Business Law I

Midterm Examination

Fall 2022

Prof. P. Stirling

Instructions:

There are two (2) questions in the examination.

You will be given 3 hours to complete the examination.

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Business Organizations I
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QUESTION 1

Dilbert, Ethel, and Fred orally agreed to start DEF Infrared Saunas ("DEF"), a business to manufacture and sell Infrared Saunas. Dilbert contributed $100,000 to DEF, stating to Ethel and Fred that he wanted to limit his personal liability to that amount. Ethel, who had technical expertise, contributed $50,000 to DEF. Fred contributed no money to DEF but agreed to act as salesperson. Dilbert, Ethel, and Fred agreed that Ethel would be responsible for designing the Infrared Saunas, and that Fred alone would handle all Sauna sales.

DEF opened and quickly became successful, primarily due to Fred's effective sales techniques. Subsequently, without the knowledge or consent of Dilbert or Fred, Ethel entered into a written sales contract in DEF's name with Geco, Inc. ("Geco") to sell Infrared Saunas manufactured by DEF at a price that was extremely favorable to Geco. Ethel's sister owned Geco. When Dilbert and Fred became aware of the contract, they contacted Geco and informed it that Ethel had no authority to enter into sales contracts, and that DEF could not profitably sell Infrared Saunas at the price agreed to by Ethel. DEF refused to deliver the Infrared Saunas, and Geco sued DEF for breach of contract.

Thereafter, Dilbert became concerned about how Ethel and Fred were managing DEF. He contacted Zeta, Inc. ("Zeta"), DEF's components supplier. He told Zeta's president, "Don't allow Fred to order components; he's not our technical person. That's Ethel's job." Fred later placed an order for several expensive components with Zeta. DEF refused to pay for the components, and Zeta sued DEF for breach of contract. Not long afterwards, DEF went out of business, owing its creditors over $500,000.

1. How should DEF's debt be allocated? Discuss.

2. Is Geco likely to succeed in its lawsuit against DEF? Discuss.

3. Is Zeta likely to succeed in its lawsuit against DEF? Discuss.

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Question 2

Emerson has a bicycle sales and repair shop, Elite Cycles. He is the sole owner and the business is a sole proprietorship. He hires Tarquin and the employment agreement states that Tarquin will work in the shop to both sell cycles and to repair them, as well as manage the operations when Emerson is traveling. As Emerson is also a triathlete, he travels often. In order to keep the business running, he provides Tarquin with a power of attorney that allows Tarquin to act on Emerson's behalf and to "enter into and execute any contract for the purchase of goods or merchandise as needed for the operation of the current business of Elite Cycles, or to sign any credit or promissory note in connection with the operation of the current business of Elite Cycles on my behalf."

While Emerson is competing at the World Triathlete Championships in Ashgabat, Turkmenistan, Tarquin comes up with an idea for selling specialty personalized helmets. He goes to the bank and tells them he has power of attorney from Emerson "to run the business." The bank manager knows Emerson and does not look at the power of attorney. Tarquin signs a promissory note for $50,000 to purchase the helmets from HM Helmets. Tarquin takes delivery of the helmets and decides he could make more money personalizing them himself and selling them online. That evening, he leaves the store closed and locked (he is the only employee with a key so no other staff can enter) and drives to Canada to create his online business. When Emerson returns one week later, the store is still locked, and he receives notice that the bank has not been repaid.

What would you advise Emerson regarding his position with the bank, Tarquin's actions, and the legal recourse (if any) he can take against Tarquin?

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ANSWER 1 (OUTLINE)

20% Organization (Similar headings – boldfaced below)

20% Issue (Spot all issues)

20% Rules (Name all rules – underlined below)

20% Analysis (Apply law to facts – all non-underlined, non-italicized font below)

20% Conclusions (Get correct conclusions – as *italicized* below)

Introduction

1. Nature of Organization
2. DEF is a partnership under definition
3. Partnerships are business for profit and if no agreement, profits are split

1. How should DEF's Debt be Allocated?

1. Just like profits, without agreement, debts are split equally.
2. D wanted to limit his liability. However, absent a formal agreement, D is going to be considered a general partner.
   a. Also D has active management (general managerial position, apparent equal voting rights), D was the one to call Zeta (Z) and tell them not to accept orders from F.
   b. Limited partners, those with limited liability, generally have no managerial functions.
   c. Under agency law, any contract or tortious action entered into in the scope of the partnership is deemed to be partnership debt, and all partners are jointly and severally liable.
3. Therefore, any contracts that were properly entered into and authorized by a partner having authority are partnership debts that D, E, and F will be jointly and severally liable for as individuals.

4. ***Therefore, the order of payment is: (1) all debt creditors, (2) all capital contributions from each partner, which would be $100,000 to D and $50,000 to E and zero to F since partners generally have no right to salary or compensation for services; (3) any remaining profits equally to D, E, F.***

2. Is Geco likely to Succeed in its Lawsuit against DEF?

1. Validity of the Agreement: Geco (G) must show that E was authorized to enter the contract.
    a. All partners are authorized agents of the partnership but the nature of authority may vary.
    b. Express authority exists when the arrangement expressly states what an agent may do, but sales were expressly reserved to F so E doesn't have express authorities.
    c. Implied authority exists when the function is 1) necessary to carry out other responsibilities, 2) one that has been done in the past dealings without objection, or 3) normal custom for someone with the position of the agent. Sales are not necessary to E's technical design responsibilities, and she has never sold before.
    d. Apparent authority exists when the company cloaks the agent with authority to do certain things and later withdraws or limits that authority without notifying a customer who is still relying on that authority. In this case, there is no indication that DEF held E out to be a sales representative in the first instance. There was likely no good basis that G had to rely on any authority from DEF. However, given that E herself is a managing partner, G likely could argue that E's actions were sufficient to show that the corporation had given her authority to act. As such, they will argue that it was reasonable to rely on this without any other notice. This would bind DEF.
2. ***Failing to perform on the contract is a breach of duty and the partnership, as well as the individual partners, will be obligated to pay as described above.***
3. Breach of Duty of Good Faith and Loyalty
    a. Partners have fiduciary duties to each other that are described as the utmost duty of good faith and loyalty.
    b. Duty of Loyalty means a partner must not engage in self-dealing, usurping business opportunities, or competing against the company. In this instance, E engaged in a transaction with her sister who owned G. The terms were apparently very favorable to G. This could be viewed as self-dealing because it promoted E's familial interest with her sister and was not in the best interest of the company.
    c. Duty of Good Faith requires that partners act in a way that solely benefits and is advantageous to the partnership. Again, E's deal with G didn't garner the profits that it should have. Furthermore, this duty requires disclosure of conflicts of interest to the other non-interested partners so that they can either cleanse the transaction through ratification or disapprove it. There is no indication that E

informed her partners. The other partners have a very strong argument to bring a claim against E for these breaches in duty.

4. ***Therefore, the entire liability for the breached contract would be on E, which would deviate from the normal liability scheme described above, and G could only succeed against E.***

3. Is Zeta likely to Succeed in its Lawsuit against DEF?

1. Validity of the Agreement
    - Zeta's (Z) claim on this contract again hinges on the authority of F to enter into it. In this instance, F has the express authority to enter into sales contracts. However, this contract was for components being purchased by F, which is outside his express authority.
    - Implied authority: Z may argue that components are necessary to production and later sales, which gives F implied authority to enter into contracts. Plus, it is reasonable to assume that a partner who can sell can also buy. This reasonable assumption lends credence to a claim of apparent authority.
    - Apparent authority: Z will argue that DEF has held F out as a person whose sole responsibility is to contract, and it reasonably relied on that representation. Z will argue, therefore, that any resulting contact liability would be distributed among the partnership and D, E and F.
2. Actual notice to Z of Lack of F's authority
    - Z's main issue is that D called and gave actual notice that F could not enter into this contract. This would destroy any reasonable reliance that Z had. D told Z that E was the technical person, not F. As such, Z should have seen that his was outside the scope of F's authority. But F is still a general partner in the company.
    - Z could rightly assume that one partner doesn't have the sole authority to terminate the management authority of another partner. <u>Management functions are only transferable and alterable upon a unanimous vote of the partnership.</u> D alone tried to limit what F could do. Z may argue that it knew this wasn't a proper action by D and more reasonably relied on F.
    - DEF will argue that Z at least should have investigated further once given notice that F may not have authority and failure to follow through made their reliance on his apparent authority unreasonable. DEF will argue that this contract is invalid and will not bind DEF for this persuasive reason.
3. Effect of D's Notice on F's Duties
    - D might also claim that F's activities outside his scope of duty were not in good faith.
    - The argument is that acting in an area in which F knows nothing about shows a lack of obedience to his agency limits and lack of good faith in honoring partnership agreements on authority.

- But D didn't act with the consent of E. As such, there is no indication that the majority of management is at odds with F's decision to enter the contract. This appears to be solely the reservation of D with E and F.
- ***In the end, there was likely no breach of duty and any potential liability from this contract would flow to all, not just F.***

ANSWER 2 (OUTLINE)

20% Organization (Similar headings – boldfaced below)

20% Issue (Spot all issues)

20% Rules (Name all rules – <u>underlined</u> below)

20% Analysis (Apply law to facts – all non-underlined, non-italicized font below)

20% Conclusions (Get correct conclusions – as *italicized* below)

Introduction

Nature of the business: No facts indicate that there are any other owners of Elite, nor that it is incorporated, so this would be a sole proprietorship owned by Emerson.

Nature of the relationship

- <u>An agency relationship exists when one party, the agent, consents to act on behalf of, and under the control of another, the principal</u>.
- In this case, Tarquin agreed to employment by Elite Cycles and to act on behalf of Emerson. *Accordingly, Tarquin is an agent of the principal, Emerson.*
- <u>As an agent, Tarquin owes particular duties to the principal, including fiduciary duties such as a duty of loyalty, a duty of care and a duty to obey or follow instructions</u>.

Does Emerson have any recourse with regard to the loan payable to the bank?

- Emerson expressly empowered Tarquin to act on his behalf by providing a power of attorney that included the signing of promissory notes.
- The power of attorney was limited, however, to the business of the shop, which did not include purchasing and selling helmets.
- *As such, Tarquin violated his fiduciary duty to Emerson by entering into a transaction for which he had no authority.*

- Be that as it may, a principal is responsible for the act of the agent taken in the course of employment. As such, it would appear that Emerson is responsible for the loan signed on his behalf by Tarquin.
- The bank manager may argue that Tarquin had apparent authority to sign the loan document. Apparent authority arises when a principal holds an agent out as having a certain level of authority. Emerson may argue, however, that Tarquin's authority was not apparent, but rather express by way of the power of attorney. The manager did not read the power of attorney which would have informed the bank that Tarquin was not authorized to obtain the loan unrelated to the business of Elite Cycles, and thus the loan agreement itself was invalid. *Emerson can therefore argue that he is not responsible for the loan as it was invalid.*

Does Emerson have any legal recourse against Tarquin?

- An agent has various fiduciary and other duties to the principal, such as the duties of care, loyalty and to follow instructions.
- In this case, Tarquin was empowered to sign promissory notes, but only related to the business of the shop which did not include helmets.
- Tarquin would not be able to argue that he had implied authority to obtain the loan and purchase helmets. Implied authority includes ancillary actions that the agent may logically conclude are within his/her power as part of the overall authority. Had Tarquin signed the loan to purchase repair parts, implied authority may have been present. In this case, however, the shop did not sell helmets, nor was the loan related to necessary parts.
- *Accordingly, Tarquin violated his fiduciary duty of care and acted outside of the course of his employment, and thus Emerson would not be responsible for the purchase of the helmets*.
- Secondly, Tarquin was responsible for running the shop in Emerson's absence which included opening and closing the shop and managing the other employees. As such Tarquin violated his fiduciary duty of care to Emerson to keep the business running. Tarquin may have a legal complaint for loss of business for the days the shop was not operating.
- Thirdly, Tarquin decided to take the helmets and start his own business. Such an action would be a violation of his duty of loyalty to Emerson. It should be noted, however, that Tarquin may argue that Elite was not in the business of selling helmets so there would be no violation of a duty of loyalty. Regardless, Tarquin was an employee and has absconded with the helmets that were the property of the shop, and in doing so has not only committed criminal theft, but also a violation of his duty of loyalty to the principal.
- Finally, with regard to the question of whether Emerson can succeed in pursuing legal action against Tarquin for the above noted issues, the facts indicate that Tarquin has left the country. Unless Tarquin returns, any legal action may be procedurally challenging.
- *In summary, Emerson should argue that he is not responsible for the loan as it was an invalid transaction for which he gave no express approval. Emerson does have legal recourse for the lost revenue for they days Tarquin failed to open the shop.*

1)

Introduction to the Hypothetical

Emerson is the sole owner of Elite Cycles, a sole proprietorship. Tarquin is an employee of Emerson's. Tarquin maintains a power of attorney to conduct business dealings as Emerson. Tarquin comes up with a new idea for the business, and takes out a loan as the company's agent, then leaves for Canada, without continuing his employment duties. When Emerson attempts to return to the brick-and-mortar building, it is locked, and the bank has not been repaid.

Agency

In this hypothetical, Tarquin is the acting agent, and Emerson is the principal. An agency requires the consensual agreement between two parties that one party will engage in business on behalf of the other, in the other's best interest, based on a contractual agreement. Tarquin acting as an agent of Elite Cycles makes him responsible to Emerson for various duties, and Emerson to Tarquin for various duties as well. In this case, Tarquin violated a Duty of Care that should be maintained between the agent and the principal.

Employment Agreement

The employment agreement and contents within that are provided in this hypothetical are considered reasonable and clear. Tarquin is to work in the shop selling and repairing bicycles. There is no information provided that states this is outside of a reasonable expectation as an agent working for a bike shop. Tarquin is also to manage the operations of the business when Emerson is traveling, which is a lot of the time. These operations are assumed to be the day-to-day operations of the business, but this fact is important, because it may open an issue for argument on Tarquin's behalf, that the normal

operations of Elite Cycle include new products and marketing. If this argument is made and found in favor of, it could complicate Emerson's position on the blatant violation of the power of attorney agreement signed between Emerson and Tarquin, pertaining to Tarquin's employment at Elite Cycles.

Therefore, it is important to mention that although Tarquin's actions could be considered a blatant violation of the Duty of Care between Tarquin and Elite Cycles, the fact that Tarquin was granted the ability to manage the operations of the business while Emerson was away, and Emerson was away at the time the loan was taken, means there is a window for argument about the definition of "managing the operations of the business," which may take away from Emerson's argument regarding Tarquin violating his power of attorney by taking out a loan with a new business idea, if it is found that new business ventures were considered a part of the normal day-to-day operations of the business, and therefore considered "managing the operations of the business," as stated in Tarquin's employment agreement.

Duty of Care

Emerson, acting as the principal of Elite Cycles provided Tarquin with a power of attorney allowing him to conduct business dealings as Emerson with business that the business was already engaged in. No issues are provided that insinuate the agreement would allow Tarquin to engage in any new business while Emerson was gone, therefore, the contract was already breached before Tarquin even left the country, because Tarquin knowingly violated the Duty of Care that needed to be maintained by the agent. After the fact, Tarquin continued to engage in egregious behavior that not only neglected the business, but injured it, to the tune of $50,000. This is not to be taken lightly, because the fact that Tarquin took the money and engaged in business for himself is a blatant violation of a Duty of Care Tarquin was required to maintain to the company, and therefore, even before fleeing, Tarquin breached his agreement with Elite Cycles and Emerson.

There is argument for Tarquin having not violated the Duty of Care by taking out the loan, see the argument above. Because of this, Emerson should be advised to bring copies of the employment contract and power of attorney in order to be more carefully reviewed beyond what is provided in the hypothetical. The fact that Tarquin engaged in business using the power of attorney and the bank allowed him to do so cannot be the crux of the argument in favor of restitution and repayment for Emerson, but it can be a part of it.

Banking Business

Emerson needs to be advised of his position with the bank based on what we know about the transaction and the subsequent debt notice. The fact that Tarquin's power of attorney stated he was able to "execute any contract for the purchase of goods or merchandise as needed for the operation of ***current*** business" could be an argument for his responsibility to the debt, since the bank did not verify Tarquin's power of attorney, and loaned Tarquin money in the name of the business, in violation of the terms of the power of attorney. There is even more argument for Emerson's responsibility to the debt when it is noted that the banker allowed the money to be given to Tarquin without inspecting the power of attorney, which could have very well prevented the loan from ever being created, since the information provided does not include any allocation for the power of attorney to be used to obtain a loan in order to engage in new business.

The fact that the bank did not follow protocol when loaning the money to Tarquin should void Emerson's responsibility to the loan to begin with. The fact that Tarquin took the loan out as an agent of Elite Cycles indemnifies Emerson and makes him liable for Tarquin's actions, but only to a certain extent. The egregious actions of Tarquin that followed his taking of the loan could not have been anticipated, nor would a reasonable person think to engage in such actions, especially on behalf of the principal. The fact that Tarquin did so is theft of the company, since the company is receiving no benefit from Tarquin's actions, therefore, if there is any duty Emerson has to the bank, it should be

able to be collected through Emerson's actions against Tarquin for his actions after taking out the loan.

Tanning Tarquin

Emerson's position with Tarquin is complicated. He is Tarquin's principal where Tarquin is the agent, but gave Tarquin the power of attorney allowing him to work as a purported partner, essentially. A purported partner is one that which works as if they are a partner, without an official title, but does so so realistically, that a reasonable person would know no different than to assume the person is a partner. Here, it can be assumed that the banker felt that way about Tarquin, when it is mentioned that the banker knows Emerson, and does not bother to look at the power of attorney prior to providing the loan to Tarquin. The fact that the bank manager was that comfortable at the time the loan was created means he is very poor at his job, or was reasonably under the impression that Tarquin was a partner of Elite Cycles, due to his relation with Emerson.

It can be argued that since the bank manager provided the loan to Tarquin without verifying the power of attorney, the bank should be at fault, but in this case, Tarquin knew his actions were adverse to the company's standards, and that his permissions did not allow for him to bring in new products or create new business without Emerson's knowledge, yet Tarquin still did so.

Power of Attorney

It is worth assessing the power of attorney established between Emerson and Tarquin, because it will most likely be the most argued based on position. The power of attorney states that Tarquin can act on Emerson's behalf to "enter into any contract for the purchase of goods or merchandise as needed for the operation of the current business of Elite Cycles, or to sign any credit or promissory note in connection with the operation of the current business of Elite Cycles on my behalf."

The fact that the note allows Tarquin to sign a promissory note can be argued in Tarquin's favor. The bank provided Tarquin a promissory note in exchange for the $50,000 he borrowed against the company. That part of the power of attorney could be argued that it was not breached because Tarquin is given the power to execute the loan based on the language above, and it would be a moot point for Emerson to argue that.

The better argument in the power of attorney is the statement that Tarquin can only engage in this promissory note if it is in connection with the operation for the current business of Elite Cycles. Without Emerson being aware of Tarquin's business idea, he could not have agreed for the idea to be considered current business of Elite Cycles. The idea would have been considered new business. The fact that Tarquin purchases helmets does not protect him from the fact that the personalized helmets were not previously being sold by Elite Cycles, and therefore, cannot be considered to be current business. It would definitely be in Emerson's best interest to support his argument with original documents from the power of attorney in regards to the language of the power of attorney and Tarquin's employment contract in their entirety.

Legal Recourse Available

The legal recourse available to Emerson is to sue (whom?) for the amount of the loan. Any potential lost income from the closing of the building cannot be required to be repaid, but restitution for injury to the business can be, if filed for correctly. Emerson can file for injury, but it is highly likely the court will not be as interested in restitution as they may be in the repayment of the loan, since the loan documents can be provided to support Emerson's claim of breach.

E may also ask for the loan to be voided since the signatory (T) had no authority and the bank had reason to know this

Conclusion

It is highly likely that Emerson would win a suit against Tarquin for the amount Tarquin took ($50,000) and potentially any reasonable interest fees applied during the course of

the suit, because Tarquin knowingly violated the Duty of Care he was supposed to maintain as an agent of Elite Cycles.

The court is likely to rule in favor of Emerson, not only because of Tarquin's violation of both the power of attorney and his employment contract, but the public policy position that there is a mutual understanding between parties engaged in business relationships that which the duties to each other are upheld in order for good faith and fair dealings to take place. Tarquin not only violated those standards, but then moved to another country and creates another business with the money he took as an acting agent of Elite Cycles.

good!

2)

Whether a partnership formed when D, E, and F joined to make a business of manufacturing and selling infrared saunas for profit.

A partnership consists of 2 or more partners engaged in some form of doing business for a profit. A partnership requires consent from each partner to wanting to join and make a profit, but a partnership could be established by conduct, it doesn't have to be an express partnership agreement (even though it would be recommended). In other words, a partnership could be formed inadvertently when two or more people join together to gain some type of profit by engaging in business.

General Partnerships: The most basic type of partnership is a general partnership (GP). GP do not require a specific filing to become a partnership, and do not have to be in writing, unless the statute of frauds applies.

Here, the facts indicate that Dilbert (D), Ethel (E), and Fred (F) orally agreed to start a business (called DEF) in manufacturing and selling infrared saunas. It is clear that a partnership existed because there is three parties (D, E, F) who all decided to engage in a business in order to make a profit from selling saunas. Not only is a partnership presumed by the "oral agreement" but it is also inferred by the conduct of the parties joining the business and making various contributions. Since the partners did not file appropriate forms with the secretary of state, the default is a general partnership. The facts indicate that D wanted to limit his liability to $100k, but in order to be a limited partner, it requires a filing, which did not occur.

The court would conclude that a general partnership was formed.

Whether Ethel had authority to enter into a sales contract in DEF's name with GECO.

note that partners are agents of the partnership so these rules apply

The agent has three types of authority (1) express authority; (2) implied authority; (3) apparent authority.

Express authority of the agent: (1) must be narrowly tailored and expressly delineating the agent's duties; (2) oral express authority is okay, as long as the Statute of Frauds doesn't apply.

Equal Dignity Rule: provides that if a matter in a contract has to be in writing, then an agency agreement regarding that matter would also have to be in writing. ✓

Implied Authority: Implied authority is usually based on the principal's conduct and what the agent reasonably believes. There are generally 3 circumstances that give rise to implied authority (1) when the agent has to do what is necessary and proper to carry out a duty (2) customary to carrying out the duty (3) the P is aware of the A's conduct and accepts it, or does not tell A to stop. ✓

Apparent authority: apparent authority is regarding what a 3rd party believes the agent's authority is. In this situation, the 3rd party has a reasonable belief that the agent has authority to bind the principal.

should be in intro

All partners are agents of the partnership. All partners generally have equal management and control of the partnership, but can agree otherwise. Similarly, all partners share both profits and losses equally, but they could agree to apportion profits and losses otherwise. ✓ Each partner has a right to an accounting at any time. Incoming partners are not liable for losses that occurred prior to their entry, only future losses and profits.

Each partner has a right to enter into agreements or contracts that are in the regular course of the partnership business. If the partner was acting in the ordinary course of business, any contract they make generally binds the partnership. If a partner does

unless the partners agree otherwise to limits.

something that exceeds their partnership authority because they were acting outside the scope of the partnership business, the partner could get consent from the majority of the partners. However, a partner can become liable, and relieve the partnership itself from liability if the agent acted grossly negligent or reckless. However, bad decision making by a the partner making a contract would still hold the partnership liable.

Here, E had authority to enter into a contract with GECO to sell saunas to them, because that is the regular course of business. As mentioned at the beginning, the purpose of DEF is to manufacture and sell infrared saunas. Although the facts indicate that E was the technical expert and in charge of designing, F was the salesperson, and D's duties were not specifically mentioned. However, none of the duties, losses, or profits were in writing, so they all have equal management and control of the business in general and could make contracts with 3rd parties as long as it was in the regular course of business. Here, E made a contract with GECO to sell it saunas, which is in the ordinary course of business. However, fiduciary violations might have occurred, which will be discussed in further detail below. The all the partner's authority was express, because they all orally agreed to start a partnership. Furthermore, E could claim that she had implied authority because she was acting on behalf of the partnership and for the benefit of it by doing what was necessary and proper to continue bringing in business and revenue. Although DEF could claim that it shouldn't be liable for the contract E made with GECO because it was a bad business decision since the contract "sold GECO saunas at a price extremely favorable to GECO." However, bad business decisions are more of a bad judgment call on that individual partner, but it does not relieve the partnership of liability.

The court would hold that E had authority as an agent of the partnership to enter into a contract with GECO to sell it saunas because it was in the ordinary course of business.

but what about the partners' agreement on E's limited authority to only design.? was there a breach of fid. duty on her part because she did not obtain a majority's agreement?

Whether Fred had authority to continue ordering components from Zeta for DEF when Dilbert contacted Zeta and told its president that Fred did not have authority to buy components since he was not the technical person.

(see authority rules supra)

Here, Fred did still have authority to continue ordering parts from Zeta because he is a partner, which also has the right to act as an agent on behalf of DEF. This means that Fred could enter into contract, and make agreements with 3rd parties as long as it was in the ordinary course of the sauna manufacturing and selling business. Although the fact indicate that at the time that Dilbert called Zeta's president he was "concerned about how E and F were managing DEF", this is irrelevant. As mentioned above, all partners have the right to equal management and control of the business. If D was truly concerned about E and F's management, he should have had a conversation with the other partners, or dissociate from the partnership if they could not come to an agreement or reconcile their differences. Even though D gave Zeta personal notice to not allow F to order anymore components, D did not have the authority to make that decision since all partners have equal management and control of the business, unless agreed to otherwise.

The court would find that Zeta would be successful in its lawsuit against DEF.

Whether the E breached any duties owed to the partnership and other partners by selling saunas to GECO (her sister's company) at an extremely low price.

A general partnership typically abides by the same rules as an agency. General partners all owe one another, and the partnership, the duty of care, the duty of loyalty, and the duty of good faith and fair dealing.

Principals Duties to the Agent: Generally, the principal (P) owes the agent (A) 5 duties: (1) the duty to indemnify the agent (however, the P need not indemnify the agent if the agent acted negligent or illegally in carrying out its duties. (2) the duty to pay the A compensation (3) the duty of care (4) the duty under social legislation (to pay into social security and worker's comp) and (5) the duty of good faith and fair dealing: which provides that the P has a duty to inform the A of any risks of physical harm or pecuniary losses that the principal has reason to know about.

Agent's Duties to the Principal: generally, the A owes P 3 duties: (1) the duty of good conduct and to obey, (2) the duty to account (3) the duty to indemnify the principal (usually for 3 reasons (1) losses caused by the agent's misconduct; (2) agent exceeding its authority; (3) the agent acted negligent or illegally.

this should be analyzed in terms of p'ship rules

An agency creates a fiduciary relationship between the agent and the principal. The Agent owes the principal various fiduciary duties. Such as (1) the fiduciary duty to use reasonable care: the A has a duty to used reasonable care when carrying out it's actions for the agent; or use whatever higher level of skill the agent claims to have (2) the fiduciary duty to disclose: the agent has a fiduciary duty to disclose information that a reasonable person would find important in making a decision. (3) the fiduciary duty of loyalty: the fiduciary duty requires the agent to act only in the principal's best interest. Acting in the principal's best interest includes (1) the duty to refrain from receiving a material benefit from a 3rd party when acting on behalf of the principal. (2) the duty to refrain from acting on behalf of an adverse 3rd party in connection with a transaction related to the agency. (3) the duty to refrain from competing with the principal, unless (1) the agent discloses to the P all material information and (2) the principal consents (Note: CA does not permit covenants to not compete) (4) the duty to not use the principal's property for the agent's personal use. (5) the duty to not disclose confidential information about the principal, unless it is general knowledge.

Here, E breached various duties owed to the partnership and the partners. E broke her fiduciary duty to act with reasonable care. This is so because E knew that her sister was the owner of GECO, and selling the saunas to her sister's company at an extremely low price, disabling the company from their ability to make a reasonable profit. Furthermore, E breached her fiduciary duty of loyalty to act in the partnership's best interest in several ways. First, E acted on behalf of an adverse party in connection with an agency transaction. More specifically, her sister has adverse interest to DEF because she is trying to obtain their products the cheapest way possible. E specifically made the agreement with GECO knowing that it would be an adverse interwst if she did not make a reasonable profit by selling the saunas. Additionally, E essentially engaged in competing with the partnership by providing GECO (a saunas selling rival) with infrared saunas, so they could then sell DEF's saunas at an increased price and retain an extreme profit for herself. If E wanted to compete with the partnership then she should have disclosed all the material facts to each partner and get their consent before competing with the partnership. Here, the partnership (DEF) could possibly be entitled to disgorgement from any potential profits that E made by selling the saunas to her sister's company at a lower cost. Additionally, DEF could be entitled to a reimbursement of the cost of each sauna that was sold to GECO.

The court would hold that E breach several fiduciary duties and DEF could be entitled to any profits E made from the sale and reimbursement costs of the sold saunas.

Whether there was partnership property.

Partnership property is generally presumed to be the property titled in the partnership's name or order. If the partnership name is not on the property title, then the intent of the partners governs. There needs to be a clear indication of whether or not the property was or wasn't supposed to be owned by the partnership.

It is also presumed that property acquired with partnership money is partnership property. Each partner has a right to manage and control the partnership property for carrying out the scope of the partnership duties.

Here, there is presumably partnership property. The partnership property would be any machinery, tools, devices, products that the partnership owns to conduct its business.

The court would hold that there is partnership property that should be liquidated upon dissolution or dissociation of a partner.

Whether the partnership has goodwill.

Goodwill is also an asset of a partnership. Goodwill is the expectation of future patronage. Usually the partnership has an accountant come in to figure out if there is any goodwill value in order for it to be distributed along with the other liquidated assets.

Here, this type of business could have goodwill since it is a sauna seller. It could be presumed since DEF "opened and quickly became a huge success". However, since DEF went out of business, there is no longer an expectation that customers would come back to continue purchasing saunas because they're unable to since DEF went out of business.

The court would hold there is no goodwill remaining in DEF.

Whether the partnership terminated.

Dissociation: occurs when one partner wants to leave the partnership but there is still enough partners in order for the partnership to continue. Dissociation could occur by will of the partner, a court order for bad conduct, or being voted out by the rest of the partners. A partner can always dissociate at any time, but depending on whether it was good or bad cause, the partner could still be liable for violating an express partnership agreement.

Dissolution: occurs when the partnership will no longer continue; this could be a decision by all the partners to not continue or by a judicial decree ordering a dissolution for irreconcilable differences.

Here, the partnership essentially terminated by "going out of business". Bankruptcy is another way that a partnership could terminate. Since the partnership went out of business, the partnership needs to start the winding up process.

The court would hold that the partnership terminated.

How the $500k debts should be allocated among the partners.

Once a partner dissociates, that partner is entitled to an accounting.

Once a dissolution occurs, the partnership starts the winding up process, and begins account. In accounting, the partnership liquidates all the assets and settles any outgoing liabilities or debts. The priority of payment is: creditors and partner's that loaned money to the partnership; then any money remaining would be divided pro rata among the partners, or by the partnership agreement. If the partnership does not have enough

liquidated assets to settle liabilities and pay creditors, then the partners must share the losses equally and individually pay off the creditors.

Creditor collections: depending on the jurisdiction, some allow partners to be jointly and severally liable, and some only jointly liable. Sometimes the creditor is required to collect from the partnership assets itself, then once depleted the creditor could go after the partners jointly or severally. Other times, a writ of execution against the partnership is required before it could try to go after an individual partner.

Here, since the partnership terminated, the next phase is the winding up process. This means the partners need to liquidate their assets and settle any outstanding debts or settlements in order to pay off any creditors or any partner that loaned money to the partnership. The facts do not indicate how much money is owed to each creditor, only there is $500k owed to creditors. Depending on whether there is any cash left after paying out the creditor, each partner can split the profits pro rata, or otherwise provided by agreement. However, if there is no profit to be distributed to the partners and there is still outstanding creditors, debts will also be distributed pro rata among the partners, unless agreed to otherwise. If any of the $500k is due to the contract that E made with GECO, the partnership would seek reimbursement and any profits E wrongfully made by breaching her fiduciary duties to the partnership, and E would be personally liable for those debts.

order of settlement - 3P debt/creditors
- capital from partners
- profits

However, the general conclusion is that since there is no specific written agreement to the contrary, each debt is assigned to each partner pro rata.

Notice

It is important for the partnership to let all third parties know of the termination of the partnership as well as termination of authority. The only remaining authority the partners

have is when liquidating the assets to wind up the partnership. Otherwise, each partner could still have lingering authority that could bind the partnership. The partnership could personally notify all 3rd parties of the termination of authority, and I would also suggest that the partners give written notice and filled with the correct secretary of state or recorders office to put other 3rd parties on constructive notice of the termination of authority. I would recommend doing both, just to ensure that there is no more lingering authority.

good!

I would recommend the partners to give notice to all third parties.

END OF EXAM

very good!