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## **1. ARNOLD'S PERSONAL LIABILITY FOR DAMAGES TO LANDLORD CO.**

Generally, a De Jure Corporation shields liability to the corporate shareholder or owners of the corporation. Here, Arnold (A) and Betty (B) agreed to launch a business selling a durable paint that A had developed and patented. In the beginning of the business venture, both A and B agreed to share all profits and to act as equal owners. Such characterization indicates there was a general partnership formed.

### **A. General Partnership**

A general partnership exists whenever at least two person agreed to share profits and lost in a business venture. Writing is generally not required as long as both parties agreed upon. Each party will have equal management and control on the day to day operation because they are each agent to the partnership. When liability occurs, both partners will be personally liable to the creditor.

Thus, at the beginning, A and B formed a general partnership and if anything happened, both A and B will be personally liable even if she did not commit the wrong.

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## **B. Je Jure Corporation**

A corporation requires filing of the article of incorporation, setting forth the purpose of the business venture, with by law of the corporation, and the person who is incorporating and process of service designation. All papers must be filed with the Secretary of the State where the corporation is incorporated.

Here, the fact says A took the necessary steps and Durable Paint, Inc. was incorporated.Â Thus, it appears that A had met all the requirement by filing papers with the Secretary of State and acquired a De Jure corporation which shields liability on the corporate shareholder or owners.

## **C. Corporate Formality - Board Meeting**

In observing corporate formality, A and B attended the first board of directors meeting and named themselves as sole directors and officers. The fact is unclear as to whether there were shareholders in the start up corporation because generally shareholders vote to elect board of director who will be the managers in making decisions on behalf of the corporation. The director then elect the Officer who will conduct the day to day business.

It is possible that A and B were the only shareholders as they had initially formed their general partnership from the outset and made business contribution toward the business entity as general partners.

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During that meeting, A and B voted for the corporation to assume all rights and liabilities for the leasehold agreement of which A had entered into with Landlord Co for a one-year lease on behalf of Durable Paint, Inc.

**D. Did A Have the Authority to Act on Behalf of Durable Paint, Inc.**

As director of the corporation, both A and B voted themselves as Officer for the corporation. Officers are considered Agents for the Corporation. Here, A and B voted to assume all right and liabilities for the lease, thus as directors, they both expressly authorities and adopted A's leasehold agreement that was entered into with Landlord, Co. The issue here is whether Landlord Co is aware that A was acting on behalf of Durable Paint.

**E. Express Authority**

As discussed above, A and B expressly assumed all rights and liabilities under the lease, thus A had the authority which was adopted by Durable Paint.

**F. Apparently Authority**

Apparent authority requires whether the person has disclosed the principal to the other party that he was acting on behalf of the corporation.

Here, A did have the apparent authority because he presented himself as Officer for Durable Paint, Inc and the lease

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agreement also signed in the name of Durable Paint Inc.Â Since A held himself out as Officer or Agent for the corporation of which Landlord Co acknowledged as such, there was apparent authority.

### **G. Piercing the Corporate Veil**

Generally, shareholders are not personally liable for debt of the corporation because they are passive investor only and will not be liable beyond his/her contribution to the corporation.

However, creditors can pierce the corporate veil under three situations: 1) Under-capitalization; 2) Alter ego; or 3) Not observing corporate formality.

Here, under-capitalization is at issue because due to A's unsound development for the product of which he received a patent, the corporation turned belly up after six months of incorporation.Â Generally, a starting up corporation requires a closer look into the expenses before it is formalized. Because A was not honest from the outset and over exaggerated on the worth of his developed patent, consequently, the patent failed and the corporation went under due to other competitor's superior product.

At the end of the first six month, Durable exhausted all its capital and was two months behind on rent. Under this situation, Landlord Co can pierce the corporation due to under-capitalization.

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Since the corporation will be in dissolution and winding down, the default entity will fall back to the general partnership status.Â Because B fully adopted A's rights and liability on the lease hold, but the corporation is insolvent.

Thus, A will be personally liable to Landlord Co.

## **2. BETTY'S PERSONAL LIABILITY FOR DAMAGES TO LANDLORD CO.**

Betty will also be personally liable for damages to Landlord Co for the same reasons as stated above under Piercing the Corporate Veil.Â As director and officer of Durable Paint, she should have look closer to A's business decision and not to rely on A solely, but take due diligent to investigate the patent.

### ***Business Judgment Rule***

A will try to argue that under the Business judgment rule, he had diligently conducted his research and found that leasing from Landlord Co has a viable business. Unless there is some showing that A did not exercise his business as a reasonable prudent person, and here there is no showing of any malfeasance act on A's act. Thus, A did not breach his duty of care under the business judgment rule.

However since B adopted A's action on the leasehold agreement and there is no capital available, B will also be personally liable under the fall back theory as a general partner.

### **3. ARNOLD IS PERSONAL LIABLE FOR DAMAGES TO BETTY**

A will be personally liable for damages to B based on the theory of misrepresentation. From the outset when the business entity was a general partnership, while B contributed \$100,000 to the business, it would expect A to contribute the equal amount in \$100,000. In fact, A told B that his patent was worth \$100,000, however, A knew that he never had offered more than \$50,000 for his patent.

The amount of contribution was material to the starting up business. When A told B that his patent is sound and worth \$100,000, he knew or should know that he will induce B to act along with him. Here, B did justifiably rely to her detriment that the patent was worth \$100,000 and agreed to work with A. By accepting the assignment of A's patent rights, B detrimentally relied on A misrepresentation and suffered damages.

Thus B will have an action against A for misrepresentation in order to off set her personal liable on the Landlord Co.

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