

Empire College of Law

Business Organizations Examination

Fall 2025

Prof. S. Loring

Instructions

1. This examination consists of three (3) questions.
2. There is a three (3) hour time limit to complete the exam.

Essay Question 1 **(60 minutes)**

You have one hour to complete this essay. Read the fact pattern carefully and address all relevant issues. Answer in IRAC format. Assume that all facts are true.

TechNova, Inc., (“TechNova”) is a publicly traded software company known for its rapid growth and aggressive innovation strategy. For the past fifteen years, the Board of Directors for TechNova (the “Board”) included: Alice, TechNova’s CEO, President of the Board, and former CEO of the largest computer chip manufacturer in the world. Ben, a finance expert with a history of serving on multiple boards. Cynthia, a long-time friend of Alice and a retired tech executive. Derek, a venture capitalist. Evelyn, an economics professor and former hotel industry executive. Every three years, the Board (with the exception of Alice who recused herself), approved Alice’s compensation package which contained a severance clause granting Alice \$50 million if she were terminated “without cause.”

Recently, TechNova’s management proposed acquiring BlockCom, a start-up developing cryptocurrency security tools. The proposed acquisition was valued at \$500 million, nearly half of TechNova’s market capitalization. The Board unanimously approved the acquisition after a 90-minute meeting in which Alice presented a brief slideshow summarizing BlockCom’s “immense strategic potential.” No outside valuation, fairness opinion, or due diligence report was sought. Several directors later admitted “trusted Alice’s vision.”

Within six months, BlockCom’s technology proved unworkable, leading to massive write-offs and a 70% drop in TechNova’s stock price.

During the same period, TechNova faced an SEC investigation into falsified user growth and revenue metrics. Evidence showed that for at least the prior two years, internal audit teams had issued multiple reports warning of systematic data manipulation and “noncompliance with revenue recognition policies” to the Audit Committee. The Audit Committee, led by Ben, met twice per year to review the financials of the company, including the internal audit teams report. Every quarter, the TechNova’s CFO, a member of the Audit Committee prepared the company’s financials for the Board, which included a less alarming summary of internal audit teams reports. The SEC fined TechNova \$200 million.

Following the BlockCom failure, Alice proposed hiring Cynthia, as a “strategic innovation consultant.” The consulting contract was worth \$1.5 million per year. During an informal call led by Alice, the contract was unanimously approved by the Board, with the exception of Cynthia who was not present. Alice did not recuse herself, Alice’s friendship with Cynthia was not disclosed to the Board, and no independent review of Cynthia’s qualifications or market rate was performed.

When TechNova’s financial position deteriorated, the Board, with the exception of Alice, requested Alice resign to avoid public confrontation. Alice, sensing that she lost the support of the Board, agreed to resign. Alice claimed that she was due \$50 million per her compensation package. The Board reluctantly paid Alice the \$50 million.

The shareholders of TechNova brought a derivative suit against the TechNova Board alleging the Directors breach their fiduciary duties.

Analyze the fiduciary duties of TechNova’s Directors for following issues. Identify and discuss the fiduciary duties of specific directors, when they differ from those of the other directors:

1. The Board’s approval of the BlockCom acquisition.
2. TechNova’s falsified user growth and revenue metrics.
3. The Board’s approval of Cynthia’s consulting contract.
4. The Board’s payment of \$50 million to Alice.

Essay Question 2 **(60 minutes)**

You have one hour to complete this essay. Read the fact pattern carefully and address all relevant issues. Answer in IRAC format. Assume that all facts are true.

Harbor Cove Construction, LLC (“Harbor Cove”) is a properly formed limited liability company that constructs large scale industrial buildings. Harbor Cove formed by Michael Roberts, who owns 95% of the membership interests. His sister, Elaine, owns the remaining 5%. When Harbor Cove was formed five years ago, Michael initially capitalized the company with \$10,000 despite immediately entering multi-million-dollar construction contracts.

Michael and Elaine are the only directors of Harbor Cove. Michael serves as president and treasurer; Elaine serves as secretary. She performs no managerial duties. Michael and Elaine have only held 4 board meetings. No minutes were recorded for those meetings.

Michael routinely takes business trips to entertain clients. On these trips he stays in expensive hotels, leases luxury cars, and dines in trendy restaurants. Once the business meetings conclude, Michael regularly extends the trips by a week. The trips are paid from Harbor Cove’s operating account, categorizing them as “marketing expenses.”

Over time, Harbor Cove’s financial position worsened. Michael began personally loaning funds to the company, issuing written promissory notes without durations and with high interest rates.

Two years ago, Harbor Cove began sharing office space and a bank account with Roberts Holdings, Inc. (“Roberts Holdings”), a real estate investment firm owned solely by Michael. Renee, a bookkeeper paid directly by Roberts Holdings, kept records for both companies in the same accounting software file. Customers of Harbor Cove often made checks payable simply to “Michael,” and Michael deposited them in the bank account owned by the two entities.

Recently, Delta Steel Supply extended \$500,000 in credit to Harbor Cove for steel materials used in industrial building projects. Two months later, Harbor Cove repaid Michael \$300,000 on his shareholder loans but failed to pay Delta. Shortly after, Harbor Cove ceased operations, leaving only \$5,000 in its bank account.

Delta obtained a judgment against Harbor Cove for \$500,000 but was unable to collect. It now seeks to hold Michael and Elaine personally liable for the debt. Michael asserts that he is a

creditor of Harbor Cove with a claim superior to Delta's claim. Elaine sues Michael to indemnify her against Delta.

Analyze the following issues:

1. Michael's and Elaine's liability to Delta.
2. The superiority of Michael's creditor claim.
3. Michael's liability to Elaine.

Essay Question 3 **(60 minutes)**

You have one hour to complete this essay. Read the fact pattern carefully and address all relevant issues. Answer in IRAC format. Assume that all facts are true.

Jordan and Casey are childhood friends. Jordan has a college degree in business and finance. Casey is a trained chef who worked for 20 years in restaurants, learning all aspects of the restaurant business. Over dinner one night, they decide to open a small farm-to-table restaurant called “Harvest & Hearth.” They agree that each of them will own one-half of Harvest and Hearth, sharing equally in the profits. They open a joint bank account in the name of the business and each deposit \$50,000 into the account. They buy equipment, rent a building, hire staff, and begin operating. Casey develops the recipes, runs the kitchen, and manages the dining room operations; Jordan handles the marketing, purchasing, and finances. Jordan and Casey create a website for Harvest & Hearth that tells the story of how Jordan and Casey started the restaurant.

Without telling Casey, Jordan signs a written contract with FreshFields Cooperative, a local farm collective, agreeing that Harvest & Hearth will purchase \$150,000 worth of produce and meats over one year. Jordan signs the contract “Jordan Lee, Owner, Harvest & Hearth.” FreshFields begins supplying ingredients, and the restaurant initially pays on time.

After several months, the restaurant experiences severe cash-flow problems. Jordan contacts Gourmet Capital, Inc., a private investment and lending firm specializing in restaurant financing. Gourmet Capital agrees to extend a \$200,000 line of credit to “Harvest & Hearth,” but insists on significant involvement in the business’s operations. Gourmet does not purchase an ownership interest Harvest & Hearth. Gourmet is not mentioned on the Harvest & Hearth website. However, Gourmet requires the following from Harvest & Hearth:

- Weekly financial statements from Harvest & Hearth;
- Approval for all expenditures over \$5,000;
- Input on menu pricing and ingredient sourcing;
- Direct communications with FreshFields to “assure them that Gourmet is financially backing the restaurant”;

- Approval for all new hires and terminations; and
- That all checks from the restaurant's account be co-signed by Gourmet's representative, Ms. Vega.

Casey objects to Gourmet's interference but feels powerless to stop it. Despite these measures, the restaurant continues to lose money and eventually defaults on payments owed to FreshFields.

FreshFields sues Jordan, Casey, Harvest and Hearth, and Gourmet Capital, alleging breach of contract.

Analyze the following issues:

1. Casey's and Harvest Hearth's liability to FreshFields.
2. Gourmet Capital's liability to FreshFields.

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GRADE

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Q1: 94

Q2: 98

Q3: 82

Total: 274

91.33%

With a board with such extensive experience in various sectors of business, the directors violated their duty of care and duty of loyalty in multiple instances. In their derivative suit, shareholders will seek for removal of each of the directors and potentially personal liability if it is proven there was an intentional dereliction of their duties.

2)

MICHAEL'S AND ELAINE'S LIABILITY TO DELTA

Piercing the Corporate Veil

Whether Michael (hereinafter "M") and Elaine (hereinafter "E") can be held personally liable to Delta (hereinafter "D")?

The facts indicate Harbor Cove (hereinafter "HC") is a properly formed limited liability company. Limited liability company's generally shield directors from personal liability. Directors may be found personally liable for actions as directors if the corporate veil is pierced. When determining whether or not to pierce the corporate veil, Courts will apply the *Van Dorm* test, which is a two prong inquiry that determines whether 1) there is such unity of interest between person and corporation 2) that adherence such a legal fiction of seeing them as two distinct entities would lend itself to fraud or promote injustice.

WHAT IS M's DEFENSE?

Here, the facts indicate that M routinely takes expensive trips to entertain clients (which are regularly extended) paid for on the company dime, M personally loans funds without duration at high interest rates, that checks are made payable to M directly and cashed into an account which holds money from M's other entity (Robert Holdings). Considering the aforementioned, Delta will argue that not only does M treat HC's operating account as his sugar daddy [eloquent legal term to describe M's actions omitted], but M has commingled personal funds, funds of Robert Holdings, and HC funds into one account. One of the principles of business law is that the law will recognize the corporation if the corporation acts as such. Here, M clearly has blurred the lines between business and personal. Not only are his funds commingled, but he has his bookkeeper of one company keeping books for his other company (likely without additional compensation). HC has also only held 4 board meeting and has never recorded minutes for any of these meetings.

M and E will argue that the business has been kept informal since M is the president and treasurer and the one handling all of the operations of the business. This argument will have no legal merit and the Court will find that the corporate veil can be pierced and M and E can be personally liable to D since there is only \$5,000 in its operating account.

E's Liability to D

Whether E is liable to D?

Liability of directors in an LLC (supra).

Here, the facts indicate that E is a 5% shareholder, a director, and the secretary of HC. The role of a secretary is to handle the internal administrative affairs of the entity (LLC) and is an officer role. The facts indicate that E serves no managerial duties, which is the sole argument E will make to avoid liability: E should not be personally liable because she is not involved with the managerial duties of the LLC. D will argue that she should still be personally liable because she

is a director and the structure of the LLC does not shield her from liability. It is true that had E & M formed a limited partnership with an express written agreement, naming M as the general partner and E as the limited partner, then E would not be held personally liable. That is not the case here. If it is true that the Court would limit personal liability based on capital contributions, E may have little to no personal liability as the facts are silent as to whether she contributed anything to the corporation. Despite not being involved with the corporation, it is likely the Court will hold E personally liable for a portion of the judgement.

M's Liability to D

Whether M is liable to D?

Liability of directors in an LLC (supra)

Here, M is the party completely if not mostly responsible for the actions taken. Not only is he the 95% owner, but he is the president and treasurer. While M may use the argument of LLC structure as a reason to avoid personal liability, through the piercing of the corporate veil analysis above, he will be found personally liable for the debt to D.

SUPERIORITY OF MICHAEL'S CREDITOR'S CLAIMS

Whether M's shareholder loans are superior to those of D?

Under the rule of subrogation (internal affairs doctrine) a shareholder who is a creditor of the company it owns shares of cannot use their status within the company to leverage superiority of claims during the repayment of debts at dissolution/liquidation of the corporation.

Here, the facts indicate that two months after receiving the line of credit, M was repaid \$300k on his shareholder loans without paying D. Not only has M not issued proper promissory notes (without duration), but he also gave personal loans with high interest rates. High interest rates can be inferred to indicate that the rates were given at higher than comparable market rates. The facts are silent as to the amount M loaned to HC, so it is uncertain what amounts of \$300k were to pay principal vs interest. In any event, M should not have repaid himself for the personal shareholder loans before repaying off the loans from D. M's argument as to repayment lies with the idea that his loan was first in time and so repayment by first in right is only just. This will be an unsuccessful argument given the rule of subrogation (supra). M's claim of repayment is not superior to those of D.

MICHAEL'S LIABILITY TO ELAINE

Whether M is liable to E?

Shareholders may bring suit against Directors for breach of fiduciary duties (duty of care and duty of loyalty). The duty of care imposes a duty on directors to act reasonably and in good faith to the corporation. The business judgment rule imposes a presumption of good faith on directors actions which can be rebutted by a shareholder bringing suit. The duty of loyalty imposes a duty on directors to act in the best interest of the corporation when carrying out their duties. While there is an appearance of impropriety with self dealing, it is not prima facie a violation of the duty of loyalty (*Guess v Jordache*). If there is self-dealing, it must be done in good faith and fairness.

M may have breached his duty of care when he chose to take extravagant trips to entertain

clients and then categorizing them as marketing expenses. While this is something M will argue was needed to secure new clientele, E will argue that the LLC was already under-capitalized (M only capitalized with \$10k cash). M will argue that these expenditures were appropriate and not a concern to the well-being of the business since he had already secured multi-million-dollar contracts. E will argue that the extension of the trips by a week and regular expenses at expensive hotels and luxury car rentals is an unreasonable use of corporate funds.

E will further argue that M has a duty of loyalty to the corporation and that this duty was breached when M chose to give personal loans to the company without duration and with high interest rates. M will argue that the business needed money and that by not putting a duration on the loan, he is able to forego repayment for an indefinite time period. While in theory this could be good to the company, the fact that there are high interest rates indicates indicia of unjust enrichment. The facts are silent as to whether the interest rates were at current market rates and whether M sought loans from any institution. E will conclude that M breached his fiduciary duty of loyalty when he chose to repay himself on funds that were lent to HC by D "for steel materials used in industrial building projects." It can be inferred that M used \$300k of the \$500k lent by D to repay himself since it occurred two months after D lent him the money.

E will argue that she performed no managerial duties and was designated as a secretary which is an officer role. Not only did she have no say in the operations of the business, but she contributed no capital and did not even perform any duties as a secretary (four meetings - NO MINUTES). E can argue that she had no knowledge of being a director and she was only added as a 5% owner upon request from M. E can show that M only added her so that he could limit his own liability in the event he was found to be personally liable. It would be inequitable to find E personally liable for the actions taken by M in regards to HC. M should be personally liable to E for what she owes to D (if any).

3)

CASEY'S & HARVEST HEARTH'S LIABILITY TO FRESHFIELDS

Whether there was a valid partnership between Casey (hereinafter "C") and Jordan (hereinafter "J")?

A partnership is two or more persons intending to carry out a business for profit as co-owners. A partnership does not need to be agreed upon via written agreement. Here, C and J agreed to own half of Harvest & Hearth (hereinafter "HH") and share the profits equally. They also opened a joint bank account in the name of business and contributed \$50k capital respectively, which shows an intention to carry out business. There is a partnership, C & J are partners of HH.

Whether C is liable to FreshFields (hereinafter "FF")?

Partners are equally responsible for management of the partnership: here, J handles marketing, purchases, and finances while C develops recipes, runs the kitchen & restaurant. Partners owe each other a fiduciary duty. Each partner has a right/say in what the partnership does since partners are jointly/severally liable for actions taken on behalf of the partnership. Here, it is clear that C has little to do with the business outside of the day-to-day of the restaurant. Therefore, J has a duty to keep C informed of financial decisions she is making on behalf of HH.

The initial contract with FF was signed solely by J as owner of HH WITHOUT C's knowledge. C will argue that this absolves her of liability because she was not told about the contract and was

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Q1: 85
Q2: 98
Q3: 85
Total: 268
89.33%

and even hiring her for that matter. These would all violate the conflict of interest element pertinent to duty of loyalty.

4. The Board payment of 50 million to Alice.

Issue: Did the board violate their duty of care by granting Alice a 50 million severance package? Did Alice breach her duty of loyalty by accepting the severance package? **Rule:** The duty of care (supra) may be breached if payments to certain fiduciaries are considered grossly over paid, or irrational, leading in harm to the company, depending on the context (**Disney case**). A fiduciary may violate their duty of loyalty (supra) by influencing the board to give them an absorbitant and irrational payment plan. **Business Judgment Rule (Supra) Analysis:** It can be argued that a 50 million severance package, is far to much in payment and would negatively affect the company, especially when factoring that Alice is most likely resigning due to the deteriorating business and her conflict of interest with Cynthia. And while the facts don't show it, Alice is the CEO, and may have put outside pressure on the board to give her an absorinant payment plan. The board of directors will argue the **Business Judgment Rule (supra)**, and that Alice is an elite expert and her industry insight is so well valued that a 50 million severance package is worth her being at the helm of the company. Alice will argue against breaching the duty of loyalty by showing that their was evidence that she recused herself during the board meetings in which her severance package was decided, and therefore, took steps not to illicit pressure to recieve that payment. **Conclusion:** Due to the highly subjective nature of compensation plans and what has been shown in past cases, the board will likely succeed in using the business judgment rule when offering the severance package to Alice. There seems to be more evidence that Alice took steps not to put pressure on the board for a big payout (self-dealing), and that she actually recused herself from meetings, and likely will not have breached her duty of loyalty.

2)

Question 2: Analyze the following issues:

1. Michael and Elaine's liability to Delta

Issue: What kind of business entity is this? **Rule:** A corporation is its own separate legal entity, and in order to exist there must be a filing with the secretary of state. It has **shareholders (owners)**, who vote on company matters and elect directors. The **directors** oversee management and set the guidelines for general corporate policy. The directors appoint **officers**, who deal with the day to day operations of the business. A corporation **may sue or be sued**, and has perpetual existence. It may also purchase property and assets deemed valuable to the corproation. Shareholders have **limited liability** and are only liable up to their capital contributions to the company. There must be annual board meetings as specified in either the **charter** or the **bylaw**. The corporation taxation is referred to as **double taxation**, where the corporation itself (the entity) is taxed, and shareholders are taxed on any dividends they recieve from their shares. A **de jure coporation** is a corporation that is properly filed with the secretary of state and meets statutory requirements. A **de facto corporation** is when there is a good faith attmpt to incorporate, colorable compliance with the statutes, and the entity acts as if its a corporation. Corporation by estoppel occurs when if the entity acts as a corporation and a third party relies on that presentation, estopping the corporation from denying its

COMPANY

existence. **Analysis:** It is shown that the company is properly formed (filing requirements), it is an LLC (Limited Liability Corporation), Michael and Elaine are both directors (staple of a corporation), and serve as officers (president/treasurer), and they hold board meetings (staple of a corporation), and seem to have shareholder ownership percentages, albeit uneven. On the other hand they have very few meetings and its not discussed if their annual (not a staple), never record minutes when they have their meetings (not a staple of a corporation), Elaine performs no managerial duties (not a staple of a corporation). **Conclusion:** It seems that the basic structure and filing requirements are in place for them to be a **de jure** corporation, although they are quite unorganized when it comes maintaining these structures.

Issue: Will Delta succeed in **piercing** the corporate veil to personally hold Michael liable? **Rule:** **Piercing the corporate veil** takes place when 1. there is such unity of interest between the corporation and individual that they become indistinguishable and 2. to respect the corporate form would sanction fraud and promote injustice, and is used by a third party to hold specific individuals within a corporation personally liable. Courts will look to certain **factors to deem it indistinguishable** such as undercapitalization, commingling of funds, failure to comply with corporate formalities, lack of separate records, fraud, and using the corporation as a facade for personal interests. **Analysis:** Delta will clearly be looking to collect on the 500k from Harbor Cove, obtained initially from Michael. They will first look at the unity of interest between individual and entity. It is shown that Michael, using company expenses, uses business trips to entertain clients, he stays in expensive hotels, leases luxury cars, and dines in trendy restaurants, extends trips by a week if he can. He also uses both Harbor Cove and Robert Holdings inc. essentially as a personal bank account. Delta will argue that Michael is basically using company funds to live a lavish lifestyle, and using the bare minimum funds for business expenses, leading one to believe hes using Harbor Cove as a facade for his own benefit. They will then look to the basic factors of PCV (supra). They will point to Michael investing only 10k into the company initially (undercapitalization), a joint bank account with Robert holdings inc (commingling funds), with records for both companies in the same accounting software file (lack of separate records), and checks payable to only Michael (fraud). Michael will argue against the unity of interest by simply saying he uses company funds for the lavish trips as a genuine business purpose, arguing that top notch experiences leads to top notch clients, and use the **business judgement rule (supra)** as a defense. To argue against the factors for PCV, which there aren't many, Michael will say that Harbor cove, despite low funds, has managed to reel in multi-million dollar contracts, proving his worth as a reputable company by industry standards. **Conclusion:** The factors weigh heavily in favor of Delta being able to pierce the corporate veil and hold Michael personally liable for the 500k in credit.

2. The superiority of Michael's creditor claim

Issue: Does Michael have superiority for his creditor claim? **Rule:** **Priority** of claims generally applies to whomever transaction, loan, or credit was initiated first, at dissolution. Although, courts will look to how much the initial creditor etc. was paid to see if second in line can also receive payment. **Analysis:** Harbor Cove is at near dissolution and has already paid Michael a significant chunk of his money back 300k for the loans he issued (with interest). Delta came after Michael with their line of 500K in credit. Michael will argue first come first serve. Delta will argue not only did Michael get paid back with interest, he may have been simply providing loans so that he could further enrich himself at the companies expense, which would be fraudulent. **Conclusion:** Michael would have gotten first priority had it not been for his fraudulent loans, and therefore Delta has priority in its creditor claim.

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3. Michael's liability to Elaine.

Issue: Is Michael liable to Elaine for any issues? **Rule:** **Duty of Care (supra), Duty of Loyalty (supra), de jure corporation (supra).** **Analysis:** Elaine will argue that Michael is liable to her for essentially destroying the company that she had financial value in. She'd argue, as mentioned earlier, breaching his duty of care by taking out giant loans only to have himself repaid, taking out 500k in credit when they lacked funds. She'd argue he breached his duty of loyalty (self interests) by going on personal lavish trips using corporate funds and then establishing what was dual-personal bank account in Harbor Cove and Robert Holdings. She will argue that, as mentioned earlier, Michael acted in a way that made him and the company indistinguishable PCV, in an attempt to salvage the corporation and hold him personally liable, and in essence, indemnify herself. After Michael pays back Delta and other creditors, she would then request payment from him (**there's a term for it...**), for any losses incurred as a result of his reckless business management. Michael will argue that Elaine, although a 5% shareholder, did virtually nothing to help the business. She was negligent in that she didn't do anything and reaped all the benefits. He will also argue that there was proper filing, he used business money for business expenses, and acted like a proper corporation, holding the corporation liable against Delta and not Michael himself. **Conclusion:** Michael will likely be personally liable to Elaine for his obvious breach of duty of care and duty of loyalty when running Harbor Cove.

3)

Question 3

1. Caseys and Harvest Hearth's liability to FreshFields

Issue: What kind of business did Jordan and Casey create? **Rule:** **A partnership** is formed when two or more persons carry on a for-profit business as co-owners, sharing in equal management and equal profits. There is no filing with the state done by them, unlike limited partnerships, which require a state filing. A partnership can be formed by words, conduct, and intent. A partnership has unlimited liability, which means joint and several liability, which means each partner can be held personally liable for all partnership debts, with partners allowed to obtain judgment from the others when all debts are paid. There is pass through taxation, meaning the entity isn't taxed, each partner's income is taxed that is a result of profits from the partnership. **Analysis:** Jordan and Casey report no filing taking place, they agree over dinner to open up Harvest & Hearth (words and conduct), they agree to share equally in profits/management (staple of a partnership), and they show conduct consistent with forming a business by creating a joint bank account for that sole purpose and putting in 50k, and also create a website. **Conclusion:** There is strong evidence to show that Casey and Jordan created a valid partnership.

Issue: Did Jordan have the authority to sign the contract with Fresh? **Rule:** Agents act for the benefit and behest of the principal (the business entity). Partners can also be considered agents. Agents are given authority to carry out tasks for the principal, the two main ones being **Actual Authority**: which can be expressed, implied, or incidental and **Apparent Authority**. **Express authority** occurs when an agent is granted direct tasks in express words or writing by the principal. **Implied authority** occurs when the agent carries out tasks that are within their express authority (job titles, manager titles etc.), and **Incidental authority** occurs when an agent can carry out minor tasks that are naturally connected to authorized tasks. **Apparent Authority** occurs when a reasonable third party contracts with an agent who seems to be

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Q1: 97

Q2: 90

Q3: 80

TOT: 267

89.00%

1)

a corporation is a legal entity recognized by the state, separate from the owner, which has options and rights similar to that of a natural person.

1) Boards Approval of BlockCom Acquisition:

Was the board in breach of their duty of care to TechNova when they approved of the purchase of BlockCom?

A board of directors owes two fiduciary duties to the corporation, 1) Duty of Care ("DOC"), 2) Duty of Loyalty. The duty of care requires that directors enact their business decisions in good faith and base those decision in reasonableness. The Business Judgment Rule ("BJR") is also another way by which directors may be absolved from liability of their business decisions. This rule fosters a presumption that a director is acting in good faith and is making reasonable business decisions, absent a showing of fraud, illegality, or gross negligence. The courts do not like to interfere with the business decisions of a corporation and will only do so if there is a strong enough showing of bad act. Duty of loyalty is not at issue with this purchase, and will be discussed appropriately below.

Here, the board made the decision to purchase BlockCom after a single 90-minute presentation by the CEO Alice. The shareholders will state that the board breached their duty of care as they did not base this business decision on an informed and reasonable understanding of the benefits and potential shortfalls of BlockCom. They will argue that the board acted with gross negligence when approving of this \$500 million dollar purchase after one single 90-minute brief presentation by the CEO. They will argue that these sort of purchases are made with months of planning, with long negotiations, financial information and other market projections shared between the business as the deal is made. Shareholders will find that the board acted without reason and good faith and that they should be responsible for this breach of duty of care. The share holders will argue that the board should have done independent research and not listened only to the CEO. Director Ben is a financial expert with a history of serving on multiple boards and should be readily aware of how these types of business decisions are made. Evelyn in an economics professor and should understand and know the importance of looking at another company's financials. They will argue that this board was way to knowledgeable to have made such a reckless decision. They will also argue that as CEO and a board member Alice also breached her DOC by also voting in to purchase blockCom without negotiating or gaining any other information as all she was able to prepare was a 90-minute breif presentation, which certainly would not contain enough information to allow the board to make an informed businesses decision.

On the other side, the board of directors will argue that generally, the business judgment rule would apply to protect the board of directors who base their judgment and decisions on the facts, information, and materials provided by other directors or trusted officers. They will state that they made a sound business decision, that they were acting in the best interest of the company and that they made a reasonable, yet risky decision to purchase BlockCom. They will argue that they made their decision based on the representations made by Alice and that this was an appropriate way to make such a choice. They will argue that they are not liable for the failure of a business venture and that they are protected under BJR.

The court will likely side with the shareholders on this issue based on the fact that the board did not conduct an outside valuation, there was no fairness opinion nor due diligence report. The court will find that the Board breached their fiduciary duty to the shareholders when they purchased this company after a single, brief 90-minute meeting with the CEO. They will find that there was no representative from BlockCorp who spoke with the board and no further deliberation made to ensure that this would be a sound business decision that would protect shareholders interests and equity. The board failed to do their due diligence and failed in their duty of care by making this grossly negligent multi-million dollar decision.

2) TechNova's Falsified user Growth and Revenue Metrics

Did board member Ben breach his duty of care when he allowed summaries of the internal audit reports to downplay the reality of the situation and the seriousness of the concerns raised by the SEC?

DOC, supra. BDM, supra.

The SEC fined TechNova \$200 million dollars for their systematic data manipulation and noncompliance with revenue recognition policies. Shareholder will argue that the board, and specifically Ben, breached their duty of care in allowing this manipulation and noncompliance to occur. They will argue that the board acted with fraud and illegality and are not protected by the BJR. They will point out that the Audit Committee committed complete fraud by downplaying the alarm of their findings and that by doing so, they helped to perpetuate the very fraud and illegality that the SEC found and thus fined them for it. The shareholders will specifically point to Ben as the one who breached this duty as he was the leader of the Audit Committee Team.

Ben will argue that the BJR will protect him as he was making a business judgment when allowing these reports to be prepared and that he acted with good faith and reasonableness. Unfortunately for him, his conduct would constitute both fraud and illegality as there was data manipulation and noncompliance with revenue recognition policies. Fraud and illegality are exception to the BJR and would not protect him. The rest of the board will argue that they should be blameless as they relied on Ben's interpretation, reports and representations made. That argument may work for them, however they still have their own duty of care that is owed to the shareholders and knowing that the SEC was investigating them, they should have provided more oversight to the CFO and Audit Committee and require that they meet more frequently and the CFO should not have been permitted to allow watered down reports to be provided. The board is not blameless and very well could still be found in breach of the DOC.

3) Board approval of Cynthia

Did board member Alice breach her duty of loyalty to the company when she failed to disclose the nature of her relationship with Cynthia when she proposed hiring Cynthia, did the board breach their duty of care by failing to make further review of Cynthia prior to her hiring?

As discussed, a board of directors owes two fiduciary duties to the corporation, 1) Duty of Care, 2) Duty of Loyalty ("DOL"). DOL is the concept that a board member will not put their own interest, nor a 3rd parties interest ahead of the corporations interests. A Safeguard to a duty of loyalty concern is total disclosure of any conflict of interest or material information that would otherwise influence a board members decision making.

Shareholders will argue that Alice breached her DOL when she failed to timely disclosure her

relationship with Cynthia. Alice was a personal friend of Cynthia and she failed to disclose this relationship. Alice participated in this vote that awarded her friend a \$1.5 million dollar contract and to do so was breach of her DOL to the company. They will argue that the board also failed in its due diligence and DOC when they failed to independently review of Cynthia's qualifications and failed to conduct additional interviews with her, seek outside consultants or negotiate a lower contract price.

The board will argue that BJR applies and would protect them from any claim against their action to hire Cynthia. They will also argue that Cynthia was already an active board member, and thus known to the board. They will also argue that Cynthia was not present for the vote, so there was no wrong doing. This will backfire, and only strengthen the shareholders position that Alice, and thus the board likely breached their DOL by simply hiring a board member without due diligence and basically gifted her \$1.5 million for a made up consulting job. The court will likely rule in favor of the shareholders and find that Alice did breach her DOL by failing to disclose the relationship or recuse herself from the vote, the board failed their DOC by acting with gross negligence by failing to due anything beyond taking the word of Alice prior hiring Cynthia for \$1.5 million.

4) Boards Payment of \$50 million to Alice:

DOC. supra. DOL. supra.

Is the board in breach of their fiduciary duties by approving of the \$50 million payout to Alice?

Shareholders will argue that yes they are in breach of these duties by approving of the payout. The terms of this payment was only upon termination of Alice "without cause." The shareholders will argue that this agreement did violate the DOL as Cynthia, Alice's friend and fellow board member failed to recuse herself, disclose the friendship or by other-way make right the situation when she would approve of this severance clause. They will also argue that the board was putting Alice's interests above the corporations by agreeing to pay her out per the clause when she resigned. Alice was not terminated by the board, they requested that she resign, which she chose to do so. This is not a termination and thus her severance clause would not be triggered.

Alice may argue that she was practically terminated and had no other choice but to leave. She may argue that she did nothing wrong, was virtually fired without cause, did not violate her DOC by recommending the purchase of BlockCom and did not violate her DOL by recommending the hiring of Cynthia.

The court will likely find these arguments unpersuasive and find that even if Alice was terminated, there most certainly was cause as she breached her DOC and DOL multiple times. And in this case the facts plainly state she resigned, so there is no way that the \$50 million payment should have been made. The board failed to act with DOL when they put their relationship with Alice above the interests of the corporation and the shareholders when they agreed to make this payment without meeting the terms of the clause.

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Exam Length: minutes (Started @Dec 8, 2025, 6:30 PM; Ended @Dec 8, 2025, 9:19 PM)
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Total Number of Characters in this Exam = 34540
Total Number of Characters in this Exam (No Spaces, No Returns) = 28899

Q1: 88

Q2: 83

Q3: 98

Tot: 269

89.67%

trips for personal vacation while still using the company funds to pay for them, categorizing them as "marketing expenses." Michael was commingling funds and mismanaging the companies assets, which is a direct violation of his Duty of Loyalty and Duty of Care to the business.

Michael would be liable to Elaine for breaching his duty of care and duty of loyalty. It is likely that Elaine would be able to get the Court to pierce the corporate veil and hold Michael personally liable for all of the poor decisions he made for the company.

3)

3)

Question 1: What are Casey and Harvest Hearth's liability to FreshFields?

Partnership

A partnership is 2 or more people who intend to associate and who are carrying on a for-profit business as co-owners. Here, Jordan and Casey created a partnership. They intended to associate with each other, and wanted to carry on a for-profit business. They also intended to be co-owners, each carrying a shared 50% interest in the partnership. The partners are personally liable for the business obligations, as well as joint and severally liable for the business obligations. This means that Casey can be liable for Jordan's business decisions, and vice versa. The management of a partnership is spread among the partners, which is what Jordan and Casey are doing here. To form a partnership, you do not have to have a formal written agreement (though it is highly recommended), and you do not need to file with the Secretary of State. A partner can only transfer their right to profit, but not their management rights, with consent from the other partners. A partnership is taxed on an individual level not an entity level, meaning that the partners put their profits/losses on their individual tax returns. A partnership dissolves if all of the partners leave/die, but it can continue if one partner leaves, as long as all partners agree.

If the partners do not have a written agreement that states how profits/losses will be allocated, then the UPA states that these will be shared equally among partners. Partnership property belongs to the partnership, not to the partners individually. If one partner leaves, they are disassociating from the business. If the business closes, it is a dissolution.

Jordan and Casey have a valid partnership called Harvest & Hearth. The facts do not indicate that they have a formal written agreement, so the profits/losses of the business will be shared equally among Jordan and Casey. Jordan entered into the agreement with FreshFields on behalf of Harvest & Hearth for purchasing produce/meats for the restaurant. Jordan was allowed to do this given that his management rights included handling marketing, purchases, and finances of the business. Even though Casey was not part of this agreement, because he is in a partnership with Jordan, he is jointly and severally liable for any contracts that Jordan enters into on behalf of the business. This means that Casey will be liable to FreshFields for the \$150,000 contract that Jordan entered into. Once the business stopped paying FreshFields, the contract was breached, and FreshFields can go after Jordan and Casey for the debts from the contract.

Agency

An agency is the fiduciary relationship that governs an agent (A) and a principal (P). An agent is a person who is authorized to act on behalf of a principal. In business law, the principal is typically the business, and the agent is the employee of the business. Here, Jordan and Casey are both Agents of Harvest & Hearth. An Agent has authority to bind the principal in 4 ways: (1) Actual Authority, which is where the agent is given either the express written authority to complete a specific act, or the agent is given the implied authority to complete that act based on what they were hired for, (2) Incidental Authority: which is where the agent is authorized to complete an act if that act is incidental to completing the main task in which the agent was hired for, (3) Apparent Authority, which is where a 3rd party believes that an agent has authority for a certain act and relies upon that act, and Ratification, which is where the agent has already acted and the principal (knowing fully what the agent did) assents to being bound by those acts.

Here, Jordan was acting as an agent when he entered into the contract with FreshFields. He has the implied authority to do this and bind the partnership with this contract, given that he was in charge of purchases for the company. Jordan was properly acting within his implied authority when he did this.

Agent/Principal Liability for Contracts Agent Enters with 3rd Parties

If an Agent enters into a contract on behalf of the principal, there are several ways for liability to arise, depending on whether the principal was disclosed, unidentified, or undisclosed. If the 3rd party knows about the agent/principal relationship and knows who the agent is, then the principal is solely liable for the contract, not the agent. If the 3rd party knows about the agency relationship, but does not know who the principal is, then the Agent and Principal are both liable. If the 3rd party does not know about the agency relationship and does not know who the partner is, then the agent and partner are both liable. Here, Jordan signs the contract with his name and "Owner of Harvest & Heath." By doing this, he is disclosing who the principal is that he is acting on behalf of, which is Harvest and Heath. Given the fact that this was disclosed, the company Harvest & Heath will be liable for the contract that Jordan entered into.

Given that Jordan and Casey were in a partnership, Jordan had the authority to enter into this contract, and that Jordan disclosed the principal business, Harvest & Hearth will face liability for this contract. This means that Casey and Jordan will both be personally, jointly, and severally liable for this \$150k contract with FreshFields.

Question 2: What is Gourmet Capital's liability to FreshFields?

Partnership

Partnership, supra. The facts indicate that Gourmet Capital did not purchase an ownership interest in the company, meaning they are not going to be considered part of the partnership. The partners did not intend to carry on this business as co-owners with Gourmet Capital, which is a requirement for a partnership.

Given that Gourmet Capital is not going to be a partner in this business, Jordan/Casey cannot assign any rights to management to Gourmet Capital. They can only assign their right to profit to Gourmet Capital, which is what they are doing when taking out the \$200k line of credit. They are assigning their profit rights to Gourmet Capital until that \$200k is repaid. Gourmet Capital demands management rights to the business, but these cannot be properly given to Gourmet Capital since they are not part of the partnership.

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Agency

Agency, supra. When Jordan brought in Gourmet Capital to finance the restaurant, he created an agency relationship between Gourmet Capital and Harvest & Hearth. Gourmet Capital would act as the agent, providing capital to Harvest & Hearth so that they could pay their FreshFields contract. Gourmet Capital was given the express authority to provide the capital, as well as the additional requirements that Jordan and Casey agreed upon. Jordan and Casey reluctantly agreed to abide by the rules that Gourmet Capital set out for them, which were part of the agency relationship. This included informing FreshFields that Gourmet Capital was financially backing the restaurant, and that FreshFields would be paid from Gourmet Capital's financial backing. This was disclosure to FreshFields of the agency relationship between Gourmet Capital and Harvest & Hearth. FreshFields, the 3rd party to the contract, relied upon this information and knew that it would be paid back for its \$150k contract with Harvest & Hearth based on Gourmet Capital's representation that it backed the company financially. This created apparent authority, which meant that the 3rd party, FreshFields, relied on the Jordan and Gourmet Capital's assertions that it was financially backed and would be able to pay the contract. However, given that FreshFields was aware of the agency relationship between Gourmet Capital and Harvest & Hearth, and knew that Harvest & Hearth was the principal, Harvest & Hearth are the only ones liable for this contract. Gourmet Capital is not liable to FreshFields for the contract, only Harvest & Hearth, since they were the disclosed principal in this agency relationship.

Harvest & Hearth will try to argue that Gourmet Capital should be liable for this investment given that they were the ones who forced Harvest & Hearth to let FreshFields know that they were now financially backed by Gourmet Capital. However, given that Harvest & Hearth agreed to this with the agency relationship, this defense will not work.

Harvest & Hearth will be liable to FreshFields for the contract, but Gourmet Capital will not.

END OF EXAM

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Total Number of Characters in this Exam = 29812

Total Number of Characters in this Exam (No Spaces, No Returns) = 24543

Q1: 98

Q2: 91

Q3: 100

Tot: 289

96.33%

1)

1. The Board's approval of the BlockCom Acquisition.

A. Did the board violate a fiduciary duty owed to the shareholders of TechNova by approving the acquisition of BlockCom?

Duty of Care

A fiduciary is one who must act on behalf of the best interest of another when acting within the scope of that relationship. Directors of corporations are fiduciaries of the Corporation and by extension the shareholders. The shareholder votes in directors for the purpose to manage the strategic direction of the company. Thus, a board of directors has a fiduciary relationship to the shareholders of the corporation. There are two relevant fiduciary duties to this relationship; the duty of care and the duty of loyalty. The duty of care obligates the directors (and officers) to act in good faith and with the prudence that a reasonable person would exercise under the same or similar circumstances. There are incidental obligations that come as a result of this duty include the need to stay informed and make informed decision, duty to commit waste, duty to prevent illegal conduct, and others

The board of TechNova (TN) must observe the duty of care when they act in the scope of their directorial capacity. Here the question surround whether the acquisition of BlockCom (BC) was a breach of this duty. The board is under the obligation to act diligently and make informed decisions. They will be shielded by the Business Judgement Rule (BJ), which is a presumption that when a board acts within the scope of their authority they do so in good faith and considering the best interest of the shareholders under the available information and circumstances. As a matter of public policy, this shields them from mistakes from decisions, as long as they made an informed decision and that their conduct has some rational basis for being in the best interest of TN. Absent this showing, the Board will be shield from liability for the business decision, which ultimately cost TN nearly 70% of its stock value. Directors may make mistakes, only when there is gross negligence or other intentional conduct will directors be liable (*van Gorkum*)

The facts state that BC is a cryptosecurity tool company, which could be considered within TN's area of business, since TN is a software company. Thus the consideration of this acquisition alone does land it within rational basis for a business acquisition. Cryptocurrency heavily uses software to manifest its exchange. However the details of the acquisition are questionable. We are told that the cost to acquire is nearly half of the value of TN. Shareholders may argue that it unreasonable for the board to spend 50% of the company's capital on a startup company that has no track record or sufficient history to prove its accompanying value. The shareholders have a valid argument for two reasons. A reasonable board of directors would consider that diversification in the types of companies or assets is prudent to protect the shareholder interests if an investments turns out to bust. Second, the company has yet to prove itself. The board will counter and argue that due to the experience of the individual members of the board with their respective fields (including some matters related to venture capitalism and tech) they are within reason to act in the best interest of company and should be sheltered under BJR. However, the facts state that board unanimously approved the acquisition, with only a 90 minute meeting from Alice. This is troublesome since there was no outside valuation, fairness opinion, or due diligence report. If these things were performed, the

board would have a better argument that they should be sheltered by BJR due to a reasonable reliance on competent reporting, competent committee findings, or the efforts of a competent professional doing the evaluation. The board has a duty to due their due diligence and make an informed decision. The facts do not support that the board observed theses duties and thus it weakens their argument that a 90 minute meeting where they spent half the assets of the company.

Ultimately, the court would likely rule that the board breached a duty of care in approving the acquisition and that they are not shield from liability by the BJR, since they did not make an informed decision and cannot reasonably rely on a single 90 minutes meeting to approve the merger. The board will argue they have significant experience and didn't need more than 90 minutes, but it is likely not enough to protect themself from liability.

2. Did the Board, and specifically Ben, violate a duty of care by subjecting TN to a SEC Investigation?

Duty of care Supra.

Another duty arising from the duty of care is the duty to prevent illegal conduct. A director, here it is Ben, has a duty to inform the board of conduct which would subject the company to liability. The facts state that TN faced an SEC investigation regarding falsified user growth and revenue metrics. There was evidence that over the last two years there were many reports that showed data manipulation and noncompliance to an Audit Committee. In *Caremark*, the court found that a corporation only needed to establish channels of timely communication for the board to not breach their duty. Ben, who heads that committee, is tasked with the affirmative duty to prevent illegal conduct. If the committee learned of these issues it formed a report and passed the information to the CFO. A breach of duty of care can be found when there is a systematic failure to report illegal conduct, but as long as the board develops practices for the timely passage of information to the board, then it is likely not in breach of a duty of care. Here we are told that internal audit teams made reports of illegal conduct and that those reports were passed to the audit committee and passed to the board. The facts do not state that there was any inaction by Ben in relation to his work on the audit board. He is receiving information from lower teams and passing it up to the director. He is acting in good faith as discussed above. The shareholders would likely argue that further, affirmative action should have been taken by Ben to prevent further illegal conduct which ultimately ended up costing the shareholders 200 million in fines. The board could have issued some policies to prevent the further falsified user growth, which the facts are absent on. The shareholders would point to the knowledge that this conduct was going on and the lack of affirmative action by any board members, other than "passing the knowledge" up the chain of command. The shareholders would point out that the CFO undermine the significance of these reports of illegal conduct and made it seem "less alarming". This is problematic and invokes a breach of the duty of disclosure. The shareholders would argue that CFO breached this duty in not fully informing the board of the seriousness of the problem and was a major cause in the harm to the shareholders (200m penalty)

The court would likely rule there was a breach of duty by the board, because there was a lack of affirmative response to the knowledge of current ongoing legal action. Knowledge and informing the superiors is not enough to prevent illegal actions. However, they may find that Ben, in his capacity of an committee member, is serving his purpose to pass the information up the chain to the board. Ben, in his capacity as a director, has no authority to make changes to the corporation, as it must be done at the board level as a whole by majority vote. The CFO

likely breached by failing to disclose the seriousness of problem, since its full scope was seemingly known to him but he made it seem less serious in his report to the board.

3. Did the Board, who voted unanimously to approve the consulting contract with Cynthia, breach either duty of care or duty of loyalty?

Duty of Care Supra.

Here, Cynthia's (C's) compensation package, a consulting contract, is valued at 1.5M per year.

C is a retired tech executive and is hired as strategic innovation consultant. However, there are no facts offered to bolster her resume which would warrant a package for 1.5M per year. Like the previous approval, it was unanimous without due diligence into the value that C offers TN.

This is likely a breach of duty of care because a reasonable director/board would not hand over a substantial yearly package without some diligence into the value they offer the corporation (shareholders). A lack of due diligence here means that the board couldn't make an informed decision regard the compensation package. We are also explicitly told that other valuation of her skills was performed. and that no independent review of the market rate for her Skills was done. the board may try to defend its actions by relying on an informed call with A, who has experience in being a board member and making strategic decisions. However, in light of all circumstances, that will be insufficient to defend the boards approval. IF the court doesn't find that the consulting contract is a "compensation package", then it can still apply a general analysis of a breach of the duty of care, which is to say that its unreasonable for the board approve such an action in light of all circumstance and the decision is not sheltered under BJR because it has no rational basis to the interest of the shareholder.

The court will likely find a breach in duty of care by approving such an action.

Duty of Loyalty

The duty of loyalty obligates the directors to act in good faith considering the best interests of the shareholders. They must not act in a way to put their own interests or the interests of a third party before the shareholder interest. A court may find a breach in the duty of loyalty when there is unreasonable waste of corporate resources in approving a compensation package. To avoid liability for approving such a package, it must be demonstrated that it is not unfair to the corporation to approve the package, disinterested directors approved the compensation plan, or that it was approved by an authorized committee, and finally that it doesn't unreasonably waste corporate resources. The duty of loyalty also includes aspects of BJR, when the decision is reasonably considered in good faith to be in best interest of the corporation.

Here, the compensation is not backed up by a fair deal to the company, since its unclear the true value that C brings to the company, beyond her experience as a "retired tech executive". Absent a more clear showing, its a hard argument for the board to make that this is fair to the company. Also, due to the imbalance in the fairness of the deal, its likely that this deal represents and unreasonable waste of corporate resources.

Did A violate the Duty of Loyalty by not Recusing herself as an interested director?

Duty of loyalty supra. A director has a duty to not engage in self dealing. Self dealing can be found even when there is not direct financial stake, but rather an increase to reputation. A stands to gain reputation with C by helping to get C's package approved, since we are told that A and C are close friends. A does not disclose this information, which she is obligate to do as

an interested director. The facts state that she doesn't inform board of the relationship and doesn't recuse. She is an interested director. A will try to argue that even though she is interested, a majority of the disinterested directors voted to approve the package, and that the package was inherently fair. However, the corporation will defend by point to the lack of inherent fairness in the deal, pointing to the factors discussed above like the lack of outside evaluation of her skill and no independent review of the market rate. A court would likely side with the shareholders, that A violated a duty of loyalty to act in the best interest of corporation.

4. Did the Board's Payment of 50M to A. violate a duty of care or duty of loyalty?

Duty of Care Supra, Duty of loyalty Supra. Compensation package Supra.

A agreed to resign when she was asked by the board. Here the analysis is somewhat different from C's compensation package, since we are told that A has extensive experience as a former CEO of largest chip manufacturer. The 50M figure is a large amount, but it may be considered fair, since A has served for 15 years in that capacity and contributed her experience and knowledge in leading the strategic direction of the company (directors are tasked with making managerial decisions that set the strategy and direction of the company). The court must consider whether there was fair to the corporation. Unlike C, whose track record is unknown, it's more likely for the compensation package to be considered fair given A's involvement with the company. We are told that the board chooses every three years to renew this compensation package. We may infer that if they did not find it reasonable they could cancel the contract when it came up for renewal. The shareholders may be estopped from denying the compensation package, because the shareholders have the capacity to remove any directors who are approving such a package. Thus it may be fair to say that the shareholders have implicitly considered the package as acceptable, since they took no actions in regard to the director's who are approving it. All together, they have 5 chances to deny the packages during A's tenure but choose not to do so. It is more likely that the compensation package will not be considered unreasonable use of corporate assets given the circumstances and thus within the scope of the BJR of the directors to approve such a package. Ultimately it's likely not a breach of any duty of loyalty or care.

2)

1. Michael (M) and Elaine's (E) liability to Delta

Are M and E personally liable to Delta

An LLC, or Limited Liability Company, is an organization that must file with the state secretary. Its members enjoy limited liability for obligations of the LLC and is taxed at the member level only, unless opting to be taxed at the corporate level. It is a distinct legal entity and is typically member managed and has continuity of life. As a limited liability entity, its members are typically only liable to creditors of the LLC for the amount of their capital contributions. However, circumstances may arise throughout operation of the business that warrant a creditor bypassing the limited liability and holding individual members liable for the debts/obligations of the LLC. This doctrine is known as Piercing the Corporate Veil (PCV) and a court will apply the Van Dorn Test to find when it is appropriate to PCV and hold members accountable. The two factors are a unity of interest between corporate entity and the individual and a promotion of injustice or fraud by not disregarding the entity status. The court will look to specific

circumstances to find whether these factors exist.

Here, Delta (D) entered into a contract with Harbor Cove LLC (HC) to extend them 500k in credit for steel materials used in the business. This is contract debt with binds HC to an obligation to pay them back for the debt amount, assuming that D delivers the materials and they are used by HC in business. We aren't specifically told that HC used the materials, but in the absence of the facts we can assume that HC owes this debt to D. HC is unable to pay this debt and D goes after M and E to get paid back. In order to hold them personally liable, the court must allow the creditor D to PCV and hold M and E personally liable on the debt. Here, the court will look to the Van Dorn factors to consider whether it should pierce. An important factor to consider is observance of corporate formalities. We are told that M and E both are officers with specific duties associated with those positions. As secretary E, performs no recording of minutes in the meetings and the two of them rarely hold board meetings. A failure by M and E to observe these duties will be noted by the court. Further, M takes business trips and spends more than reasonably necessary for furthering the purpose of the business, and even purposely labels these activities as marketing expenses. M also personally loaning funds to the company and issues promissory notes with high interest. M's conduct is not observing corporate formalities and is closer to commingle personal expenses with the business and is beginning to look more like an alter ego of M as opposed to a distinct corporate entity. The position of M is worsened when the court considers other facts like making checks payable to his personal name. The disregard for the entity status of HC is profound, and the disregard for proper records is evidenced by instructing Renee, an employee of another of his entities, to unify the records in the same software file. Finally, a lack of sufficient capitalization which are reasonably anticipated to cover expected corporate expenses is a factor that court may consider. Here M initially capitalizes with only 10k but he plans to enter multi million dollar contracts, and that when ceasing operations he has only 5k despite owing 500k to D. The initial deliberate undercapitalization is worse for M since a mere inability to pay a debt is not undercapitalization per se. M may try to argue that these factors are insufficient to find that it would be promoting fraud or injustice to pierce, but its a weak argument when you take all of these findings together.

The court will likely hold that D will be able to pierce HC's corporate veil of limited liability and reach into the pockets of the individual members M and E.

2. Does M have a superior credit claim to D?

Under the doctrine of subordination, the claims of creditors can be adjusted relative to another depending on superiority or inferiority. The court will consider the circumstances which would merit an equitable decision to place M claims over D's claims as a creditor to HC.

M claims that he has a creditor claim against HC, which is likely arising from his initial capitalization of 10,000. However, under all circumstances M has acted in a way that would promote injustice or fraud because of his unity of interest in his own personal expenses and the business. M claims that he must be paid first, but the court would likely hold it would inequitable to not allow D's claim to proceed first.

3. Can E indemnify herself from liability against M?

Indemnification is when a party reimburses another party for liability that arises out of some relationship between the two parties. Here, as a 5% owner in HC compared to M's 95%, E is likely seeking for M to take the brunt of the personally liability resulting from the piercing which is likely to occur, resulting in a personal judgment against the two contributors for the remainder amount once the 5k in the HC account is used up. The court must consider that it was not solely due to M's conduct that the veil was pierced, since E also did not maintain corporate records, or partake in sufficient board meetings, which ultimately played a part in the veil piercing. However, because of the imbalance in conduct that lead to the veil piercing, M may be ordered to indemnify E. The strongest argument for this is that E' conduct alone, would have been insufficient to pierce. In other words, if the only issue with HC's conduct was that it didn't record minutes in 4 board meetings or a lack of continual board meetings may not have been enough to pierce. it was primarily the undercapitalization and severe disregard for corporate entity which likely motivated the court to pierce. M will argue that E is just as responsible as a member, director, and officer in HC. Ultimately, the court may consider E less responsible for her conduct and coupled with the limited capital she contributed and minority position, that M should indemnify her against D's creditor claim.

3)

1. Casey (C) and Harvest Hearth (HH) liability to FreshFields (FF)

Did C and and Jordan (J) form a general partnership?

A general partnership arises when two or more persons agree to associate and carry on a for profit business as co-owners. A formal agreement is not necessary to form a partnership and an agreement to share equally in profits carries presumption to form a partnership in the presence of the other factors. General partnerships do not have to file with the state, are taxed at the partner member, and share equally in the management and control. Importantly, they do not offered limited liability to partnership, and each general partner is personally, jointly and severally, liable for the actions and obligations that arise of operation of the partnership. Partners owe each other fiduciary duties of care and loyalty.

Here, J and C are having dinner and agree to open a small farm to table restaurant (HH). They agree to each own one half and share equally in the profits, in the absence of further agreement it is presumed that they will also similarly share equally in the debts of the partnership. Further, they open a joint bank account and contribute an equal amount of 50k into the account. J and C then contribute various skills the partnership, including talent in the kitchen and business management. They purchase equipment, rent a building and operate. They create a website which describes how the business came into being. This is all evidence of an intent to carry on a business together. They're equal share in profits (and presumptively losses) and equal capital contributions are indicative of co-owner status. J and C are likely formed a valid partnership

Did Jordan have the authority to bind the Partnership, and by extension Casey to a contract for the purchase of 150k in food?

An agency relationship between and principal and agent occurs when there is a manifestation of assent for the agent to act on behalf of the principal within the scope of matters that the principal manifests intention for the agent to act within. Actual authority is when there is a reasonable belief that the agent is acting in a manner that the principal intends for the agent to act. There are three forms of actual authority. Express authority is when there is explicitly

statements within the four corners of some agreement that tells the agent exactly what they can do. Implied authority is found by nature of an agent's position or power and is the type of act which is reasonable for a similar agent in that position to believe they have authority do. Incidental authority occurs when there is a task or item that arises incidental to some task in which the agent has actual authority to bind the principal. Further, apparent authority refers to the ability of an agent to affect the legal relationship between a principal and third party, when the principal has manifested some intention to the third party that the agent has authority to act on behalf of the principal. It is key that that the principal acts in a way that reasonably makes the third party feel as though the agent has authority to act on principals behalf. Finally, there can be authority found when the principal ratifies or adopts the conduct of the agents either expressly or through conduct or when the principal is estopped from later denying that an agency relationship was present.

In the context of a general partnership, each partner may have authority to bind the partnership in contract when the court finds the above circumstance present in the facts. To find that C is liable, there must have been authority for J to bind HH in Contract to FF. Here, we are told that J signs a contract with FF to purchase 150k worth of produce and meats. J does not tell C of this. The partnership does NOT have an operating agreement or other partnership agreement (they aren't required to have one), but the implication is that J cannot rely on actual authority. J as a co-owner of the partnership may point to implied authority, since it is in the ordinary scope of business for a restaurant to enter a contract for the purchase for supplies to be used in the restaurant activities. Further, FF supplies ingredients and the restaurant operates using those ingredients. This is likely considered to be an adoption of the authority, since the conduct of continuing to use the ingredients and the benefits received to the partnership by operation condones the contract. C is likely to be estopped from denying the authority of J to bind the partnership. There do not appear to be facts supporting apparent authority, since the partnership does not take any active steps to manifest an intent for J to bind the partnership. FF would point to J signing as owner of HH, as the manifestation, but it would not be considered toward apparent authority, since the manifestation must come from the principal not the agent (here J is the agent). However, it is moot since implied authority and ratification by the partnership are likely sufficient to bind the partnership. Personal Liability supra. C, as general partner will argue that he is not personally liable for contract debt. Here the contract debt is disclosed and the principal is identified as HH. Typically this would mean that only the principal is liable and not the agent, but since all general partners liable for obligations of partnership jointly and severally, then C will be liable.

HH would argue that sufficient authority exists to find the partnership liable and by extension is general members. C will argue that is never agreed and that J didn't have authority, but he will be estopped from denying authority since the partnership implicitly ratified by observing a benefit from the contract and even paid for a while for the product.

2. Gourmet Capital (GC) liability to FF

Is GC liable to FF for the contract debt of 150k for produce and meat to be delivered over the course of the year?

General Partnership Supra.

Authority Supra.

When HH experiences problems, J contacts GC, who is private lender. GC agrees to

contribute a 200k line of financing in exchange for significant involvement in the business. GC will be involved with various aspects of the business, such as approval for major expenditures, input on menus and ingredient sourcing, and communication with FF. J and C will likely argue that this extension involvement in the business should make GC a general partner to the partnership. J and C will point the significant involvement, to operate as co-owner of the restaurant, as opposed to a mere investor who only contributes capital and doesn't engage further. GC would counter that they do not purchase an ownership interest in HH and that HH is not mentioned on the restaurant website. The lack of mention on the website is not as significant of the former. General partners may agree to split in the profit and losses unequally, as long as the other elements of the partnership are met. There is nothing stopping new partners from joining, as long as the critical elements are met. Here, we still have two or more (now three) persons (legal persons) since GC is incorporated and as separate entity status. The three "persons" are intending to carry on a for-profit business as CO OWNERS.

Here the co ownership element is key and mentioned prior, since GC wants involvement in the business beyond a mere investor, J and C will point to the circumstances that GC will be a co owner. J and C may also point to the requirements of GC terms that they must get approval for various aspects of the business, including co-signing of checks for all purchases, a mere investor would likely not require such things. J and C have a strong argument that GC has become a general partner. If GC is treated as a general partner it could be liable for the obligations of the partnership, namely a contract debt to FF in the amount of 150k (less whatever payments have been made already)

In the alternative, GC will try to argue that it merely entered into a contract with J and that the terms of the contract require the various requirements (mentioned above). GC will argue that J had the authority to bind HH into a contract on the basis of implied authority has a general partner in the ordinary course of business. Restaurants routinely obtain financing for their operation and despite not having explicit authority to enter such a contract due to the absence of a partnership agreement, it is reasonable for J to believe he has authority to bind the partnership as a co owner. If GC is merely in contract with HH to provide financing, in exchange for no ownership, but with terms for management internal tasks of the restaurant, then there cannot be liability to FF from GC. Of course, GC will attempt to deny the claim that they became a general partner to HH. GC would also argue its improper for them to be a general partner, since they are a limited liability entity and in effect it would create a limited liability limited partnership, which require state filings. J and C could defeat this argument because a limited partner is not supposed to engage in managerial tasks, and if they do they lose limited partner status (and lose limited Liability) and are in effect general partners. J and C could then argue that there is no filing requirement due to no limited partnership (all members are managing in some capacity)

Ultimately, J and C have a better argument. Because general partnership only requires an intent by two or more "persons" to carry on a business for profit as co-owners. These elements are met, despite unequal profit sharing, which is acceptable when it is agreed to by all partnership. GC is likely jointly and severally to FF by nature of its general partner status in the general partnership.

END OF EXAM