a partnership can be a partner depending on the facts involved and how much they are involved in the business or how much control they have. IN this situation there was no specific payback plan for the loan and this leaves much to guessing. Those seeking liability on mom would argue that she is a partner beacause she never specificed how she was to be paid back, that she is recieveing 15% of the profits of the business, and profit sharing is a sign of the partnership and that she has control by being able to inspect the books. Mom will argue that a partnership does not exist because she clealy stated that the money was a loan not a capital contribution as a partner, also as a creditor she should have the right to inspect the books to check on her investment. SHe also would make the argument that she agreed to not be involved in the day to day operations of the business.

How does this relate to partnership rules?

If she was found to be a partner and not just a creditor then mom may be open to liability as a general partner. She would not be a limited partner because there was not filing with the state that this business was a limited partnership and the default rule is that a business is presumed a general partnership unless told otherwise. Under a partnership the partners are joint and severally liable for the debts and liabilities of the business. The truck owner, furniture supplier, and landlord can only go after the partners if they exhaust all of the partnership assets first and then may seek damages from the partnership. If mom is a partner she will be joint a severally liable for the damages.

Agency

Agency is when a relationship is created when the principle manifests in another person (the agent) the consent to act on behalf of the principle. Agency can be created by Acutal authority, which is the express or implied manifestation of an agency relationship, through apparant authority, when the principle manifests to a third party that there is a agency relationship in a non-agent, or through inherent authority, which is the nature of the angecy relationship alone creates the authroity. FOr mom to have liability to the Truch owner, Furniture supplier, and Landlord (creditors) the crediotrs must establish some kind of agency relationship. ✓ good.

In this situation teri signed as her moms agent. There is no actual authority because there is no expressed or implied creation of agency in teri from mom. THe question is whether or not there is an apparant authority for an agency. The creditors would not have an argument because there was no contact with the mom so there could be no manifestation. The creditors may also try to argue that there was an agency by estoppel. Agency by estoppel occures when a party negligently also another to change their position and the principle having notice of such a change does nothing to stop it. The creditors arguement would be that they changed there position here based on a false sense of agency and that mom knew about it and did nothing to correct the problem. The facts never tells us whether mom knew or didnt know about the false agency, so most likely she would not be liable through agency. ✓ good!

IF no agency relationship can be established teri would be liable all on her own for the creditors.

MOMS RIGHTS

Moms rights would be determinative on whether or not she was a partner in the business.

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The loan

If mom was not partner she would have the right to get her loan paid back as a creditor of the business. As a non-partner creditor she would be first in line with the other creditors to get her money back from the business on dissolution and winding up.

Breach of Fiduciary Duties.

Under a partnership partners owe eachother a fiduciary duty of care and a fiduciary duty of loyalty. The duty of care is to run the business to the best interest of the partnership. Under the duty of loyalty the partners must deal with other partners with good faith and fair dealing. They also have a duty to not compete, or make a profit with the company assets. ✓

In this situation teri sets up a business with Jim. THey share the profits 50-50 and do not include MOM. Teri is using the business to assits her other business with jim. THe partnership is entitled to those profits because it is another partnership between JIm and the Partnership. When teri kept profits for herself she was breaching her duty of loyalty to MOm, (if mom was a partner), by not including her in the profits. The other problem is when Teri became so involved in the carpet business she let the other business die. THis would be a breach of the duty of care. The business did not die because there was no market, or jsut didn't do well, it died because teri, as the day to day manager, allowed it breaching her duty of care to run the business in the best interest of the partnership Good!

As a partner Mom as the right to dissolve the business and to seek any damages that may have been caused by the breach of her fiduciary duty.. Good.

2) 85

======== Start of Answer #2 (1515 words) ========

ANNA AND HER DIRECTOR SEAT

It is important to note that this is a California corporation. Under the internal affairs doctrine, the state of incoproators laws will govern integral disputes, in this case the law of California. Unless the company is pubically traded, in California shareholder must use cumulative voting. There are no facts to assume this was a publicly traded company. This is an S-Corp, a form of a closely held corporation. As it is not public ally traded the corporation must use cumulative voting.

In a cumulative voting jurisdiction the shareholders cannot remove a director without cause if the votes against would be sufficient to elect the director. If the shares were evenly split Anna would be able to secure her position as in an election cumulative voting would have to be used and she would be able to multiply her number of shares by the number of directors slots to fill and cast the shares for one or more candidates, including herself.

In this case Anna owns 40 shares and Nick and Rosa own 30 each. This mean under cumulative voting at an election Anna would be able to vote up to 120 shares for herself. Nick and Rosa would each have 90 shares to vote in an election. Each would undoubtedly cast their votes for themselves, meaning that as a practical matter in the election Anna would be able to secure her spot using cumulative voting. As such she should be able defeat the removal vote as she has sufficient votes to elect herself. Good!

Shareholders agreement are a valid form. Part of this share holders agreement appears to be a vote pooling agreement, which is a written agreement to vote shares a specific way as

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specified in the agreement itself. It has no formal requirement other than it be in writing and signed. In this case it was signed by all the parties. The agreement was essentially that the would elect each other directors. Although a closely held corporation can agree to dismantle a board they cannot get around their obligation to have an annual meeting at which at least one director slot is elected and filled. As such it can be inferred from the agreement that they needed to vote each other in.

Pooling agreements, if valid are specifically enforceable and Anna can petition the court to order that she be reinstated as per the pooling agreement.

Furthermore shareholders cannot remove a director without cause by a written action of the shareholders. This would require a special meeting which can be called by the president, the board, or 10% of the outstanding shares. All of the parties in this case have to power to call a special meeting. Even if the meeting is to remove without cause it needs to written notice regarding the purpose of the meeting delivered at least ten days before the meeting. This was not an effective removal due to lack of notice and a special meeting. Anna will retain her seat.

DISCONTUANCE OF DISTRIBUTIONS

Although shareholders do not have the power to declare distributions, this power rests with the board of directors, the majority shareholders in a close corporation owe a fiduciary duty to the minority shareholders and may not freeze out or oppress the minority shareholders. As we have seen Anna will be able to reclaim her board seat. She has been frozen out already, however even if she gets back on the board there will likely be a deadlock as the shareholders agreement calls for unanimity amongst the directors. If the shareholders agreement is valid all of them will have to agree on everything, this sounds unlikely considering the current affairs of the corporation. If this occurs Anna could request judicial dissolution of the corporation due to deadlock.

There is a very simple reason why Nick and Rosa's decision to terminate distributions represents oppression by the majority shareholders of a closely held corporation against the minority, Anna. The simple reason is that the shareholders agreements calls for 50% annual earnings to be distributed to shareholders. The reason getting rid of this violates the fiduciary duty is that under any of the california dividend tests will allow for the 50% dividend.

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California uses two specific test under Cal. Corp. Code section 500. The first is the retained earnings test. Under the retained earnings test the corporation may declare a dividend so long as the retained earnings, immediately prior to the dividend, equals or exceeds the amount of the proposed dividend plus any preferential dividend amounts in arrears.

There are no facts to suggest that any proffered dividend rights are in arrears as there is only common stock. As such, the corporation may always pass the retained earnings test because the 50% distribution will always only be 50% of the retained earnings and therefore the dividend cannot exceed the retained earnings.

Under Cal. Corp. Code section 500's balance sheet and liquidity test the corporation may pay dividends if assets exceed the liabilities immediately after payment of the dividend, plus the preferred rights. Preferred rights refers to the amount of money the corporation will have to pay to preferred shareholders upon dissolution. Again there are no preferred shareholders in this closely held S corporation. Indeed there cannot be because an S-Corp may only have one class of stock. This test could make it possible that the corporation would be unable to make a 50% earnings dividend if their liabilities greatly increased. Furthermore directors cannot allow a dividend to make the corporation insolvent either as a going concern, or what would be needed for dissolution.

So long as it can meet the test the corporation must adhere to the shareholders agreement and pay the distribution unless they make an agreement to the contrary. Rosa and Nick are still collecting salaries of 100K. There revocation of the distribution is a tactit to oppress anna as the minority shareholder. She has a reasonable expectation under the agreement to make at least something if there are profits. Anna could the court to order Rosa and Nick to release the dividend in their director capacity in order to try and palce anna as nearly as possible to the position she was in before the wong doing.

Isn't terminating the lease part of oppressive conduct?

THE LEASE

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Alhtough a director has a duty to the corporation, the shareholders and other directors not to self deal. Self dealing may be ratified by a majority of the board directors, two or more directors of a committe, or by a majority of the indiependent shareholders. In this case it can be inferred that the board, when anna was still on it, uananimously approved entering hte lease agreement knowing, Anna owned the warehouse. Whle Anna owed a fiduciary duty to Frizzy she is not stopped from incidentally benefiting. The warehouse is being leased for a reasonable price. If the warehouse was not leased for a reasonable price it would be a breach of the fiduciary duty and Frizzy could bring action to disgorge any profits made by anna its agent. It is however in this case a, reasonable rental value. It is true that Frizzy could disgorge any profits above the market rental value of the property because an agent cannot make a profit above the market value if they already owned the property before the agency relationship and are now selling or charging the principal for the property. This is an incidental benefit to Anna and because it is reasonable fair market value price it does not violate her duty of loyalty to the corporation.

good!

The directors meeting after the improper and innefective attempt to remove anna from the board was invalid because the decision to terminate the lease as not unanimous as under the shareholders agreeement. Again if Anna comes back and the re-vote their is likely to be a deadlock. It is also possibly anna would have to remove herself from the vote due to her conflict of interest and that so long as she was initially included the vote could pass unanimously between Rosa and Nick, the disinterested directors to terminate the lease. But as it stands the lease termination was invalid.

ANNUAL SALARIES

Anna can argue that while although directors can receive salaries, that given all the facts the salareis are a furhter attempt to oppress her as minority shareholders. In a close corporation there is an intergration of ownerhsip and management. There is often no public market for the shares, and the shareholders themselves work or depend on profits from the business. Nick and Rosa, by discounting the distributions have left Anna with no money besides the lease, which they have also tried to terminate. She needed the lease money to pay bills. As such Nick and Rosa continuing to receive the salary but no distribution places them in a situation to thrive while Anna suffers.

However, the annual salaries were called for in the shareholders agreement upon which many

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of Anna's arguments rely. It is doubtful she could rely on the agreement to her benefit but then try and void the sections which do not benefit her.

Good job.
The issue of the Shareholders duties to each other in a closely held corporation deserve more discussion.

========= End of Answer #2 =========

======== Start of Answer #3 (1783 words) ========

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RML Wines, Inc.

RML wines is a typical small, closely held corporation. Generally it will enjoy limited liability; it's shareholders can only be liable to the extent of their capital contribution. However, there are several facts here which potentially expose the three to liability.

Bill's Claim as a Creditor

Bill is a creditor to the corporation, and as such, is entitled to priority distribution over shareholders in the event of liquidation or bankruptcy of the company. However, we must first determine who is directly liable to bill; Rick as a promotor of a then non-existing corporation, or RML Inc, as a corporation

In acting as president of the corporation, rick was fully authorized and empowered to make managerial decisions on behalf of the company, and to bind the company in

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contract. Typically the president has the authority to do this, and Rick was not exceeding that authority or acting *ultra vires* when he signed purchase agreement. However, it's probable the corporation didn't exist yet.

In order for a corporation to be validly formed, articles outlining the corporate structure, stock plan, incoporators, and other details must be filed with the SoS. The corporation does not exist until the filing of the articles of incorporation is approved by the state and the corporate charter is issued. Only then does the liability shield arise, and only then can the corporation actually be bound as a separate entity apart from its promotors or incorporators.

Where a promotor acts for a non-existing corporation, they are deemed to be an agent of a nonexistent principal, and as such, have the liability for any K made in that capacity on them. A corporation must adopt the contact as it's own, and then issue a novation to the promotor in order for them to released from liability. The corporation cannot ratify the act because it did not exist when it happened, so it must adopt or assume the K.

Because the facts say that RML corp did not exist when the agreement was signed by Rick, Rick was acting as an unauthorized agent and will have full liability for the K. Rick (and possibly Bill) can possibly argue corporation by estoppel. This arises where the corporation had been all but validly formed and the only thing missing was a paperwork or clerical error, such as missing fees. However, modernly, corporate protections are considered to start only when the charter is issued, and not sooner. Rick should have waited for verification from the state that the corporation was born and existed before acting on its behalf. Also, even if the corporation is deemed to have existed by estoppel, the K that Rick signed could not be completed in less than one year, and was for over $5000 in goods, and as such, required a writing under the statute of frauds. Therefore, any agency relationship Rick could have had would have also required a writing under the equal dignities rule. Under this rule, where a transaction requires a writing, then the agency relationship authorizing the transaction must also be in writing. Here, Rick will have to hope that the corp is willing to assume the K now and novate

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him, or he is on the hook.

Watered Stock

If Rick is successful in showing corporation by estoppel, or if the corp adopted and novated the K, then Bill will have to use an alternate theory to get at the personal assets of Rick, Mark and Lisa to get his $250k. One theory he can argue is watered-stock liability. Under par-value statutes, such as Delaware, a company must set a par value for it's stock, and must charge at least that amount for the shares. This is because the par value is the base, or "cost value" of the stock, and that number times the number of shares is the amount recored on the corps balance sheet as stated capital. This amount is suppose to serve as a baseline value of the company to creditors, although today it rarely reflects reality in that way. When a company is actually far less funded than it's par value/stated capital says it will be, it is often unable to meet its debts and obligations. When stock is issued at less than par value, as was the case here, where the SHs got 10k shares each for 5k, which amounts to $.50 a share, the stock is considered "watered" because it is diluted - it isn't worth what it says it is. Any shareholder that holds watered stock is liable for the amount owed to bring the stock up to par value. Therefore Bill can argue that the R, M, & L should all have to contribute the other 9.50 per share for their 10k shares each, bringing the total value of the company to $300,000, which would provide enough to pay out Bill's debts as creditor.

Good!

Piercing the Veil

Bill can also argue that a court should peirce the corporate veil in order to get at the shareholder's assets. Typically, courts are hesitant to hold SHs accountable beyond the amount of their stock investment. However, where certain conditions are met, the veil can be pierced to satisfy claims.

First, in deciding whether or not to peirce the veil, the court will consider whether the corporation was really just doing the personal business of one or more individuals who were abusing the corporate form to get its protections. Second, the court will consider whether equity demand that the veil be pierced. In analyzing the first part, the court will

look at various factors; including whether or not commingling of personal and business assets occurred, whether or not the corporation was undercapitalized, whether or not fraud or misrepresentation was afoot, whether corporate formalities were followed, and whether or not he corporation was really an alter ego or shell entity for an individual or group. In this case, the evidence is not good. There was serious commingling when Mark deposited the entire corporate capital amount in a personal bank account. Lisa never issued the stock certs (itself not required) and never kept minutes. Combined, these two things look like a failure to maintain basic formalities. As well, the corporation was seriously undercapitalized. They were claiming a stated capital of 1,000,000 (100k shares times $10 each par value) but in reality only had 15k in invested capital. This may be an adequate amount to start a company, but certainly is not enough to meet the occasional tort injury demand. In this case, it does appear that they got liability insurance, but by Delaware law, they were undercapitalized because of the watered stock. There does not appear to be any fraud, and the corporate does not appear to be an alter ego of any one of the shareholders, or them as a group. The factors here are well balanced, it is not immediately apparent that the veil should be pierced based on an analysis of the *Baatz* factors alone.

In analyzing whether equity demands piercing the veil, the second prong of the test, the court will mainly look to two factors; one, will unjust enrichment result if the veil is not pierced? second, is the creditor an involuntary one, such as a tort victim? In these cases equity will demand piercing. Here, Bill is an equipment vendor, who had ample opportunity to evaluated RML's fiscal health and was dealing with them at arm's length in a commercial transaction. However, given that the corporation was nowhere near capitalized enough to support this kind of debt, and unjust enrichment will result if the veil is not pierced, they could go after (especially Rick, as the K signer) the individual shareholders.

Nicely done

The Bicyclist's Claim

Generally, corporate shareholders are note liable for the negligent acts of the corporation, unless the acts were committed by them personally and they were

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personally negligent in doing so. As well, where the corporation is undercapitalized, under insured, or otherwise not properly funded to meet it's reasonably foreseeable obligations, the court can "pierce the corporate veil" to get at the personal assets of the shareholders if they are complicit in any wrongdoing.

Here, following the corporate veil piercing analysis defined *supra*, one comes to a similar conclusion, however, in this case, equity truly demands the veil be pierced because the bicyclist was an involuntary creditor; a tort victim. As well, the injury was a result of Mark's direct, personal negligence, so the corporate protection should not extend to him.

Mark will argue that the corporation would be responsible to indemnify him under the theory of respondeat superior. Where an agency rises to the level of employment, the principal is liable for the tortious acts of the agent when they were done in the scope of the agents authorized duties. An agent is deemed a "servant" or employee when they are controlled and scheduled by the principal, instead of setting their own rules as an independent contractor. Here Mark was clearly a servant or RML, Inc. He work as treasurer for the corp and was paid to work as the corp saw fit. He was also driving a vehicle while on the way to or from corporate business, so he was acting in the scope of his agency, and therefore, the corporation is also liable.

Because the equity prong of the piercing test requires the veil be pierced here, and the Baatz factors show an undercapitalized, informal, commingled corporation, it's like the veil would be perused here to get the bicyclist his recovery.

Corporate Duties

The shareholders in RML may have some internal bickering coming when they face all this liability. They may start pointing the finger at each other, which is where corporate duties come in. As SHs in a closely held corp, and as directors, all SHs in RML, Inc had a duty of loyalty and care to each other. The duty of loyalty requires the SH to act in the best interests of the corporation whenever conducting corporate business, and the duty

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of care requires them to act in a way that a reasonable SH/director would in like circumstances to prevent unreasonable risk or loss to the corporation. This typically, at a bare minimum, requires that shareholder/managers perform there assign duties diligently. Marks' failure to separate and not commingle the corp funds is a clear breach of these duties as he was corporate treasurer. Likewise, Lisa as Secretary should have, if nothing else, shown up to mtgs and taken minutes. These are serious breaches and could be grounds for Rick to seek recovery from M & L once the dust settles, as the piercing necessary to get recovery to bill and the bicyclist are foreseeable damages of these breaches.

═══════ End of Answer #3 ═══════

END OF EXAM