4)

1. What viable claims can Supplier assert regarding the $25,000 and $30,000 debts?

Formation of a Partnership - $25,000

A partnership is formed when there is a valid written agreement between the parties. A clear indication of validly formed partnership is sharing in the profits. Directors and shareholders usually enjoy immunity from outside creditors attacking their assets.

Here, there is valid partnership between Anne and Beth because they entered into an agreement to open a Toy Shop. Furthermore, there is a valid partnership because there is a sharing in the profits because both Anne and Beth started the Toy Shop with a total $1,000 of initial capital and their plan was to expand the shop so that they may raise more capital. Anne and Beth might argue that they did not have an agreement to enter into a partnership because they wanted to incorporate and Anne even mailed the completed articles of incorporation to form "Toy Shop Co." However, this argument will likely not suffice because the articles of incorporation were not properly filed and until they were both Anne and Beth remained as partners or agents of the partnership.

Thus, Anne and Beth started Toy Shop Co. as a valid partnership.

Agency Creation

An agency and principal relationship is created when the agent: 1) in under the control of the principal, 2) acts for the benefit of the principal, and 3) consents to carry out tasks for the principal's benefit.

Here, there is a valid agency relationship between Beth, the agent, and Toy Shop Co, the principal, because Beth is under the control of the principal and acts as the agent's secretary and treasurer. Furthermore, Beth is acting for the benefit of Toy Shop Co. because she is committed to making it successful buy purchasing the necessary toy inventory to run a successful shop as that is the purpose of the agent and principal relationship. Finally, Beth has consented to carry out tasks for the principal, Toy Shop Co.'s, benefit because she has signed off the secretary and treasurer which indicated her informed written consent, confirmed in writing.

Thus, there is an agency relationship between Beth and Toy Shop Co.

Express Authority

Express authority is given when the principal orally or through written documents informs the agent of their responsibilities and what decisions they are able to make on behalf of the agency.

Here, Beth has express authority through written documents because while the articles of incorporation were not initially properly filed they still clearly and unequivocally indicated that Beth is to act as the secretary and treasurer of Toy Shop Co. Supplier will argue that it was within Beth's express authority to make an agreement with them to purchase inventory because it is squarely within the articles of incorporation.

Thus, Beth has express authority.

Actual Authority

Actual authority is given when the principal believes that there are certain responsibilities outside of those clearly expressed to the agent that are within the scope of the agent. These responsibilities must be communicated as well.

Here, Beth has actual authority to enter into agreements with outside supplies and retailers to purchase inventory for the Toy Shop because it is the secretary and treasurer's job duties to keep the books, ensure that enough money is coming in as it is going out and that entails being able to purchase inventory to run a successful business. Supplier will argue that Beth had actual to enter into an agreement with the to purchase the $50,000 worth of toy inventory because it was required to run a Toy Shop that did not have any present inventory.

Thus, Beth has actual authority.

Apparent Authority

Apparent authority is established through what the agent deems are their responsibilities in order to successfully carry out the duties assigned to them and if they believe they are acting in the benefit of the principal.

Here, Beth has apparent authority because it is her understanding that she must enter into various contracts to purchase inventory while keeping the books in order to run a successful toy shop with Anne. Supplier will also argue that Beth has apparent authority because she signed a contract with them and purchased inventory worth up to $50,000, which indicates Beth's belief that these acts were necessary.

Thus, Beth has apparent authority.

Implied Authority

Implied authority is established when a third party enters into a contract with the agent under reliance that they have valid authority to bind the principal to such contracts.

Here, Supplier will argue that Beth has implied authority because Beth purchased $50,000 worth of initial toy inventory from Supplier which clearly indicates Beth's authority to act on behalf of Toy Shop Co. Furthermore, Supplier will argue that because Beth signed the contract "Beth, Secretary/Treasurer of Toy Shop Co" it is a unambiguous indication that she has authority to enter into contracts on behalf of Toy Shop Co and on that reliance Toy Shop Co signed the contract with Beth.

Thus, Beth has implied authority.

General Partner Liability - $25,000

A general partner may be personally liable for contracts entered into on their behalf when there is clear indication that they have authority to do so.

Here, Beth will be held personally liable for entering into the contract with Supplier because she had clear authority to do so as analyzed above. Beth will attempt to argue that she alone should not be liable because the contract was entered into on Toy Shop Co's behalf and not for her personal benefit but this argument will likely not suffice given that Toy Shop Co in undercapitalized and does not have any available funds.

Thus, Beth will be personally liable for the remaining $25,000.

Formation of a Corporation

A corporation is formed to have a valid for profit business that protects the directors and shareholders of the corporation. A corporation is officially formed when the articles of incorporation are filed with the Secretary of State.

Here, Beth and Anne formed a valid corporation two weeks after the Anne initially sent the articles of incorporation to the Secretary of State because the initial articles of incorporation were not properly filed. Anne will argue that the corporation was formed when she filed the articles of incorporation but this argument will likely not stand because after Anne promptly corrected the Toy Shop's address is when they were successfully filed and processed. The outcome of these actions will be that any contracts entered into after the articles of incorporation were filed will hold Anne and Beth accountable as equal owners of the business and anything entered into before that will hold them each individually liable.

Thus, Anne and Beth formed a valid corporation.

Piercing the Corporate Veil - $30,000

Piercing of the corporate veil allows outside creditors to reach the assets of shareholders and directors when the corporate formalities are not being followed, the corporation acts as the alter ego of the directors or shareholders, there is undercapitalization at formation, and to prevent fraud.

Here, Supplier will attempt to pierce the corporate veil to for the remaining $30,000 because Beth purchased additional toys from Supplier and again signed the contract "Beth Secretary/Treasurer of Toy Shop Co" which clearly indicated her authority to enter into the contract on behalf of the corporation that was validly formed at this time. Furthermore, Supplier can show that the corporation was undercapitalized at formation because Beth and Anne only put in $1,000 worth of capital to form the corporation but then continued to enter into contracts with them for far more money. Furthermore, Supplier can prove that corporate formalities were not being followed because Beth and Anne failed to hold any shareholder, board, or incorporating meeting or even an organization meeting.

Thus, Supplier will be able to pierce the corporate veil to reach into Beth and Anne's personal assets for the $30,000 remaining.

2. What viable defenses can Anne, Beth, and Toy Shop Co. assert?

De Facto Corporation - Anne and Beth's Defense

A de facto corporation is a corporation that is not properly formed but may still be held out as a valid

corporation. A third party that enters into a contract with a de facto corporation knowing that they are not properly incorporated may not later state that there is no valid contract.

Here, Anne and Beth will argue Supplier entered into a contract with Toy Shop Co when they knew that the corporation was not validly formed in order to induce fraud. However, this argument will likely not stand because Supplier was not aware that Toy Shop Co was not validly formed when they entered into contracts with Beth.

Thus, Anne and Beth may not utilize this defense.

Duty of Loyalty - Supplier

A director owes a duty of loyalty to their shareholders and the corporation in such that they may not engage in self-dealing, must not usurp corporate opportunities, or not act in the best interest of the corporation.

Here, Supplier will argue that Beth and Anne owed a duty of loyalty to Toy Shop Co to keep it from being under capitalized at all times and because they continued to enter into contracts with Supplier while knowing that they had valid competition from online suppliers and higher-than-expected operating expenses they breached this duty. However, Supplier is not a director so they may not utilize this defense.

Thus, Supplier may not utilize this defense.

Duty of Care - Supplier

A director owes a duty of care to their shareholders and the corporation to act in the best interest of the corporation and to act as a reasonably prudent person when engaging in outside contracts.

Here, Supplier will attempt to argue that Beth and Anne did not follow their duty of care owed to the corporation because they continued to enter into contracts with Supplier when they were undercapitalized and drowning in outside competition. However, again, Supplier is not a director and may not utilize this defense.

Thus, Supplier may not utilize this defense.

3. What is the likely outcome of Supplier's claims?

Deep Rock Doctrine

The Deep Rock Doctrine is available to outside creditors which subordinates a director's access to any assets at the time a dissolution if they engaged in fraud or did not follow corporate formalities.

Here, Supplier will be able to utilize the deep rock doctrine to ensure that Supplier's debts are met first because while Beth and Anne did not engage in any fraud they did not follow corporate formalities due to the reasons analyzed above. Furthermore, while Toy Shop has no cash, valuable assets, or inventory as analyzed above Supplier will be able to pierce the corporate veil to receive the $30,000 from Beth and Anne's personal assets and the $25,000 from Beth's personal assets.

Thus, Supplier may recover both amounts from Beth and Anne.

END OF EXAM