

BUSINESS ASSOCIATIONS

Professor John Orcutt

Spring Semester 2006

MIDTERM EXAMINATION – IN CLASS**INSTRUCTIONS:**

1. This is a closed-book examination. You may not bring any materials to the examination with the exception of ESL students who are allowed to bring and use a Home Language/English dictionary.
2. This is a 65-minute examination and is worth 65 points. The examination consists of:
 - ▶ 1 essay question worth 25 points
 - ▶ 20 multiple choice questions worth 2 points each (for a total of 40 points)

It is your responsibility to apportion your time appropriately amongst the questions. I have written the exam as if it were a 65-minute exam. If you base your time on the possible points per question, the time apportionment should be:

- ▶ The Essay Question = 25 minutes
 - ▶ Multiple choice questions = 2 minutes per question (for a total of 40 minutes)
3. The grading of examinations is anonymous. So, you must write your examination number on the examination, your blue book and your Scantron sheet. **YOU MAY NOT WRITE YOUR NAME ON ANYTHING – YOU MAY ONLY USE YOUR EXAM NUMBER.**
 4. ***For the essay question:*** Please write your answer in a blue book. Remember to write your examination number on your blue book. The only answer that will be graded is the answer written into a blue book. While you are free to use scratch paper, answers written on scratch paper, or anything else other than a blue book, will not be read and will not be counted for any credit. Please write only on the front side of the pages in the blue book. Please remember that organization, persuasiveness, neatness and legibility all count in determining your grade on the essay answers. To improve the organization of an answer, you may wish to quickly outline the answer on a separate sheet of paper prior to writing your full answer in the blue book.
 5. ***For the multiple choice questions:*** The multiple choice questions are to be answered on a Scantron sheet. Your proctor will provide you with specific instructions regarding the filling out of the Scantron sheet.
 6. I have tried my best to write and proofread the exam so that there are no distracting typos or other errors – but, I may not have been totally successful. If you believe there is a typo or other error that makes it difficult to answer a particular question, make your best selection and write out the error on the back of the Scantron sheet (for the multiple choice questions) or in your blue book (for the essay questions) and any assumption you used to answer the question. Be sure to indicate the number of the question involved.

Good luck on the examination!

DO NOT TURN TO PAGE 2 UNTIL THE PROCTOR TELLS YOU TO BEGIN

ESSAY QUESTION

(This Essay Question is worth 25 points – 25 minutes suggested)

ABC Corporation (“ABC”) develops and distributes highly-customized software products. ABC recently hired Jane Doe as its new Head of Sales to revitalize its sales process. Upon Jane’s hiring, ABC issued a press release announcing that Jane would be ABC’s new Head of Sales. The press release included the following statement:

“ABC is very excited to have Jane Doe on board. It is our belief that one of the biggest keys to success in the customized software field is for a company’s sales force and development force to be completely in sync. When a client speaks to a salesperson, the client should feel as though it is speaking directly to the company and its development team. We think we have accomplished that by hiring Jane.”

Shortly after her hiring, Jane had a meeting with Karen Jones, ABC’s President and CEO. Karen spoke generally about Jane’s responsibilities with the company. During the conversation, Karen told Jane that Jane could sign contracts on behalf of ABC, but only after receiving approval on the contract from both Mary Smith (who is ABC’s head of development) and Karen.

A few months into the arrangement, Jane had a meeting with one of ABC’s oldest clients, RED Company. RED had just finished negotiating a contract for a highly complicated custom software project with BAD Company, ABC’s biggest competitor. RED was planning on signing the contract with BAD that afternoon. However, because of RED’s long-standing relationship with ABC, RED would give ABC the opportunity to sign the contract in place of BAD, but ABC would have to do it in the next 2 hours. Jane tried to call Karen and Mary but they were completely unreachable for the rest of the day. Jane made the executive decision to sign the contract with RED without first getting Karen’s and Mary’s clearance.

Jane did reach Karen and Mary the next day. Karen was excited about the project (the contract was for \$8 million), but Mary was more hesitant. She explained that it usually takes her close to a week to approve a contract, because she has to do some basic work on it to determine whether the project can be done and, if it can be done, whether it can be done profitably by ABC. Karen told Mary to do that work now. Ten days later, Mary informed Karen that the RED Contract would be a disaster for ABC. She estimated that it would cost at least \$10 million for ABC to complete the project as described in the RED Contract.

At that point, Mary called RED to inform it that ABC would not be performing the RED Contract. Mary explained that Jane did not follow proper procedures in entering into the RED Contract and that ABC did not consider itself bound to the contract. Mary hoped there were no hard feelings. Unfortunately, RED had very hard feelings and insists ABC perform the RED Contract. Is ABC bound by the RED Contract? Please explain.

*** * * * * END OF ESSAY PORTION * * * * ***

20 MULTIPLE CHOICE QUESTIONS

(2 points each – 2 minutes per MC question suggested)

Questions 1 and 2 are based on the following fact situation:

Johnny O. is a law professor and is working on a book on IPOs. Johnny O. needed some assistance with the research for the book, so he hired one of his law students, Lisa. At their initial meeting, Johnny O. explained to Lisa what her basic research responsibilities would be. Specifically, he told her that he would tell her each Monday what research he needed for that week. Lisa was expected to provide him that research by the end of the week.

As Johnny O. and Lisa were wrapping up their initial meeting, Johnny O. explained to Lisa that he had been burned by an old research assistant who had entered into a contract in his name. As a result, Johnny O. told Lisa, "You will be acting as my research assistant, but you will not be serving as my agent." Lisa responded, "That's fine with me." Lisa's arrangement with Johnny O. was never reduced to writing.

1. What is the most correct statement regarding whether Lisa is an agent of Johnny O.?
 - (A) Lisa is not an agent of Johnny O. because her agency relationship is barred by the Statute of Frauds.
 - (B) Lisa is an agent of Johnny O. because Lisa's compensation for her services as a research assistant is sufficient to establish the requisite consideration.
 - (C) Lisa is not an agent of Johnny O. because Johnny O. disclaimed such an agency relationship.
 - (D) Lisa is an agent of Johnny O. because her relationship with Johnny O. satisfies the legal requirement for an agency relationship.

2. For purposes of Question No. 2 only, please assume the following additional facts:

Johnny O. instructed Lisa to drive to a neighboring library to pick up a few books that he needed. While driving to the library, Lisa was (i) talking on a cell phone to her friend, (ii) drinking a cup of coffee and (iii) trying to apply lipstick. Not surprisingly, Lisa was not paying attention to her driving and she hit another car.

Lisa was able to finish her trip to the library. Unfortunately, the book she was supposed to pick up had already been checked out by someone else. Lisa explained to the librarian that she had just called one hour ago and was told that the book would be held until she got to the library. The librarian responded by

telling Lisa, "So sue me." Lisa was so mad that she climbed across the desk and slapped the librarian across the face repeatedly.

What is the most correct statement regarding Johnny O.'s potential liability for Lisa's actions?

- (A) Johnny O. will be liable for Lisa's reckless driving and her battery of the librarian if Lisa was his agent.
- (B) Johnny O. will be liable for Lisa's reckless driving if she was acting as his servant within the scope of her employment. Johnny O. cannot be liable for Lisa's battery of the librarian because it was an intentional tort.
- (C) Johnny O. will be liable for Lisa's reckless driving if she was acting as his servant within the scope of her employment. It is questionable whether Johnny O. will be liable for Lisa's battery of the librarian.
- (D) Johnny O. will not be liable for Lisa's reckless driving or her battery of the librarian even if Lisa was his servant because Lisa did not exercise due care.

Questions 3 and 4 are based on the following fact situation:

Alice is a theatrical booking agent. She was hired by Paul to hire a clown to perform at Paul's son's birthday party. Paul told her: "Don't hire anybody who charges more than \$5,000." On behalf of Paul, Alice entered into a contract with Cleo the Clown. The contract provided that Paul was hiring Cleo for \$5,500. Paul refused to honor the contract, and Cleo sued Paul for breach of contract.

3. Which of the following statements is true, if any?
- (A) Alice had apparent authority to hire Cleo at \$5,500, because she has hired Cleo for other clients in the past without incident.
 - (B) Alice had actual implied authority to hire Cleo at \$5,500, because theatrical agents typically have discretion to determine prices paid performers.
 - (C) Alice did not have apparent or actual authority to hire Cleo at \$5,500, but Paul will be estopped from arguing lack of authority.
 - (D) None of the above.

4. For purposes of Question No. 4 only, please assume that Cleo is not able to enforce the contract against Paul. Which of the following statements is true, if any?
- (A) If it is found that Alice exceeded her authority, then Cleo can enforce the \$5,500 contract against Alice.
 - (B) If it is found that Alice exceeded her authority, then Cleo can sue Alice for breach of an implied warranty that she had authority.
 - (C) Cleo has no cause of action against Alice because Paul was a fully-disclosed principal.
 - (D) None of the above

Question 5:

Xavier, Yolanda, and Zelda are equal partners in a bakery. For years the bakery has sold cakes to Chez Alex, a local restaurant, as part of its business. Zelda has grown concerned that the cake business with Chez Alex takes up too much the bakery's resources for too little profit. Zelda expressed strong disapproval for the cake business, but Xavier and Yolanda disagreed and continued the cake business with Chez Alex. Zelda then notified Chez Alex of her disapproval and informed it that she was not responsible for any problems that may arise from the cake business.

Which of the following statements is correct?

- (A) Xavier and Yolanda violated their fiduciary obligation to Zelda by forcing her to continue a business that she felt was not sufficiently profitable.
- (B) By notifying Chez Alex that she would not be responsible for the cake Business, Zelda has relieved herself of any risk of liability to Chez Alex that may arise from the cake business.
- (C) By notifying Chez Alex that she would not be responsible for the cake Business, Zelda has eliminated Xavier's and Yolanda's authority to conduct the cake business.
- (D) None of the above.

Questions 6 – 10 are based on the following fact situation:

Bert and Ernie were 50/50 partners in a florist business called Sesame Partners. The partnership agreement was silent regarding their respective management rights in the partnership. Unfortunately, the relationship between Bert and Ernie began to deteriorate and the two partners had trouble agreeing on anything. In particular, two big disputes arose between Bert and Ernie:

FIRST DISPUTE: A few months ago, Ernie decided to hire a new employee, Oscar, to help at the shop. When Ernie asked Bert about hiring Oscar, Bert categorically forbid the hiring. Ernie hired Oscar over Bert's objections. During the hiring, Ernie informed Oscar that he was a partner at Sesame Partners and provided Oscar with a business card stating that Ernie was a partner. Bert, who wanted to remain polite, never voiced his objections to Oscar. In fact, Bert never had any communications with Oscar either prior to, or after, he began working at the store. Bert did clearly communicate to Ernie however, that he objected to the hiring and that he refused to have partnership assets be used to pay Oscar's salary.

SECOND DISPUTE: Shortly after the formation of the partnership, Sesame Partners authorized Ernie to negotiate a contract with Grover to purchase roses from Grover. Ernie entered into the contract as instructed. The Grover contract included a clause that allowed Sesame Partners to cancel the contract upon 30 days prior written notice. Bert believes that Sesame Partners could get roses from a cheaper source and wants to cancel the contract. Ernie has patently refused to cancel the Grover contract. Tired of the discussion, Bert sent Grover a written notification on January 1st that Sesame Partners was canceling the contract. Ernie told Grover not to worry about Bert. Grover continues to deliver roses to Sesame Partners and Ernie continues to accept them.

Questions regarding the First Dispute:

6. For the purpose of Question No. 6 only, please assume that Sesame Partners refused to pay Oscar's salary. What is the most likely outcome if Oscar were to sue Sesame Partners?
- (A) Oscar should prevail in a suit against Sesame Partners because Ernie had implied authority.
 - (B) Oscar should prevail in a suit against Sesame Partners because Ernie had actual implied authority.
 - (C) Oscar should prevail in a suit against Sesame Partners because Ernie had apparent authority.
 - (D) Oscar should fail in a suit against Sesame Partners because Ernie was acting beyond his actual authority.

7. For the purpose of Question No. 7 only, please assume that Ernie paid Oscar's salary on behalf of Sesame Partners (i.e., Ernie used partnership funds to pay the salary). What is the likely outcome if Bert were to sue Ernie personally to recover the partnership funds used to pay Oscar's salary?
- (A) Bert should lose because Ernie has an equal right to manage the partnership.
 - (B) Bert should lose because Ernie had implied authority.
 - (C) Bert should lose because Ernie had apparent authority.
 - (D) Bert should prevail because Ernie was acting beyond his actual authority.

Questions regarding the Second Dispute:

8. Was Ernie able to bind Sesame Partners to the Grover contract when it was originally entered into?
- (A) Yes, partners have an absolute ability to bind their partnerships to contracts.
 - (B) Yes, Ernie was acting as an agent of Sesame Partners and had actual express authority.
 - (C) Yes, Ernie had equal management rights in the partnership and entering into the Grover contract was an ordinary matter.
 - (D) No, the contract required unanimous consent of the partners.
9. For the purpose of Question No. 9 only, please assume that Grover sent an invoice to Sesame Partners for roses delivered after February 1st. Bert has refused to pay the bill saying that Sesame Partners properly cancelled the contract. Is Bert correct in saying that Sesame Partners properly cancelled the contract?
- (A) No, Bert had no authority to cancel the contract with Grover.
 - (B) Yes, Bert provided proper written notification to Grover as set forth in the Grover contract.
 - (C) No, Bert is not an agent of Sesame Partners.
 - (D) Yes, Bert properly eliminated Ernie's authority regarding the Grover contract.

One Last Bert and Ernie Question:

10. For the purpose of Question No. 10 only, please assume that Sesame Partners was an at will partnership. Bert does not want to deal with Ernie anymore and decides to dissolve the partnership. What is the impact of Bert's decision to dissolve the partnership?
- (A) Sesame Partners begins the winding-up process.
 - (B) Sesame Partners begins the winding-up process. However, since Bert is dissolving the partnership without cause, Ernie is entitled to contractual damages.
 - (C) Sesame Partners begins the winding-up process. In addition, Bert is freed from his fiduciary obligations to the partnership once the winding-up process begins.
 - (D) Sesame Partners immediately ceases to exist as an entity.

Questions 11 and 12 are based on the following fact situation:

Abe, Barry and Carla formed a partnership ("ABC Partners") to research and develop an experimental herbal medication that has potential curative effects for the coming bird flu pandemic. Abe contributed \$700,000 and his business acumen. Barry contributed \$200,000 and his medical background. Carla contributed \$100,000 and her invaluable knowledge of herbal remedies and holistic healing. Trusting that their friendship and mutual respect for each other would see them through any and all matters, the three never entered into a formal partnership agreement, with one exception. They did agree that profits would be divided as follows: 50% to Abe; 25% to Barry; and 25% to Carla.

11. For the purpose of Question No. 11 only, please assume the following additional facts: ABC Partners' work on developing a vaccine/cure for the bird flu went very poorly and ABC Partners incurred substantial losses. Abe, Barry and Carla never agreed on how losses were to be allocated. Which of the following statements most accurately describes the responsibilities of Abe, Barry and Carla for those losses?
- (A) Because the partners did not agree on the allocation of losses, the default rule under the Uniform Partnership Act is that losses are to be shared equally among the partners.
 - (B) Abe will bear 50% of the losses, Barry 25% and Carla 25%.
 - (C) Abe will bear 70% of the losses, Barry 20% and Carla 10%.
 - (D) The allocation of losses depends upon the parties' intent. As a result, the specific allocation of losses is a question of fact for the jury to determine.

12. For the purpose of Question No. 12 only, please assume the following additional facts: ABC Partners research for a vaccine/cure for the bird flu has progressed nicely. Word got out of the advances being made by ABC Partners, which resulted in the World Health Organization pledging to assist in a field test of ABC Partners' primary product. Pfizer, a major drug company, has become highly interested in ABC Partners' progress and has offered to license the vaccine from ABC Partners for \$3 million. Abe and Barry are ecstatic about the Pfizer deal, but Carla hates the idea of doing business with a major, multinational corporation. Carla would like to use her position as a partner to try to prevent the transaction with Pfizer. For purposes of this question, please assume the Pfizer transaction qualifies as an "ordinary matter" for ABC Partners.

Which of the following is an accurate statement?

- (A) Abe and Barry can bind ABC Partners to a deal with Pfizer.
- (B) Because all partners have equal rights in the management and conduct of the partnership business, Abe and Barry must persuade Carla to consent to the transaction.
- (C) Because of the pass-through nature of partnerships, Abe and Barry can individually enter into the license agreement with Pfizer and eliminate Carla from the transaction.
- (D) None of the above.

Question No. 13:

Beyonce, Kelly and Michelle form a partnership. The partnership agreement states that it is formed for the purpose of constructing and then selling an apartment complex in SmallVille. No specific duration for the partnership is included in the partnership agreement. Before the project is completed Michelle suffers from some severe financial problems and wishes to leave the partnership.

Which of the following best describes Michelle's rights and obligations?

- (A) Michelle has no right or power to dissolve the partnership.
- (B) Because no duration for the partnership was set forth in the partnership agreement, this is an at will partnership. Michelle has the right and power to dissolve the partnership and may do so with impunity.
- (C) Because the partnership agreement did not state that the partnership was at will, this will not be an at will partnership. Michelle has the power to dissolve the partnership, but is liable for any damages her breach causes to the other partners.
- (D) This may be a partnership for an implied term. If this is a partnership for an implied term, Michelle has the power to dissolve the partnership, but is liable for any damages her breach causes to the other partners.

Questions 14 and 15 are based on the following fact situation:

Edna, Frank and Gretchen decided to form a limited partnership for the purpose of owning and managing an apartment building. Approximately two years after the formation of the limited partnership, Zelda, a tenant in the building, was severely injured in an accident in one of the building's elevators. The elevator was not properly maintained and the result was the elevator fell 4 stories with Zelda inside. Zelda's claim against the partnership is for approximately \$5 million. The partnership's assets, however, are only approximately \$1 million.

14. For the purpose of Question No. 14 only, please assume the following additional facts: In forming the limited partnership, it was decided that Edna would serve as the general partner and Frank and Gretchen would be limited partners. Edna prepared a Certificate of Limited Partnership which she properly filed with the Secretary of State of the relevant state. Shortly thereafter, the partnership purchased the apartment building and began to operate the business. Edna, Frank and Gretchen held monthly meetings at which time they reviewed and made decisions on who they would accept as renters in the building, the rental rate for various apartments and what, if any, maintenance would be conducted on the building. In addition, money from the partnership's bank account could only be withdrawn with signatures from 2 of the 3 partners.

What is the most accurate statement regarding Edna's, Frank's and Gretchen's personal liability for Zelda's claim?

- (A) Zelda's only claim is against the partnership.
- (B) Edna is personally liable, but Frank and Gretchen are not.
- (C) It is likely that each of Edna, Frank and Gretchen will be liable on a joint and several basis.
- (D) Edna is personally liable. To the extent that neither the partner nor Edna has sufficient assets to cover Zelda's claim, then Frank and Gretchen will be responsible as guarantors.

15. For the purpose of Question No. 15 only, please assume the following additional facts: In forming the limited partnership, it was decided that each of Edna, Frank and Gretchen would be limited partners and the general partner would be a newly-formed corporation, named EFG Corp. EFG Corp. had three shareholders – they were Edna, Frank and Gretchen. EFG Corp. was properly capitalized (although not sufficiently capitalized to satisfy Zelda’s claim) and complied with all corporate formalities.

What is the most accurate statement regarding EFG Corp.’s, Edna’s, Frank’s and Gretchen’s personal liability for Zelda’s claim?

- (A) Zelda’s only claim is against the partnership.
- (B) Assuming the court recognizes the separate legal existence of EFG Corp., EFG Corp. will be liable, but Edna, Frank and Gretchen should not be personally liable.
- (C) As a matter of law, a court would be compelled to pierce EFG Corp.’s corporate veil and Edna, Frank and Gretchen will be liable on a joint and several basis.
- (D) A corporation may not serve as a general partner for a limited partnership. As a result, Edna, Frank and Gretchen will be liable on a joint and several basis for Zelda’s claims.

Question No. 16:

The “internal affairs doctrine” provides that:

- (A) The management of a partnership’s internal affairs shall be governed by the principal of equal voting rights amongst partners.
- (B) The internal affairs of a corporation shall be managed by its board of directors.
- (C) Those state laws typically referred to as “corporate law” are governed by the laws of a corporation’s state of incorporation.
- (D) Shareholders bringing a derivative action claim must be current shareholders of the corporation.

Question No. 17:

Andrew and Chris want to start a business together. Based on recent advancements in the field of cryogenics, the two of them want to form a company that manufactures and sells high-end cryogenic chambers (i.e., devices to freeze a person who has recently died with the hopes of reanimating that person at some point in the future). Andrew and Chris plan on forming the company as a corporation (which they will name "Ice, Ice Baby, Inc."). For purposes of this question, Ice, Ice Baby, Inc. will be referred to as IIB. Andrew and Chris will be the only two shareholders for IIB (each will own 50% of the company).

Prior to forming the corporation, Chris informed Andrew that he was personal a friend of Tom Cruise, the famous actor, and that he believed that Tom would be interested in buying a cryogenic chamber. Andrew was very excited about this news and told Chris to, "Go get a contract with Tom Cruise!" Chris met with Tom. Tom was excited about the product and he entered into a contract with Chris to purchase a cryogenic chamber. IIB was formed two weeks after the Tom Cruise contract was entered into. What is the most correct statement regarding Chris's ability to bind IIB to a contract with Tom?

- (A) Chris had actual authority to bind IIB to the contract.
- (B) Corporations are liable for contracts entered into by promoters.
- (C) IIB is not bound until it ratifies (or adopts) the contract.
- (D) IIB is bound as a fully disclosed principal upon Chris's entering into the contract.

Question No. 18:

In a suit commenced by a shareholder, which of the following is more likely to be found to be a direct, rather than a derivative, suit?

- (A) Suit to require a member of the board of directors to account for profits resulting from a business opportunity taken by the director from the corporation.
- (B) Suit alleging a breach of the duty of care by select members of the board of directors.
- (C) Suit alleging corporate waste in connection with allegedly excessive executive compensation.
- (D) Suit to enforce a right to vote by the shareholders

Question No. 19:

Morgane, a shareholder of Acme Corp., filed a suit against each of the directors on Acme's 15-person board for voting to pay themselves unreasonably high compensation as directors in 2003. Acme's current directors are the same 15 directors who approved the 2003 pay package that is being disputed by Morgane. In filing the suit, Morgane failed to make a demand on the board of directors regarding the suit.

Assuming "traditional" rules of demand are applied to Morgane's suit (i.e., *not* universal demand), was Morgane required to make demand prior to filing the suit?

- (A) No, Morgane's suit is a direct suit which does not require demand on the board.
- (B) Yes, all derivative law suits require the plaintiff-shareholder to make demand on the board.
- (C) No, demand would have been futile.
- (D) Yes, because demand is required to reduce the agency problems that are inherent in the corporate setting due to the separation of ownership from management.

Question No. 20:

Which of the following statements regarding the *ultra vires* doctrine is most accurate?

- (A) The *ultra vires* doctrine completely disappeared with the move by state legislatures to amend their corporate codes to allow corporations to have as their corporate purpose "any lawful purpose."
- (B) Under most state statutes, charitable donations by corporations are *ultra vires* unless approved by a majority of the shareholder voting power.
- (C) Generally speaking, since the purpose of a corporation is to maximize shareholder value by conducting a for-profit business, giving away corporate assets for no business purpose is *ultra vires*.
- (D) General purpose clauses in a certificate of incorporation are *ultra vires*.

*** * * * * END OF EXAM * * * * ***