BUSINESS ORGANIZATIONS

Professor Stilson

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INSTRUCTIONS:

- 1. This is a FOUR HOUR examination. It is a LIMITED CLOSED BOOK examination. You may consult ONLY YOUR CODE BOOK. No other materials of any kind may be consulted during the examination.
- 2. There are FOUR QUESTIONS, each with multiple parts. You should allot your time as follows: Question One seventy-five minutes, Question Two seventy-five minutes, Question Three sixty minutes, Question Four thirty minutes.
- 3. BLANK PAGES HAVE BEEN PROVIDED FOR YOUR ANSWERS. USE ONLY THESE PAGES TO RESPOND AND WRITE ON ONE SIDE OF THE PAGE ONLY. Allot your space accordingly.
- 4. TURN IN THE COMPLETED EXAMINATION AT THE END OF THE FOUR-HOUR PERIOD. Make sure the examination is secured and presented according to page numbers (there are 23 pages in the examination).

GOOD LUCK!

QUESTION ONE

(One and one-half hours)

Dan, John and Tom are brothers who have been employed by the same construction company for twelve years. Dan, the "rainmaker" of the three, one day suggests that financial independence can only be gained by the brothers owning and managing their own business. Accordingly, they agree to join together to form DJT Construction ("DJT"). Dan and John agree to contribute \$50,000 each to the business, while Tom agrees to contribute \$25,000 - money which Tom does not presently possess but an obligation for which he is willing to execute an unsecured promissory note, payable over five years without interest. Dan, John and Tom also agree that any profits will be distributed continuously and shared equally. Dan, John and Tom do not formalize their agreement in writing.

1. What type of business organization has been formed by Dan, John and Tom? Explain. Assume that Tom fails to make payments on the note and that a dispute arises over the brothers' profit-sharing arrangement. In your opinion, would/should a court of equity enforce the original agreement? Please explain.

Initially, DJT flourishes. Indeed, at times there is too much work for the three to handle. Accordingly, Tom asks a friend, Fred, if he will perform some odd jobs for DJT. Several months after Tom hires Fred, Dan is in a bind and needs some small repairs done on a townhouse so that DJT can go to closing. Dan has learned that Fred has worked on DJT projects, but has also learned that much of Fred's work has been shoddy. Dan contacts Fred who agrees to do the repair work. The work includes replacement of roof shingles on the townhouse. In the course of preparing for the repairs, Fred puts up a ladder, but fails to secure it from falling. While Fred is obtaining materials from his truck, the ladder falls on Pam (who is passing by) and inflicts serious injury. Pam learns that Fred is doing the repairs for DJT and sues.

2. (a) Assume that Fred was negligent in placing the ladder. Is DJT liable to Pam for Fred's negligence? Discuss.

(b) Are Dan, John and Tom individually liable for Fred's negligence? Discuss.

After the first year of business, DJT's profits disappear. However, DJT has an opportunity to pursue a new project which has great potential. Unfortunately, DJT needs additional capital to fund the start-up costs for the project. Tom, who has accumulated some cash from receipt of profits from the business, feels uncomfortable that he had not made regular payments on his promissory note to the business. As a consequence, Tom pays off the promissory note and makes an additional \$15,000 advance to the business.

3. (a) Does Tom's additional contribution change the relationship of Dan, John and Tom or give Tom any additional rights in the business? Please explain.

Assume that Dan, John and Tom reduce their original agreement to a writing and thereafter file a Certificate to form a registered limited liability partnership (LLP). Also assume that Pam's injury as a result of Fred's negligence occurs after DJT registers as a limited liability partnership.

(b) Are Dan, John and Tom each liable for Pam's injuries? Explain. What is the relevance, if any, of Tom's subsequent \$15,000 contribution to the resolution of this question?

(c) Assume that Dan, John and Tom form a limited liability company instead of an LLP. Are Dan, John and Tom liable for Pam's injuries? Explain.

Assume that Dan, John and Tom formed an LLP. Several months after formation of the registered limited liability partnership, Dan determines that the business, which is now operating at a loss, has no hope of turning a profit. Accordingly, Dan informs John and Tom that he would like to dissolve DJT. John and Tom oppose the dissolution.

4. Can DJT be dissolved without the consent of John and Tom? Discuss.

Assume that Dan, John and Tom all agree that DJT should be dissolved. Further assume that the three have agreed that none will be liable for the others' actions where those actions arise from the dissolution and winding-up of the business. Finally assume that, in order to accomplish an orderly dissolution, it is agreed that Tom will oversee the completion of all current projects of DJT.

After approximately three months, the final DJT project is completed. Upon termination of this final contract, General Contractor ("GC")(who is not aware that the business is dissolved) approaches Tom with an attractive new construction job. Tom, aware that DJT is unofficially dissolved ("unofficial" because the company has yet to file a Certificate of Dissolution), agrees to a contract with GC but requests that one-half of the payment of the job be made as a deposit to his personal bank account before work can commence. General Contractor agrees. Tom fails to disclose the GC contract to Dan or John. Three weeks into the project, with only a quarter of the work complete, Tom's construction crew quits and Tom has to abandon the job with GC. Unfortunately, Tom lost all the "up front" money at a local casino.

5. (a) Is Tom liable for the completion of the final project? Please explain.

(b) Is DJT liable to General Contractor for the deposit? Please explain.

(c) If the business were formed as an LLC, would Tom or DJT be liable to General Contractor? Please explain.

QUESTION TWO

(Forty-five minutes)

Assume a corporation is capitalized as follows:

A	\$40,000
В	Services to be performed in one
	year valued at \$15,000
С	Real estate valued at \$20,000
D	Promissory note for \$15,000

Assume that A, B, C, and D each receive 100 shares of par value common stock for their contributions. Assume also that the shares are restricted on resale only to existing shareholders or the corporation at an aggregate price of \$15,000. Further assume that the shareholders, on formation of the company, entered an agreement to elect themselves as directors and officers, to pay each a reasonable monthly salary for a period of at least five years (to be negotiated thereafter according to each individual's contribution to the firm), to vote their shares together for all business purposes, and to negotiate a construction loan of \$140,000 from Bank for the purpose of building and selling a home on the real estate. Assume that the shareholder agreement is performed in year one and that each shareholder has received income from the company (the corporate records do not indicate the source of the income nor do the records indicate any service provided by B).

Assume, in December of year two, that Bank grants the above-mentioned construction loan and takes a first mortgage against the property which loan is collateralized by a pledge of all the stock of the corporation. Assume also that a contract for purchase of the property was signed by Ed Buyer (your brother-in-law) on March 3 of year two, indicating a sale price of \$140,000, subject to buyer obtaining reasonable financing. After five months, when construction is 35% complete and Buyer has obtained an alternative commitment for the required financing, the corporation defaults on the construction loan.

A, B, C, and D, given the corporate situation, decide to vote their shares to dissolve the corporation, effective immediately. After a unanimous vote in favor of dissolution, a Certificate of Dissolution is filed with the appropriate Secretary of State.

Bank retains you as counsel and seeks alternative relief: (a) suit against the corporation and its shareholders for the

full amount of the loan plus interest; (b) sale of the pledged shares for any deficiency; and/or (c) specific performance of the contract and attachment of the proceeds of the sale to Buyer.

Consider, in your answer to Bank's request for relief, that the corporation is formed in either Delaware or an MBCA jurisdiction. Please also consider, before answering the questions, what relief is sought and how the Bank can accomplish same.

QUESTION THREE

(Forty-five minutes)

ABC Corporation (ABC) has three shareholders, A and B who are sisters and 37 1/2 percent shareholders, and C, an outside investor who owns the remaining 25 percent. A is also the Chairperson of the Board of Directors and President of ABC; B is Vice President and Secretary. One day, C casually mentioned to A that she might be interested in selling her stock. This casual conversation led to further negotiations and, ultimately, to the purchase by A of C's shares. The purchase was financed by a loan from ABC to A, secured by a pledge of A's stock in ABC to the company. B, suddenly a minority shareholder, seeks your advice as to whether she may compel the corporation to buy her stock in ABC for two dollars more per share than C sold her shares to A. In the alternative, B wishes to know whether she may compel the appointment of a custodian or a dissolution of the corporation due to the unfair and secret shift in control of the corporation.

(a) What advice would you give if the applicable jurisdiction were Delaware?

(b) Would your advice change if the applicable jurisdiction were New York or Massachusetts? Explain.

(c) Would your advice concerning B's dilemma have been avoided by the formation of a statutory close corporation or an LLC? Explain.

QUESTION FOUR

(One hour)

Briefly answer the following questions. Be sure to address the question/s asked.

- (1) Assume the following: a corporation is formed in New York; conducts business in Maryland, Delaware and Virginia; enters contracts in each state in which business is conducted; commits a tort in Virginia; is sued on the tort in Virginia and loses; is presented with a demand by its shareholders to sue the governing directors at the time of the commission of the tort for breach of the duties of care and loyalty (of five directors, two have been found personally liable in the tort suit); rejects the demand and files a motion to dismiss the suit; and has a provision in its certificate of incorporation which states that "all monetary liability for breaches of managerial duties is eliminated to the maximum extent of the law".
 - (a) Where will the shareholder suit be filed and why?

(b) What standard of judicial review is applicable to the Board's decision to reject the suit? Explain.

(c) What procedural burdens, if any, are imposed upon the shareholders' ability to pursue the suit and/or succeed on the merits? Explain.

(2) What is the liability of a shareholder in a de facto corporation, a corporation by estoppel or a corporation which is defectively incorporated where such corporation is found liable to a third-party claimant? Explain.

- (3) Assume the formation of a Delaware Limited Partnership (LP). S Co., a Delaware corporation, is the sole general partner of LP. LP is in the business of storing toxic chemicals. S has \$1,000 of paid in capital; LP is capitalized at \$10,000. S has two individuals, Abe and Ben, as sole shareholders, directors and officers. The limited partners of LP consist of Abe and Ben as well as their respective spouses.
- (a) What fiduciary relationships are presented by this hypothetical?

(b) If LP were sued for \$50,000 and a judgment against LP entered for that amount, what persons may be held liable for the judgment? Explain.