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### **The Delta loan**

#### Partnership

A partnership exists when two or more people carry on as co-owners in a business for profits. A partnership can be further evidenced by splitting profits. Partners in a partnership are equally liable for all debts owed by the partnership, unless the partnership agreement states otherwise.

Here, there are two or more people carrying on as co-owners in a business for profits because Ann, Bob, and Claire opened a retail store called ABC Shoes to sell shoes. Here, the partnership can be further evidenced by splitting profits because Ann, Bob, and Claire agreed to split profits equally. Thus, there is a partnership. If one were to look at ABC Shoes debt to Delta under the structure of a partnership, then Ann, Bob, and Claire would be equally liable for the debt. It does not matter that Ann signed the loan papers as "Ann, for ABC Shoes" because every partner in a partnership is equally liable for the debts of the partnership. Meaning, each partner here would be liable for \$10,000.

#### Corporation

Generally, a corporation provides limited liability to the shareholders of the corporation. Meaning, the shareholders of a corporation are not liable for the debts of the corporation. A corporation is formed when the articles of incorporation are filed with the secretary of the state. Typically, a corporation pays off its existing debts upon wrapping up business through the wind-up process. However, if a corporation still has outstanding debts during the wind-up process, it is possible for a creditor to get individual shareholders to pay the corporate debt through piercing the corporate veil. There are three types of theories for piercing the corporate veil: 1) alter ego, wherein the shareholders fail to respect corporate formalities (such as holding board meetings) or use the corporation's assets for personal reasons; 2) inadequate capitalization, wherein the shareholders can be liable for corporate debts if they failed to adequately capitalize the business at the outset; and 3) fraud, wherein the shareholders are using the corporation to perpetuate fraud.

Here, there is a valid corporation because the fact pattern indicates as much. Here, although the incorporation happened three months after acceptance of the \$30K loan for marketing purposes, the corporation may be presumed to have adopted the debt given Ann, Bob, and Claire incorporated ABC Shoes. Here, Delta Bank would argue that it is entitled to the \$30K from Ann, Bob, and Claire as individual shareholders through a piercing the corporate veil argument. However, such an argument fails for the following reasons. First, the shareholders respected corporate formalities because Ann, Bob, and Claire adopted bylaws as a board and regularly held meetings thereafter. Second, the facts state that each provided initial operating capital for the business. Third, it does not appear that Ann, Bob, and Claire used ABC Incorporated to perpetuate fraud.

Thus, Delta will not succeed on a piercing of the corporate veil theory.

Therefore, if one views ABC as a corporation, then Ann, Bob, and Claire are not liable for the Delta loan.

### **The Echo loan**

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A board of directors may take an action related to the management of the corporation by a majority vote among the board of directors. A C-level officer as an agent has the actual and apparent authority to bind a corporation (the principal) to a loan. Although a C-level officer may sign a debt with her own name, if the C-level officer has the backing of a majority of the board of directors, the C-level officer binds the corporation rather than herself to the debt.

Here, the board of directors took an action related to the management of the corporation by a majority vote among the board of directors because Ann sought Bob's and Claire's approval prior to borrowing \$40,000 for business expansion from Echo. Here, a C-level officer had the apparent and actual authority to bind ABC Incorporation to the Echo loan because the board of directors authorized this management decision and Ann, as president, conveyed to a third party that she had the authority to enter into the transaction. Here, because Ann had both a majority vote of the board of directors and the apparent plus actual authority to bind ABC Incorporation, ABC Incorporation is liable for the Echo loan.

### **The Big Shoe Co. Contract**

A board member or C-Suite member (officer of the organization) owe fiduciary duties to the corporation. One such duty includes the duty of care. The duty of care requires a board member/officer to act in the best interests of the corporation, to act in good faith, and to manage the corporation like a similarly situated person. Within the duty of care, a board member/officer may violate this duty by failing to disclose information relevant to making a managerial decision that impact the corporation. For example, a board member/officer who enters into a contract without obtaining the approval of the majority of board members violates this duty. Moreover, a board member/officer who enters into a contract can be held personally liable on that contract. Business Judgment Rule: an officer will not be held liable for her decision if she acted in good faith, had a rational basis for her decision.

Here, there is a board member/officer who owes the duty of care to ABC Incorporated because Ann is a board member and the president of the corporation. Here, Ann did not act in good faith and manage the corporation like a similarly situated person would do because Ann entered into a contract for \$50K of inventory without consulting Bob or Claire. Meaning, Ann violate her duty of care to the corporation. Moreover, here Ann entered into a contract--without the approval of a majority of the board. Consequently, during the wind-up process, Ann can be held personally liable for the \$50,000 contract to Big Shoe Co. Contract. Here, Ann might argue that she's protected by the business judgment rule with her decision to enter into the contract. However, she did not have good faith when she entered into the contract.

Thus, Ann is liable here.

### **Damages for Peter's injuries**

A corporation is vicariously liable for the torts committed by its employees if the employee committed the tort within the scope of employment under the doctrine of respondeat superior. The scope of employment is defined largely by whether the employer retained control over the person's job-related tasks, as well as whether the employee's job-related tasks occurred within the ordinary course of business. A corporation is vicariously liable for an employees's torts if the employee committed the torts on a detour (a minor variation of the employee's work-related responsibilities) but not on a frolic (a major deviation from the employee's work-related responsibilities). An employee who commits a tort on the job is liable for his own tortious conduct as well.

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Here, there is an employee who committed a tort because Fred negligently injured Peter one day while driving to pick up inventory. Here, the employee's job-related tasks were within the control of the employer because ABC Inc. hired Fred to work in the store and occasionally pick up inventory. Here, although Fred only "occasionally" picked up inventory, this level of frequency would be sufficient to constitute work conducted during the ordinary course of business. Moreover, Fred's drive to pick up the inventory cannot be categorized either as a detour or a frolic because it was one of his occasional responsibilities.

Thus, ABC Incorporation can be held vicariously liable for Peter's injuries. Furthermore, because Fred actually negligently injured Peter, Fred could also be held liable for Peter's damages.

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**END OF EXAM**