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1. On what theories might Arnold be found personally liable for damages to Landlord Co.?

Corporation

A corporation is a business entity that shield its members, directors, officers, and shareholders from personal liability. A corporation can either be a (i) de jure corporation, (ii) de facto corporation, or (iii) a corporation by estoppel.

De Jure Corporation

A de jure corporation is formed when at least one director files Articles of Incorporation (AOI) with the Secretary of State, outlining (i) the corporation's name, (ii) at least one agent, and (iii) the address of at least one agent, and (iv) the address of at least one office.

Here, the facts state that Arnold agreed that he would be responsible for filing for incorporation of the business that was a then-partnership between he and Betty. However, Arnold did not file AOI until after entering into the lease with Landlord Inc. The facts state that Arnold took the necessary steps to incorporate, but not until after entering into the contract. Therefore, at the time he entered into the contract with Landlord Co., there was not a valid de jure corporation.

De Facto Corporation

On the other hand, a de facto corporation is when a good faith attempt is made to incorporate but there is an administrative error either on the part of the Secretary of State or the one incorporating.

Here, the facts state that Arnold entered into the one year lease agreement with Landlord Co., and did not incorporate until after. Thus, there was not a good faith attempt by Arnold to incorporate even after he told Betty that he would.

Therefore, there was not a de facto corporation. Arnold still may be liable by corporation by estoppel.

Corporation by Estoppel

Under the doctrine of corporation by estoppel, an entity that holds themselves out to be a corporation cannot be estopped from denying that a valid corporation existed.

Here, the facts state that Arnold located a building within which to operate the business, and

entered into a one-year lease with Landlord in the name of "Durable Paint, Inc." Therefore, it is clear that Arnold held out his business to be a corporation to Landlord Co. Otherwise, he wouldn't have used that name and would have used the partnership name he and Betty were using (if any).

Therefore, there may be a valid corporation under the doctrine of corporation by estoppel.

Piercing the Veil

Arnold can be held personally liable if the veil is pierced through (i) alter ego, (ii) undercapitalization, or (iii) fraud. If the corporation is acting as an individual more than a corporation, and the funds are being commingled, then it can be pierced through alter ego. If the corporation was started with less capital so as to not be able to cover liability, then the veil will be pierced through capitalization. If, on the other hand, fraud is involved, then the veil can be pierced. The result of the veil of liability being pierced is that it makes the wrongdoer *personally liable*.

Here, it can likely be shown that Arnold acted with fraud when inducing the reliance on his unincorporated entity. The result will be that the veil can be pierced, and Arnold will be held personally liable.

Therefore, the veil can be pierced by fraud to hold Arnold personally liable to Landlord Co.

Voting

The Board of Directors has rights to vote, either in (i) an annual meeting, or (ii) a special meeting. There must be *quorum* to hold a valid vote, meaning that the majority of the Board of Directors should be present with each having the ability to hear one another.

The facts indicate that once incorporated, and at the first Board of Director's meeting, the only two directors (Arnold and Betty) voted for the corporation to assume all rights and liabilities under the lease agreement. This means that under this vote, if effective, the corporation would assume all financial responsibility and liability. This would be an effective way for Arnold to argue that he should not be personally liable for the breach of lease to Landlord Co. However, Landlord Co. may argue that because the corporation is now insolvent, and the veil of liability can be pierced, that Arnold should still be held personally liable.

Therefore, Arnold may still be held personally liable for the breach of lease with Landlord Co.

Pre-Incorporation Contracts by Promoter

As discussed below, there was a general partnership formed between Betty and Arnold. As a

result, any contract entered into by Arnold before incorporation would make Arnold a promoter. A promoter is typically an entrepreneur acting on behalf of the company to contract for a location, and to start drumming up business. Promoters are personally liable for contracts they enter into on behalf of the corporation. Furthermore, corporations are liable only if they expressly adopt the contract the promoter entered into, or accepted the benefit of the contract.

Here, because Arnold did not incorporate the business yet, he will likely be held to be a promoter for the company. Arnold will likely argue, however, that a corporation can be found through incorporation by estoppel, and thus avoid liability. Landlord Co. will argue that Arnold is a promoter and is thus personally liable.

Conclusion

Arnold can be personally liable if the corporate veil is pierced through fraud, or if it is found that he acted in the capacity of a promoter.

2. On what theories might Betty be found personally liable for damages to Landlord Co.?

General Partnership

Unlike a corporation, a general partnership does not need to be formally recognized by filing anything with the Secretary of State. All a general partnership requires is the intent to enter into business with two or more individuals and to carry on that business for profit.

Here, the facts state that Betty and Arnold agreed to launch a business selling a durable paint that Arnold had developed and patented. They agreed to share all profits and act as equal owners. At this moment, a general partnership was formed.

Thus, Betty will be considered a general partner.

Liabilities of General Partners

Unlike limited partners or limited liability partners, who are only liable for their amount of their contributions, general partners are personally liable to the partnership for all debts acquired, breaches of contract, or torts committed. However, they do have the remedy of suing their partner for contribution if they did not engage in a wrongful act.

Here, Betty is an established general partner. If the court finds that there was no incorporation by estoppel, there will instead be a general partnership found (discussed above). As a result, Betty will be personally liable to Landlord Co. for the breach of the lease. Her remedy would be to subsequently sue Arnold for contribution, as it was arguably more his wrongful act than hers.

3. On what theories might Arnold be found personally liable to Betty?

Duty to Disclose

General Partners have a duty to disclose to the other partner matters that are material in running and operating the business.

Here, the facts state that Arnold agreed to contribute his patent for durable paint, which he told Betty was worth \$100,000. Meanwhile, Betty contributed \$100,000 in capital to the partnership. However, the facts also state that Arnold did not tell Betty that he had previously tried to sell the patent to several reputable paint companies but was never offered more than \$50,000. Thus, there was a material misrepresentation by Arnold to Betty. Arnold had a duty to disclose the actual value (or supposed value) of the patent he owned.

Therefore, Arnold breached his duty to disclose to Betty under the partnership, and as a result, he may be held personally liable to Betty for damages.

Duty of Loyalty

General Partners have a duty to act with a duty of loyalty to all other partners, and to the partnership.. General partners must act in the best interest of the other partners and the partnership.

Here, by making a false misrepresentation to Betty and lying about the value of the patent, Arnold breached his duty of loyalty that was owed to Betty.

Therefore, Arnold breached his duty of loyalty to Betty under the partnership, and as a result, he may be held personally liable to Betty for damages

Duty of Care

A general partner owes a duty of care to the other partners.

Here, Arnold did not act with a duty of care toward Betty.

Therefore, Arnold breached his duty of care to Betty under the partnership, and as a result, he may be held personally liable to Betty for damages

Business Judgment Rule

Under the duty of care falls the business judgment rule. This rule states that all partners will act in the best interest of the partnership or business entity at all times.

Here, Arnold did not act in the best interest of he and Betty's partnership when he lied about the value of the patent knowingly and fraudulently. It put the partnership (and later formed corporation) at risk.

Therefore, Arnold violated the Business Judgment Rule.

Conclusion

Arnold can be found personally liable to Betty for damages by his breaches of the duty of care, loyalty, and the duty to disclose.

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