

EXAM # \_\_\_\_\_

# Business Associations

Professor Murphy

Midterm Examination Fall 2009

(60 minutes)

**INSTRUCTIONS:** This is a closed-book examination. The examination has a total possible score of 350 points. It consists of two parts: one mini-essay question worth 50 points and 25 multiple-choice questions worth 12 points each. You have 60 minutes to complete the examination, so you may be time-constrained, depending on how quickly you work through the examination. Pace yourself so that you will have adequate time to cover all the questions. For reference, the multistate bar examination pace is one multiple-choice question every 1.8 minutes. At that pace, you should complete the multiple-choice section in 45 minutes, leaving 15 minutes for the mini-essay question, which is set-up as one-half (shortened fact situation and half the questions) of a standard 30-minute multistate essay examination question.

For the essay question, write your answer in the single blue book provided or type your answer following the registrar's instructions. Clarity counts. Make sure you clearly indicate your response to each of the two parts. For the multiple choice questions, only the answers marked on the Scantron answer sheet will be graded. Select only one answer for each question and clearly mark your choice on the provided Scantron answer sheet. Please use care in marking your Scantron answer sheet, since unclear, double, or ambiguous answers may be counted as incorrect. Be sure your exam number is on both the Scantron sheet and the blue book.

You must stop writing as soon as the proctor announces that the examination is over or you run the risk of a conduct code violation. Do not open your examination or start reading the questions until you are instructed to do so.

In that there may be students who will be taking the exam at a different time, it is to your benefit not to discuss the examination content or format with others.

I have tried my best to write and proofread the exam so that there are no distracting grammar, spelling or other errors, but I may not have been totally successful. If you believe there is a grammar, spelling or other error that makes it difficult or impossible to answer a particular question, make your best selection and then explain the problem on the back of the Scantron answer sheet and any assumptions you used to answer the question. Be sure to indicate the number of the question involved.

Assume that the Uniform Partnership Act is applicable unless the facts of the problem or other instructions make it clear that it does not apply. Good luck.

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**PART ONE: Twenty-Five Multiple-Choice Questions** (12 points each, 300 points total)  
(Most of these questions are based on actual cases, and not even the names have been changed.)

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1. After suffering pain in his chest and left arm while lifting weights, Jack Gilbert visited the emergency room of Sycamore Municipal Hospital. Dr. Frank, the emergency room doctor, ran several tests and informed Gilbert there was no evidence of heart disease. Gilbert was prescribed pain medication and discharged that day. He died later that evening. An autopsy revealed signs of heart disease. The hospital contended it was not liable for the doctor's alleged malpractice because he was not the hospital's agent or employee. The hospital argued that the emergency room staff were independent contractors, although emergency room patients were not advised of this fact. Regarding this fact situation, which of the following is most correct?
  - a. The hospital will not be held liable absent some evidence of negligence on the part of the hospital.
  - b. The hospital will not be held liable if the doctors were considered independent contractors by both the hospital and doctors.
  - c. The hospital will be held liable because they are strictly liable for the malpractice of independent contractors.
  - d. The hospital will be held vicariously liable for the doctor's alleged malpractice under a doctrine of apparent agency.
  
2. Alexandra Kakides has filed a sexual harassment claim under Title VII of the Civil Rights Act against the real estate agency where she had worked for over 25 years. Under Title VII, the term "employee" is the same as understood by common law agency doctrine. Title VII would not apply to independent contractors. The defendant, King Davis Agency, has filed a motion to dismiss on the grounds that Kakides worked as an independent contractor and Title VII does not apply to independent contractors. When Kakides joined the King Davis Agency, she was considered an employee of the corporation, and was covered under certain benefits. In 1990, all salespeople were reclassified as independent contractors; however, Kakides (a vice president of the company at the time) elected to remain an employee of the corporation. In 1999, when Kakides was inducted as a profit-sharing member-owner of the firm, she entered into the Independent Contractor Agreement. Thereafter, the payment of fringe benefits to Kakides ceased. She received commission payments only upon the successful completion of sales. She received an IRS Form 1099, at the end of each year, reporting her commission payments. Taxes were no longer withheld from her gross income. Kakides paid her own licensing and listing fees, and scheduled her own sales calls. The company provided Kakides with a desk and office supplies. It also required that she attend weekly marketing meetings, regular training seminars, and perform periodic floor duty answering the

office telephones. King Davis argues that Kakides was an independent contractor from at least 1999, when she signed the Independent Contractor Agreement. (Any allegations of sexual harassment that pre-date 1999 are barred by the statute of limitations.) Which of the following is most likely regarding how a court will view the King Davis Agency defense that Kakides was an independent contractor?

- a. King Davis Agency will lose because once an employee always an employee.
  - b. King Davis Agency will lose because the requirements of her job since 1999 were more consistent with those of an employee than an independent contractor.
  - c. King Davis Agency will win because the filing of form 1099 with the IRS is a legally binding election of independent contractor status.
  - d. King Davis Agency will win because the requirements of her job since 1999 were more consistent with those of an independent contractor than an employee.
3. Cameco, a producer of food products, employed Gedicke as a salaried traffic manager at a salary of approximately \$38,000 per year. Gedicke's primary duty was arranging transportation of Cameco's food products to retail stores by common carrier. His duties included coordinating Cameco's shipping schedules, negotiating the lowest possible shipping rates, and supervising the warehouse employees who loaded the trucks. Because of his position, Gedicke became familiar with the identity of Cameco's suppliers, customers, and common carriers, as well as its delivery routes and rates. Without telling Cameco, Gedicke and his wife formed Newton Transport Service, which Gedicke operated primarily out of his home. Acting on behalf of distributors or truckers, Gedicke arranged for the transportation of food products to retailers. After several years, Newton Transport's profits exceeded \$62,000 a year. Two of the distributors for which Newton Transport arranged transportation sold the same products as Cameco. On over 600 occasions, Gedicke arranged for a trucker transporting Cameco's goods also to transport goods for Newton Transport's customers. However, the addition of Newton Transport freight actually enabled Gedicke to negotiate lower rates for Cameco. Gedicke admitted that he engaged in telephone conversations relating to Newton Transport's business during his scheduled hours with Cameco. However, he took no more than 15 minutes per day for such matters and used his personal credit card in making such calls. Which of the following is most correct regarding this situation?
- a. Since Gedicke was not subject to any contractual limitations preventing him from establishing an outside business, there can be no breach of Gedicke's duty of loyalty.
  - b. The duty of loyalty that Gedicke owes to Cameco does not vary with the nature of their relationship.

- c. If Gedicke had informed Cameco that he had established an independent business as a truck broker, it would have helped avoid the possibility of charges of disloyalty.
  - d. Employee agents have an absolute duty of loyalty to their employer principal regardless of whether they are a low-level or high-level employee.
4. CSX Transportation is in the business of selling out-of-service railcars and parts. Albert Arillotta, of Interstate Demolition and Environmental Corporation (IDEC), sent an e-mail to Len Whitehead, Jr., of CSX expressing interest in buying rail cars as scrap. Arillotta represented himself to be from Recovery Express. The e-mail address from which Arillotta sent this inquiry was [albert@recoveryexpress.com](mailto:albert@recoveryexpress.com). Recovery Express shared offices with IDEC in Boston. CSX prepared and forwarded to IDEC sales order forms that confirmed a sale. Arillotta then went to CSX's rail yard, disassembled railcars, and transported them away. After delivery, CSX sent invoices for the scrap railcars totaling \$115,757.36 addressed to IDEC at its Boston office (shared with Recovery Express). After a check from Arillotta to CSX, purporting to pay the invoices, bounced, Whitehead called Nancy Marto of Recovery Express. Because IDEC had gone out of business in the meantime, CSX sues Recovery Express for the purchase price of the railcars. Specifically, CSX asserts that Arillotta represented that he was authorized to act on behalf of Recovery Express. CSX based this belief on the e-mail's domain name [recoveryexpress.com](http://recoveryexpress.com) and representations made by Arillotta in the e-mail. CSX argues that at no time prior to delivery of the railcars did anyone from Recovery Express inform Whitehead that Arillotta was not authorized to transact business on behalf of Recovery Express. In light of the facts presented, which of the following is most correct?
- a. Recovery Express will be liable to CSX on a theory of apparent authority based on the communications CSX received.
  - b. Recovery Express will be liable to CSX on a theory of estoppel of an undisclosed principal because the real party in interest was Recovery Express.
  - c. Recovery Express will be liable to CSX on a theory of actual notice because of the email address and the and representations made by Arillotta in the e-mail.
  - d. Recovery Express will not be liable to CSX.
5. Edward Taylor and James Petri left their employment with Pacific Aerospace & Electronics, Inc. (PAE), to form a competing concern, RAAD Technologies, Inc. (RAAD). After leaving PAE, Taylor and Petri compiled for RAAD a list of prospective customers, projects, and history. The list was derived from their memories of information developed by or available to them at PAE and included customer contacts, information about active projects and engineers, and customers' business and design preferences. Information they could not recall, including

telephone numbers and addresses, was obtained from a business card file, which Taylor took with him from PAE. Taylor and Petri used customer information they took from PAE to contact and solicit business from PAE customers. For instance, in preparation for a sales trip to southern California, Taylor and Petri prepared a memorandum summarizing their recollections of particular PAE customers' engineers and their histories and attitudes about PAE. Because of this information, RAAD was able to negotiate a lower commission structure with potential customers. Which of the following is most correct regarding this situation?

- a. Taylor and Petri violated their duties of loyalty and confidentiality.
  - b. Taylor and Petri violated their duty of loyalty, but not their duty of confidentiality.
  - c. Taylor and Petri violated their duty of confidentiality, but not their duty of loyalty.
  - d. Taylor and Petri have violated neither their duty of loyalty nor their duty of confidentiality.
6. Linas and Lydia Gobis entered into a contract with the John Decina Development Company (Decina Corporation) to construct a custom home. The construction contract allowed for the purchase of various interior fixtures. During construction, John Decina subcontracted with H. A. Smith Lumber & Hardware to provide materials and labor. When John Decina completed the credit application with Smith Lumber, he wrote the type of ownership as corporation and listed himself as president, but in the space on the credit application asking for the name of the business/individual, he wrote John Decina. He also provided his own builder's license number, not the builder's license number of Decina Corporation. Further, he provided his personal Social Security number instead of a corporate tax identification number. In fact, Decina Corporation was not written anywhere on the application. When Decina Corporation failed to pay for the materials and labor, Smith Lumber sued John Decina personally. In light of these facts, which of the following is most correct?
- a. John Decina has no personal liability because, in arranging the credit agreement, he was merely serving as an agent of Decina Corporation.
  - b. John Decina has no personal liability because the credit application to Smith Lumber was done to benefit Linas and Lydia Gobis.
  - c. John Decina has no personal liability because Smith Lumber had a duty to discover the extent of Decina's claimed agency.
  - d. John Decina will be personally liable because he failed to disclose to Smith Lumber that he was acting for Decina Corporation when he completed the credit application.

7. Mauricio Iragorri fell to his death down an empty elevator shaft in Cali, Colombia, after a repair person employed by International Elevator, Inc. (International), propped open the elevator door with a screwdriver and left the entrance-way unattended and unbarricaded while the elevator car was not in place. Mr. Iragorri's surviving spouse, Haidee Iragorri, brought suit against Otis Elevator Company. Her complaint alleges that International (the company that maintained and repaired the elevator in question) was negligent in its duties, and that the negligence of International is attributable to Otis Elevator on a principal/agent theory. Which of the following would not be a required element for Ms. Iragorri to prove if she wants to show that International was the agent of Otis Elevator?
- There was a valid contractual agreement between Otis Elevator and International.
  - There was a manifestation by Otis Elevator that International will act for Otis Elevator.
  - There was an understanding between Otis Elevator and International that Otis Elevator will be in control of the undertaking, or there was actual control by Otis Elevator.
  - There was acceptance by International of the undertaking to act for Otis Elevator.
8. T. Reid Methvin was an agent for North American Specialty Insurance Company (NAS), which was engaged in the business of underwriting performance or construction bonds. As part of the agency agreement, Methvin was to seek prior approval from NAS before writing any bonds. During the course of the agency relationship, Methvin issued numerous unauthorized performance bonds. After learning about the unauthorized bonds, NAS accepted and retained payment of the premiums on all of the unauthorized bonds issued by Methvin. Thereafter, 12 of the unauthorized bonds resulted in defaults, causing significant losses when NAS was forced to pay claims on them. NAS now argues that Methvin, not it, is legally responsible to pay the claims on the defaulted bonds because Methvin acted without authority. Given these facts, which of the following is most correct regarding ratification of Methvin's acts by NAS?
- NAS is not legally liable to pay the claims on the defaulted bonds because Methvin acted outside the scope of his employment.
  - NAS is not legally liable to pay the claims on the defaulted bonds because it never expressly ratified the bonds.
  - NAS is legally liable to pay the claims on the defaulted bonds because NAS tacitly ratified Methvin's behavior by its subsequent actions.
  - NAS is legally liable to pay the claims on the defaulted bonds because the equal dignities rule requires that any ratification be done in a signed writing.

9. Shelly A. Johnson claims that her brother-in-law, Michael P. Donnelly, a former employee of Nationwide, induced her to invest \$70,000 in a Nationwide tax-free mutual fund. At the time she made the investment, Shelly was unaware that Michael was no longer an agent of Nationwide. After she discovered that Michael had misappropriated the funds, Shelly sues Nationwide. What is the most likely result of the lawsuit?
- Shelly will prevail because Michael still had apparent authority to represent Nationwide and the company had failed to properly notify her of his termination.
  - Shelly will prevail because Michael still had implied authority to represent Nationwide.
  - Shelly will not prevail because she could have easily determined whether or not her brother-in-law was still an employee of Nationwide at the time she made her investment.
  - Shelly will not prevail because the misappropriation of funds involves a criminal act and a principal cannot authorize an agent to commit a criminal act.
10. Stephen Carter was hired by Sara Lee Corporation to service computers for the company. While working for Sara Lee, Carter formed a company, PC Technologies, that supplied parts to Sara Lee. Part of Carter's job at Sara Lee was to order replacement parts when employees contacted him and reported computer failures. When some Sara Lee employees became suspicious of PC Technologies due to difficulties in contacting the company, Carter continually reassured his superiors that he was in contact with PC Technologies and would take care of any problems. When Sara Lee employees suggested that PC Technologies be replaced on the project, Carter told them he was concerned that Sara Lee would be breaching its contract with PC Technologies. No contract with PC Technologies was on record, however, with Sara Lee. At no time did Carter reveal that he had a financial interest in PC Technologies. Sara Lee Corporation sues Carter for breach of his agency duties. What is the most likely result of this lawsuit?
- The court will find that Carter was an agent of Sara Lee when he was hired by Sara Lee Corporation, but ceased to be an agent when he formed PC Technologies, so technically is not in breach of his agency duties.
  - The court will find that Carter is an agent of Sara Lee who will be found in breach of his duties as an agent.
  - The court will find that Carter is an agent of Sara Lee, but may or may not be in breach of his duties as an agent depending on whether or not PC Technologies performed its obligations to Sara Lee Corporation in a reasonable manner for a fair price.

- d. The court will find that Carter became a dual agent when he created PC Technologies, and since dual agency is permitted, there is no breach of his agency duties to Sara Lee Corporation.
11. Scott Busch invited his ex-girlfriend, Carolyn Freeman, and her two female friends to his Simpson College dorm room for a party. Busch's roommate, Gene Hildreth, and another friend, John Hatfield, also attended the party. All three women accepted Busch's invitation with the expectation that there would be alcohol served at the party. Busch and Hildreth had another friend purchase the alcohol for them. When Freeman became visibly intoxicated, Busch carried her to his bedroom to lie down. Eventually the others left to attend a fraternity party, leaving Freeman and Busch alone in Busch's bedroom. At some point later, Busch had a conversation with the on-duty resident assistant, Brian Huggins. Busch informed Huggins that Freeman was his visitor and that she had consumed alcohol, and that after consuming it, she had passed out. Huggins, who knew Busch because both served as Simpson College security officers, told Busch to monitor Freeman's condition and, if the condition worsened, to report back to him. Later that evening, Busch took sexual advantage of the intoxicated Freeman. After this sexual encounter, the others returned from the fraternity party to Busch's dorm room. When Hatfield was getting ready to leave, Busch called him into the bedroom. Busch directed Hatfield's attention to the unconscious Freeman. He then permitted Hatfield and Hildreth to fondle her breasts. Freeman has now sued Simpson College for the acts of its employees Busch and Huggins. In light of this fact situation, which of the following is most correct?
- Simpson College will be strictly liable for the negligence of its employees Busch and Huggins under the doctrine of respondeat superior.
  - Simpson College will not be responsible for the negligent acts of Busch and Huggins that are outside the scope of their employment.
  - Huggins had taken specific action to exercise control or custody over Freeman, so Simpson College will be liable for the subsequent actions of Busch and Huggins.
  - Simpson College acquired a legal duty to protect Freeman from the described actions of its employees Busch and Huggins as soon as Freeman entered college property.
12. Digges persuaded Levin and Wharton to join him in forming a law partnership. They enthusiastically agreed because Digges came from a long line of prominent attorneys dating back to the 17th century. Levin and Wharton devoted most of their time to trial work and left all of the money matters to Digges. According to Wharton, "[I]f you don't trust your partner, you ought not to be partners." Digges later pled guilty to stealing over \$1,000,000 from a client, Dresser Industries, by padding and falsifying invoices during a 3-year period. He then stole the proceeds from the law firm and used the money to restore his mansion. Neither Levin nor

Wharton was accused of any wrongdoing. With regard to the liability of Levin and Wharton to Dresser Industries, which of the following is most correct?

- a. Levin and Wharton will not be personally liable to Dresser Industries because Digges was not authorized to commit crimes on behalf of the partnership.
  - b. Levin and Wharton will not be personally liable to Dresser Industries because bill padding and false invoicing is a foreseeable activity when dealing with lawyers.
  - c. Levin and Wharton will be personally liable because they failed in monitoring the activities of their partner Digges.
  - d. Levin and Wharton will be personally liable because Digges was acting within the scope of the partnership.
13. Laurence Kelly entered into a partnership with Stephen MacKenzie to purchase a parking lot. While Kelly and MacKenzie were searching for investors, MacKenzie approached Russell Glidden, the principal of QAD Investors, and provided him with a copy of Kelly's personal financial statement. Kelly, MacKenzie, and Glidden met together repeatedly thereafter. At the meetings, MacKenzie referred to Kelly as a partner in the project. Glidden had committed QAD to providing \$20,000 to the venture. MacKenzie gave Glidden a written receipt stating that the money would be paid back pursuant to a note that Glidden would hold. The note had lines for the signatures of Kelly and MacKenzie, but only MacKenzie's line contained a witnessed signature; Kelly's line was blank. Later, when the partnership defaulted on the loan, QAD sued Kelly for payment. Based on these facts, what is the most likely outcome of the lawsuit between QAD and Kelly?
- a. Kelly is liable to QAD because he stood to benefit from the original investment had the venture been successful.
  - b. Kelly is liable to QAD under a theory of apparent authority.
  - c. Kelly is liable to QAD because he had constructive notice of the written receipt that MacKenzie gave QAD.
  - d. Kelly is not liable to QAD because MacKenzie had no authority to bind Kelly to the terms of the QAD note.
14. Thomas Wang's sister-in-law, Irene, wired \$1,000,000 to Thomas so he could purchase a hotel. Thomas was told that \$750,000 of this amount was provided by Irene's sister, Kuei-Ying Chen. Thomas's wife, Susanna, informed Kuei that she would contribute \$1,000,000 of her own money so they could then afford to buy the property. Ownership of the hotel and the profits were to be shared proportionately to the promised contributions: 50 percent for Susanna, 37.5 percent for Kuei, and 12.5 percent for Irene. It also was agreed that title to the property would be in all three sisters' names. The hotel was purchased for the \$1,750,000 price; however, Susanna

did not contribute any cash. It was purchased with \$900,000 of Kuei's and Irene's money, with the other \$850,000 being financed by a mortgage provided by the seller. The title to the hotel was only in the name of Susanna and Thomas. They formed a corporation, which was owned by Susanna and Thomas only, to manage the hotel. All subsequent losses generated by the business were reported only on Thomas's and Susanna's tax returns. All lease payments paid to the hotel were kept by Thomas and Susanna. When Kuei questioned Thomas about the deed, he told her that it had not yet been recorded, even though it actually had been recorded one month earlier. Have Susanna and Thomas violated their fiduciary duties owed to Kuei and Irene?

- a. Yes, because there was a partnership among Kuei, Irene, Thomas and Susanna.
  - b. Yes, because Susanna and Thomas did not contribute any cash to the enterprise.
  - c. No, because the deed was recorded in Thomas's and Susanna's names only.
  - d. No, because there was no partnership.
15. National Foods, Inc., sells franchises to its fast-food restaurants, known as Chicky-D's. Under the franchise agreement, franchisees agree to hire and train employees strictly according to Chicky-D's standards. Chicky-D's regional supervisors are required to approve all job candidates before they are hired and all general policies affecting those employees. Chicky-D's reserves the right to terminate a franchise for violating the franchisor's rules. In practice, however, Chicky-D's regional supervisors routinely approve new employees and individual franchisees' policies. After several incidents of racist comments and conduct by Tim, a recently hired assistant manager at a Chicky-D's, Sharon, a counterperson at the restaurant, resigns. Sharon files a suit in a federal district court against National. National files a motion for summary judgment, arguing that it is not liable for harassment by franchise employees. What is the most likely result of National's motion?
- a. National's motion will succeed because National routinely approved new employees and individual franchisees' policies.
  - b. National's motion will succeed because racial harassment is outside the scope of the franchise agreement.
  - c. National's motion will fail based on the degree of control that National had over its franchisees, even though National routinely did not exercise that control.
  - d. National's motion will fail because Tim is considered management and a franchisor is liable for the racist conduct of its franchisees' managerial staff.
16. John Hildreth was the sole shareholder, director, and officer of a New Jersey corporation known as HCE, Inc. (HCE-NJ). The corporation engaged in the

construction business as a subcontractor on various commercial construction projects. It began doing business in Maryland. Although Hildreth had formed a number of other corporations in Maryland, he did not register HCE-NJ in the state as was required by Maryland law. When HCE-NJ began to do business in Maryland, there was already existing a separate Maryland corporation by the name of HCE, Inc. (HCE-Md). It was properly incorporated in the state and had no connection with Hildreth or HCE-NJ. Ultimately, the Maryland corporation's president learned of Hildreth's existence and threatened legal action if Hildreth did not stop using the HCE name immediately. Such use did not stop. Instead, Hildreth was able to register HCE-NJ with the Maryland Department of Assessments and Taxation. By this time, HCE-NJ stopped making payments on a crane it had been leasing from Tidewater Equipment Company. Tidewater then claimed Hildreth was personally liable. What is the most likely result of Tidewater's lawsuit against Hildreth on the lease agreement?

- a. Hildreth will be personally liable, because he had no right to do business in Maryland under the name HCE-NJ.
  - b. Hildreth will be personally liable, because Hildreth knew that there was a Maryland corporation known as HCE, Inc.
  - c. Hildreth will not be personally liable, because HCE- NJ was a de jure corporation.
  - d. Hildreth will not be personally liable, because HCE- NJ was a corporation by estoppel.
17. When Datel Engineering Company was incorporated, Naren contributed all of the corporation's initial capital. Sennerikuppam was an officer and member of the board of directors of Datel and was involved in its formation. He also had primary responsibility for Datel's day-to-day business operations. Datel distributed shares of stock to ten of its employees and directors in accordance with a Stock Purchase Agreement. The 113 shares that were distributed were the only outstanding shares in Datel. Sennerikuppam received nine shares and paid \$2,500 per share. The Stock Purchase Agreement provides if the corporation buys back shares, "The price per share shall be . . . \$ 2,500.00 per share, which may be adjusted annually by agreement in writing of the shareholders holding 60 percent of the shares." Naren controlled more than 60 percent of the outstanding shares and could have unilaterally adjusted the share price. Over the years, no adjustment was ever made. When Sennerikuppam resigned, he sold his nine shares back to Datel and was paid \$2,500 per share. However, he also requested that he be paid his pro rata share of the corporation's retained earnings, which were estimated to be \$2,325,751, or \$ 27,362 per outstanding share. The corporation refused, citing the Stock Purchase Agreement. Sennerikuppam filed a suit against Naren. Specifically, he claimed that Naren's failure to adjust the share price, despite the undisputed increase in the actual value of the shares, constituted a breach of his fiduciary duty as majority

shareholder. What is the most likely outcome of Sennerikuppam's lawsuit against Naren?

- a. Sennerikuppam will win because a majority shareholder of a corporation has the same fiduciary duties as an officer or director.
- b. Sennerikuppam will win because the terms of the Stock Purchase Agreement are unfair.
- c. Sennerikuppam will lose because it does not appear from the facts that Naren used his majority control of the corporation to his own advantage without providing minority shareholders with an equal opportunity to benefit.
- d. Sennerikuppam will lose because a majority shareholder never has fiduciary duties and may act in his or her own self interest.

18. Loft, Inc., manufactured and sold candies, syrups, and beverages and operated 115 retail stores. Loft sold EnergyAide at all of its stores, but it did not manufacture EnergyAide syrup. Instead, it purchased its 30,000-gallon annual requirement of syrup and mixed it with water at its various retail stores (mainly to save the costs of transporting water). In May 2005, Charles Guth, the president and general manager of Loft, became dissatisfied with the price of EnergyAide syrup and suggested to Loft's vice president that Loft buy PowerJuice syrup from the National PowerJuice Company, the owner of the secret formula and trademark for PowerJuice. The vice president said he was investigating the purchase of PowerJuice syrup. Before being employed by Loft, Guth had been asked by the controlling shareholder of National PowerJuice, Megargel, to acquire the assets of National PowerJuice. Guth refused at that time. However, a few months after Guth had suggested that Loft purchase PowerJuice syrup, Megargel again contacted Guth about buying National PowerJuice's secret formula and trademark for only \$100,000. This time, Guth agreed to the purchase, and Guth and Megargel organized a new corporation, PowerJuice Company, to acquire the PowerJuice secret formula and trademark from National PowerJuice. Eventually, Guth and his family owned a majority of the shares of PowerJuice Company. Very little of Megargel's or Guth's funds were used to develop the business of PowerJuice. Instead, without the knowledge or consent of Loft's board of directors, Guth used Loft's working capital, credit, plant and equipment, and executives and employees to produce PowerJuice syrup. In addition, Guth's domination of Loft's board of directors ensured that Loft would become PowerJuice's chief customer. By 2009, the value of PowerJuice's business was several million dollars. Upon learning of the situation, Loft sues Guth, asking the court to order Guth to transfer to Loft his shares of PowerJuice Company and to pay Loft the dividends he had received from PowerJuice Company. What is the most likely outcome of that lawsuit?

- a. Loft will prevail because Guth has usurped a business opportunity belonging to Loft.
- b. Loft will prevail only if Guth had signed a non-compete agreement.

- c. Loft will lose because Loft's VP said he was he was investigating the purchase of PowerJuice syrup and failed to follow up.
  - d. Loft will lose because Loft was negligent in not monitoring the activities of Guth.
19. On September 4, 2008, John, Lesa, and Tabir formed a New Hampshire limited liability company to open a credit counseling service in Manchester, New Hampshire. John contributed 60 percent of the capital, and Lesa and Tabir each contributed 20 percent. Nothing was mentioned in the members' agreement about how profits were to be divided. Due to the economic meltdown, the business has been quite successful and has earned substantial profits during the first year of operation. Given these facts, how will the profits be distributed?
- a. John will receive 60 percent, and Lesa and Tabir will receive 20 percent each.
  - b. John, Lesa, and Tabir will receive equal percentages.
  - c. The distribution will be determined by majority vote of the LLC members.
  - d. It cannot be determined from the facts as presented.
20. In 2006, Kora Nayenga and two business associates formed a corporation called Nayenga Corporation for the purpose of selling computer services. Kora, who owned 50 percent of the corporate shares, served as the corporation's president. In 2008, Kora wished to obtain a personal loan from his bank for \$250,000 to buy a second home on Lake Sunapee, but the bank required the note to be cosigned by a third party. Kora cosigned the note in the name of Nayenga Corporation. Later, Kora defaulted on the note, and the bank has now sued the corporation for payment. What is the most likely outcome of the bank's efforts to collect from the corporation?
- a. The bank will prevail because Kora, as 50 percent owner and corporate president, had apparent authority to cosign the note on behalf of the corporation.
  - b. The bank will prevail because Kora effectively controls the corporation.
  - c. The bank will lose because cosigning a note for a personal loan is not within the "ordinary business" of the Nayenga Corporation.
  - d. The bank will lose because corporations cannot cosign for personal loans.
21. Mark Hardie was the sole member of Technical Plastics of Oregon, LLC (TPO). The company operated out of an office in Hardie's home. He regularly used TPO's accounts to pay such expenses as landscaping and house cleaning. TPO also paid some of Hardie's personal credit card bills, loan payments on his Ford truck, the cost

of constructing a deck on his house, his stepson's college bills and the expenses of family vacations to Disneyland. At the same time, Hardie deposited cash advances from his personal credit cards into the TPO checking account. Hardie did not take a salary from TPO. When TPO filed for bankruptcy, it owed BLD Products approximately \$120,000. BLD Products sues Mark Hardie for the \$120,000. What is the most likely outcome of that lawsuit?

- a. BLD will lose against Mark Hardie because the debt was owed to BLD by TPO, not Mark Hardie.
- b. BLD will lose against Mark Hardie because any funds taken from TPO by Mark Hardie were in lieu of a reasonable salary.
- c. BLD will win against Mark Hardie because Mark Hardie exercised sufficient control over TPO to create an agency relationship with Mark as principal.
- d. BLD will win against Mark Hardie because under these circumstances a court will pierce the LLC veil.

22. Norman Costello is a member of Silk, LLC, which owned a bar and adult entertainment nightclub in Groton, Connecticut, called Silk Stockings. Anthony Sulls went drinking there one night and drinking heavily. Although he was obviously drunk, employees at Silk Stockings continued to serve him. Giordano, a management employee of Silk Stockings, and Costello were working there that night. They both greeted customers (who numbered in the hundreds), supervised employees, and performed "other PR work." When Sulls left the nightclub at 1:45 a.m. with two friends, he drove off the highway at high speed, killing himself and one of his passengers, William Ridgaway. Ridgaway's estate has sued Costello personally. The defendant files a motion for summary judgment. What is the most likely ruling on this motion?

- a. The motion will be granted because Costello did not own Silk Stockings; he was simply a member of an LLC that owned the nightclub.
- b. The motion will be granted because an LLC is an effective block of liability for its members.
- c. The motion will be denied because Costello is liable for his own misdeeds as employees of the LLC.
- d. The motion will be denied because Silk, LLC, is liable and Costello is a member of Silk, LLC.

23. Olav, a retired banker, served on the board of directors for a nationally prominent charitable organization. The local chapter of the charity discussed plans to purchase and relocate to a new building across town. Olav approached Mansfield, a close friend, and the two of them quickly closed on a deal for the new building, purchasing it for \$1.2 million and placing title in Mansfield's name only. When the matter later

came before the board of the charitable organization, Olav encouraged the organization to make an offer of \$1.6 million to Mansfield. Olav did not disclose to the board that he would share in the profits of the sale. With regard to the facts as presented, which of the following is most correct?

- a. Because the facts involve a charitable organization, Olav's activities would be permitted.
  - b. Olav has violated his duty of loyalty.
  - c. Olav has violated his duty of care.
  - d. There is nothing wrong with the described activities as long a \$1.6 million is a fair price.
24. Nagy is a local television personality who serves on the board of directors for a large software company. Nagy's position on the board requires that she oversee the company's investment portfolio. Nagy enjoys the prestige of serving on this board; however, she does not have any special investment expertise and she frequently fails to review the financial statements provided by the company's accountants or trends taking place in the stock market. Not surprisingly, during the year that Nagy has been overseeing the company's investment portfolio, the company's investments have performed extremely poorly. Alan, a disgruntled shareholder, files a derivative suit against Nagy. What is the most likely outcome of Alan's lawsuit?
- a. Alan will lose because investments are always risky and the portfolio's poor performance was to be expected given the circumstances.
  - b. Alan will lose because Nagy appears to be an independent director.
  - c. Alan will win because Nagy has violated her duty of care.
  - d. Alan will win because Nagy was appointed to a position for which she was clearly not qualified.
25. On March 1, 2009, Davos Services, a Delaware corporation with its principal place of business in Portsmouth, New Hampshire, became a takeover target of Kutsumo Inc. Kutsumo made a tender offer to the shareholders of Davos Services, offering \$35 per share for each of the outstanding shares of Davos Services. Prior to the offer, Davos Services stock had been selling in a range of \$14 to \$16 per share. On March 15, 2009, the board of directors of Davos Services met and decided to resist the Kutsumo efforts and continue with its current strategy. At the same meeting, the board passed a resolution granting significant stock options to the current management of Davos Services at an extremely low price. Julian Gatspare, one of your clients and a relatively minor shareholder of Davos Services, is outraged by the board's action and would like to have the stock options nullified. Which of the following would be the best legal assessment of the situation?

- a. The business judgment rule prevents a court from assessing the business wisdom of the actions taken at the March 15 board meeting.
- b. The actions of the board may be judicially reviewed if there is a showing of a breach of the duty of care or the duty of loyalty.
- c. If both Kutsumo and Davos Services are publicly traded companies, the actions taken by Davos Services' board will not be actionable because any objecting shareholder can "take the Wall Street walk."
- d. Since the tender offer was \$19 more per share (and over twice the highest price) of the stock's recent selling range, the board of directors' sole obligation was to accept the offer.

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**PART TWO: Mini-Essay Question** (50 points) Write your well organized and legible answer in the provided blue book or type out your answer according to the registrar's instructions. Answer and mark the sub-parts separately and make sure your exam number is on any answer you turn in.

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### **Alice and Bob Start a Business**

Alice and Bob both have recently been laid off from their state government jobs as part of a sizable workforce reduction plan implemented to balance the state budget. Rather than wait for the government to rehire them or to seek work from some of the few private companies hiring during the recession, Alice and Bob decide that they should pool their skills and start a business together. Alice is a highly trained information systems specialist and Bob is an experienced marketing manager. The idea for the immediate future is for Bob to function as the rainmaker for Alice's services. They believe that there will be a very strong opportunity for information system providers once the economy begins to recover, and at that time they can grow the business by adding more information specialists to meet the demand that Bob will identify and cultivate. It is also envisioned that Bob would manage any larger business operation that evolved, while Alice would concentrate on training and supervising any addition information system specialists, as well as provide services directly. At this point in time Alice has little money to invest in the business, but Bob has around \$30,000 he inherited from the recent death of distant relative. A local bank has indicated a willingness to give personal loans of \$10,000 each to Alice and Bob to help the business get off the ground.

Alice and Bob come to you for advice regarding the legal structure that might best fit their situation. As part of that advice, you have already explained to Alice and Bob the various types of legal structures from partnership to corporation that are possible. During that discussion you have been specifically asked by Alice and Bob to explain the following:

- A. What are the two main advantages to them of the partnership form of business?
- B. What are the two main disadvantages to them of the partnership form of business?