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1. Arnold's Liability to Landlord.

Corporation:

In order to incorporate, there must be a filing of articles of incorporation. When the articles are not properly filed, but there is a good faith effort made to do so, incorporation may be de facto. A corporation may also be created by estoppel when one relies on the presence of a corporation. Corporations shield their officers and directors from personal liability.

Here, Arnold held himself out to Landlord as being Durable Paint, Inc. However, Arnold did not at first incorporate properly or take any necessary steps to do so. If it was believed at the time by Landlord that a corporation did exist, the corporation may have been formed by estoppel.

Therefore, at the time of the agreement, Durable Paint, Inc may have been a corporation.

Promoter Liability:

When an individual takes steps in anticipation of the formation of a corporation, they are considered a promoter. A promoter may bind the corporation to the agreement by estoppel. However, a promoter is also remains personally liable for contracts and agreements they enter into.

Here, the court will likely find a corporation by estoppel existed due to the way Arnold held himself out. However, the corporation itself did not initially exist when the agreement was made. Arnold was acting as a promoter in order to secure a home for his future corporation. The corporation can subsequently accept the agreement through assignment. That is what happened here. After the fact, the corporation did in fact accept the entire lease assignment. However, Arnold is still liable personally for the lease if the corporation is unable to satisfy it.

Therefore, Arnold is personally liable for the lease.

Piercing the Corporate Veil:

When a corporation exists merely as a shield to liability, the courts may pierce the corporate veil in order to reach the officers and directors directly. A corporation may be dissolved by the secretary of state and also found to be inadequate when it is undercapitalized to meet its goals.

Here, the corporation did not have sufficient capital to weather the first six months in operation and was already two months behind on rent. Because the corporation was almost immediately

insolvent, the court will likely pierce the corporate veil to reach the directors personally to secure the debt.

Conclusion:

Arnold will be held personally liable for the damages to landlord under the corporations theory.

General Partnership:

A partnership is an agreement between two entities to share ownership, control, and profits of a business. No formalities are required. Partners in a partnership with authority can bind the partnership to agreements. The partners are held jointly and severally liable for their torts and contracts.

Here, Arnold first entered into an agreement with Betty in order to sell durable paint that Arnold developed prior to incorporating.

Therefore, the parties first formed a general partnership.

Authority:

When agent acts with either actual or apparent authority they may bind the principal to agreements. Actual authority may be express or implied through the conduct of the partners. Apparent authority exists when the agent holds himself out as being authorized to act in a manner that gives reasonable belief in a third party that the authority exists. All agents are liable for their personal torts, and the partners are jointly and severally liable for their torts as well. A partner almost always has the actual authority to bind the principal (partnership).

Here, Arnold was a partner in the above partnership, and held himself out to Landlord as being able to make business decisions on behalf of his principal--then a partnership. Even though he had actual authority as a general partner, he also had apparent authority, because Landlord entered into the agreement under the belief that Arnold could act as he did. As Arnold and Betty were both general partners and no limited liability partnership had been formed, he bound the principal to the agreement, and also became jointly and severally liable for the lease as a partner himself.

Therefore, Arnold is jointly and severally liable with Betty as a partner and personally liable for the lease.

2. Betty's liability to Landlord:

Corporation:

See rule, above.

Here, Arnold entered into an agreement with the Landlord under the Durable Paint, Inc alias.

Therefore, at the time of the agreement, Durable Paint, Inc may have been a corporation by estoppel.

Promoter Liability:

See rule, above.

Here, Arnold, and not Betty acted as a promoter in securing the lease. However, Betty later agreed with Arnold during their first meeting to expressly accept the assignment.

Therefore, the corporation accepted the lease by assignment and Betty may be personally liable.

Piercing the Corporate Veil:

See rule, above.

As discussed above, the corporation itself was woefully undercapitalized. The corporation did in fact accept the assignment of the lease during the first officer's meeting. However, this was likely to quickly shield the parties from personal liability because they had previously formed a general partnership. If the Court finds that the parties created a sham corporation for the sole purpose of shielding themselves from creditors, it will likely pierce the corporate veil and hold the officers and directors personally liable for the debt.

Therefore, Betty will be held personally liable.

Conclusion:

Betty will be held personally liable for the damages to landlord under the corporations theory.

General Partnership:

See rule, above.

Here, Arnold and Betty entered into an agreement to share the profits from their business of selling durable paint. However, a partnership is an agreement like any other. If Betty is able to show that the agreement lacked mutuality because Arnold misrepresented the value of his

patent to her, she may be able to avoid the partnership agreement.

Therefore, the parties first formed a general partnership.

Authority:

See rule, above.

As discussed above, Arnold entered into the agreement with actual authority by the principal partnership in order to secure a lease for their business. Because Betty was a general partnership prior to the incorporation of Durable Paint Co. She will be held jointly and severally liable by the lease which was bound to the principal.

Therefore, Arnold had authority to bind the principal.

Conclusion:

Betty is personally liable for the lease.

3. Arnold's liability to Betty.

Misrepresentation:

Misrepresentation occurs when an individual knowingly makes a false assertion to another intending them to act on the misrepresentation, and they do act, and harm occurs.

Here, Arnold lied to Betty about the value of his paint products and intentionally misled her. His paint was only worth \$50,000 and she then contributed \$100,000 of her own money to be equal with Arnold. As a result, she entered into a partnership and then formed a corporation with Arnold. Moreover, Arnold had shown the paint product to several large paint companies who could have easily taken off with his idea. These are basic assumptions that needed to be dealt with fairly and up front. If the underlying agreement can be avoided for lack of mutuality as a result of Arnold's misrepresentation, Betty may be able to unwind the partnership, and avoid liability personally as well. Even so, once the parties were incorporated, Arnold had a duty of loyalty to the corporation and to make sound judgment about the business. The topic of the true value of the paint product could have come up then.

Conclusion:

If Arnold is found to have breached his duties of loyalty, and if he did in fact misrepresent, he may be liable to Betty for the initial \$50,000 investment. She could potentially get an **equitable lean** because the value of her earnest money investment has decreased, and been exhausted. She would not be able to seek a constructive trust, because the value has not gone up.

Question #2 Final Word Count = 1287

END OF EXAM