Kern County College of Law

Business Organizations I Examination

Fall 2024

Prof. J. Harvey

Instructions:

Answer three (3) essay questions. 100 points per question.

Time Allotted: Three (3) hours.

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Question 1

Andrew, Bob, and Christine are attorneys who formed a law firm. They filed no documents with the Secretary of State or any other state office. They equally share the firm's profits after paying all expenses and make all business and management decisions.

Associate attorneys are paid a fixed salary, plus 25% of gross billings for any clients they bring to the firm. Senior attorneys are paid based upon the number of hours they bill plus an annual bonus if they bill more than 2,000 hours in a year. The senior attorney bonus pool is equal to 5% of firm profits, which is split equally by the number of qualifying senior attorneys each year. Andrew, Bob, and Christine agreed to bestow the title "non-equity partner" on senior attorneys even though senior attorneys have no management authority.

The firm website and business cards for senior attorneys list their title as "partner." Martha, a senior attorney, met Nancy at a social function. Nancy told Martha about her business's legal problems. Martha gave Nancy her business card. After looking at the card, Nancy asked Martha if as a "partner" she can agree to the firm handling her legal problems at a reduced hourly rate in return for a promise of future business. Martha was aware that the firm has a strict policy of not reducing hourly rates, but signed a written agreement for it to handle Nancy's legal matters at a reduced hourly rate.

1. What type of business entity is the firm using to conduct business? Discuss.
2. Are the associate attorneys employees, partners, members, or shareholders of the firm? Discuss.
3. Are the senior attorneys employees, partners, members, or shareholders of the firm? Discuss.
4. Is the firm bound by the agreement that Martha signed with Nancy? Discuss.

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Question 2

Amy, Bob and Carl are partners in the ABC law firm, which operates under a general partnership agreement. ABC provides all firm attorneys with cell phones to facilitate prompt attorney-client communications. ABC has a policy that all firm attorneys must carry their work-provided cell phones with them at all times and that all client emails must be responded to immediately, at least with a personal acknowledgment of receipt.

Sam, an attorney well known for his many highly publicized trials, often works closely with ABC, but is not a party to the written ABC partnership agreement. ABC believes that Sam's presence raises the profile and prestige of ABC. Sam leases an office in the suite of offices used by ABC, for which ABC charges Sam $3,000 per month. The ABC receptionist greets all clients of ABC and Sam. Sam uses the ABC firm name and telephone number on his letterhead. Sam bills his clients directly for his services. Sam also receives 10% of the annual profits of ABC in recognition of his value to the firm.

After work one day, Amy was driving in heavy traffic to attend a baseball game when she received an urgent email from an ABC client. While briefly stopped in traffic, Amy attempted to answer the email on her work-provided cell phone. Due to this distraction, Amy negligently caused a car accident that was the actual and proximate cause of serious injuries to the other driver, Priya. Priya sued Amy, ABC, Bob, Carl, and Sam for damages arising from the car accident. Which of these defendants might reasonably be found liable for damages arising from Priya's car accident and why? Discuss.

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Question 3

Daniel owns a florist shop, Bloomscapes that specializes in weddings and other celebrations. He is the sole owner and the business is a sole proprietorship. He hires Bill and the employment agreement states that Bill will work in the shop to both talk to customers about designs and help with the creations, as well as manage the general operations when Daniel is traveling (there are delivery and installation workers that need to be paid). As Daniel is also a world-ranked marathon runner, he travels often. In order to keep the business running, he provides Bill with a power of attorney that allows Bill to act on Daniel'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 Bloomscapes, or to sign any credit or promissory note in connection with the operation of the current business of Bloomscapes on my behalf."

While Daniel is running in a marathon in Manaus, Brazil, Bill comes up with an idea for selling specialty personalized gift baskets containing chocolates, candles and potpouri. He goes to the bank and tells them he has power of attorney from Daniel "to run the business." The bank manager knows Daniel and does not bother to look at the power of attorney. Bill signs a promissory note for $50,000 to purchase the baskets from Bertha's Basketville. Bill takes delivery of the baskets 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 have access) and flies to Cambria, Wales to create his online business. When Daniel returns one week later, the store is still locked, all the flowers in storage are dead including $100,000 of rare orchids, and he receives notice that the bank has not been repaid and no employees paid so they all quit.

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

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No Answer Outline

1)

1. Andrew, Bob, and Christine have formed a general partnership because they co-own a law firm, share in the profits and losses of the firm, and they all have the authority to manage the business and other affairs of the firm.

Formation of a General Partnership

A general partnership is formed when two or more persons engage in an enterprise as co-owners and agree to share in the profits and losses of the business. A general partnership may be formed by any two or more persons so long as they have the legal capacity to form contracts. The subjective intent to form a general partnership is not required. This means that, to form a general partnership, two or more persons merely have to engage in the activities of a general partnership. It does not matter if the persons who formed the partnership did not intend to form a partnership. Here, Andrew, Bob, and Christine formed a law firm. The law firm engages in the business of representation of their clients for money (and hopefully, for profit.) The three partners share equally in the profits and losses of the firm. There is no indication from the facts that they did not intend to form a partnership with eachother.

Management Rights of the Partners

In a general partnership, each of the parties has equal right and responsibility to manage the partnership unless otherwise agreed in a partnership agreement. The partnership agreement may be written, oral, or implied by conduct. The facts state that Andrew, Bob, and Christine all share equally in the business and management decisions of the law firm.

Duration of the Partnership

Unless otherwise specified in a partnership agreement (if one exists) a general partnership will last in perpetuity until one of the partners declares that they are withdrawing. At that point, the partnership must be wound up by the partners and may engage in no further business except the business of winding up the partnership. The partnership agreement may provide for an alternative to the winding up of a partnership in the event one partner withdraws or is otherwise dissociated from the partnership (by expulsion, death, or bankruptcy.) There is no mention of a formal partnership agreement in the facts, and the conduct of Andrew, Bob, and Christine suggests that there is no agreement to terminate the partnership at a specific time or upon the happening of a specific event.

Co-Agency

All general partners in a partnership have the authority to bind the partnership to contracts and other liabilities because, unless the partnership agreement specifically states otherwise, all partners are co-agents of the partnership. Andrew, Bob, and Christine, as partners, all have the authority to conduct business on behalf of the partnership, and can bind the law firm to contracts and other liabilities.

The partnership is not a limited partnership or any other form of business entity.

The general partnership requires no formal filings with the state or any sort of declarations to anyone that the partnership has been formed and is engaged in business. This is unlike a limited partnership, where a formal filing (statement of qualification) is filed with the state authorities--usually the secretary of state. A limited partnership limits the liability of one or more of the partners, but the partner with limited liability is not vested with any authority to manage the affairs of the partnership. All limited liability partnerships must have at least one general partner who has management authority over the partnership. The facts specifically state that no documents were filed with the Secretary of State or any other state office. This precludes the possibility that they formed a limited partnership, a limited liability limited partnership, an LLC, or any other formal business entity. And three people are involved in business together, the only remaining possibility is that they have formed a general partnership.

2. Associate attorneys are employees of the firm because they do not have the right to manage the business of the firm, they do not belong to an association, and they do not own equity.

As stated above, a general partnership is formed when two or more persons associate as co-owners to carry out some type of business and share in the profits, losses, and management of the partnership. The associate attorneys are not partners.

The associate attorneys are being compensated as employees, not partners.

The associate attorneys of this particular firm are paid a fixed salary, and receive 25% of gross billings for clients they bring to the firm. The associates of the firm do not have the authority to manage the affairs of the firm, they are not required to contribute capital to the firm for operation or expansion, they are not entitled to distributions of profits, they are not responsible for indemnifying the other partners, and they do not hold shares (because none exist--this is not a corporation.) Although the associate attorneys receive 25% of gross billings, this is part of their compensation package as employees. The distribution of gross billings to the associate attorneys is not even profit-sharing--the facts do not state that the 25% distribution of gross billing is contingent on the law firm turning a profit. It appears from the facts that the associate attorneys simply receive 25% of their gross billings for new clients. This would be part of their compensation and a benefit of employment, not distributions made to partners.

Associate attorneys have no management rights and make no business decisions.

Further, none of the employees has the right to manage the firm or make other business decisions. This is critically important for a general partnership. A partner can be limited from making management and business decisions, but the partnership agreement usually controls the authority of a partner. Absent a partnership agreement, a majority of the other partners would have to agree to limit the authority of one of the partners. The facts do not discuss either a partnership agreement which limits the management right of associates (because they do not have any management rights) nor does it discuss the three general partners ever meeting and agreeing to take management rights away from associates (again, because they do not have any.)

Associate attorneys have not formed an association which is acting as a law firm.

The associates are also not members. The associates would be members if there was a formal association of independent business owners (or other partnerships, LLCs, Corporations..whatever) who grouped together to conduct business as an association. A classic example of an association which takes this form are the California Raisin Growers. Several central valley grape farmers have formed an association to better market and distribute raisins. Each of those farmers owns or controls their own business and has voluntarily associated with others to engage in an association. The facts of this case do not suggest anything along these lines, so the associate attorneys of this law firm are not members.

Associate attorneys are not shareholders because there are no shares to own.

Finally, the associates are not shareholders. A shareholder is typically someone who owns equity in a corporation. The law firm is not a formal business organization like a corporation. The law firm did not file articles of incorporation with the secretary of state, they do not have shareholder meetings, the law firm has never issued stock, and there is not a board of directors for the law firm. The only people who manage the law firm are Andrew, Bob, and Christine--and they do so informally, as a three-person general partnership. One cannot be a shareholder in a general partnership, so the associates are not shareholders, either.

3. Senior attorneys are also employees, for the same reasons as associates, in spite of the facts that they receive profit sharing and are called "non-equity partners."

Profit-sharing as compensation is not the same as sharing in the profits and losses of a partnership.

The analysis for senior attorneys is slightly more complicated. The compensation structure for senior attorneys is different: instead of a 25% distribution of new client billing, senior attorneys receive a portion of a 5% profit sharing pool. This suggests that senior attorneys may be partners, because they share in the profits of the firm. But they are not. Sharing in profits is only half the story for partners: the other half is that partners *also* share in the losses of the partnership. The facts of this case do not state that the senior attorneys are ever liable for sharing in any of the losses of the firm. It is true that they only receive a payout from the profit sharing pool *if* there are profits, and *if* they bill more than 2,000 hours in a year--but this is a far cry from sharing in losses. The possibility that a senior attorney will not receive their profit sharing for the year is not the same thing as the possibility that the senior attorney has to contribute capital to the firm to make up for any losses realized in the year.

"Non-equity partner" is a term used to make employment more prestigious--not to confer the authority of a partner on a non-partner.

Further complicating the issue is that the senior attorneys are called "non-equity partner." This suggests that the senior attorneys are *partners* but they do not share in the equity of the firm. This is just a fancy way of saying they are not partners. In order for a partner to be a partner, they have to contribute capital to the firm, and are entitled to distributions of profit (and are responsible for sharing in losses.) The distribution of both profits and losses are in proportion to the equity a partner has in the firm (if the partner contributed 10% of the total capital, then the partner is entitled to 10% of the profits, or liable for 10% of the losses), but if the partner has contributed 0% of the equity--the partner is not a partner. Contribution is required to be a partner. The title "non-equity partner" is simply marketing to make employment with the firm more attractive.

So despite their profit sharing status, and the title of "non-equity partner", senior attorneys are just employees like associate attorneys, for all of the reasons discussed in the answer to #2, supra.

4. Although Martha is not a partner, the firm's actions created the apparent authority in Martha to bind the firm to the agreement she made with Nancy.

Agency relationships defined

Generally, partners are agents of the partnership. A principal/agent relationship exists when the principal gives authority to an agent to act on their behalf, subject to the principal's direction and control, and both the agent and the principal consent to the agency. Principals are bound by the acts of their agents when the agents act with actual or apparent authority.

Actual and Implied Authority

Actual authority exists when the principal gives their agent the authority to do a specific act. Implied authority is the authority the agent reasonably believes they have based on the acts and directions given to them by the principal. An agent acting outside the scope of their actual or implied authority is liable to the principal for any damages their unauthorized acts cause. An agent can also gain authority through ratification: that is, the principal approves of an act the agent took after the agent acted. Ratification can occur explicitly, when a principal expressly approves the acts of an agent after the fact, or it can occur when the principal realizes a benefit from the acts of the agent.

Apparent authority is necessary to bind the principal to an agreement with a 3rd party.

Apparent authority is not granted to the agent by the principal. The agent gains apparent authority based on the conduct of the principal toward third parties. If the third party reasonably believes, based on the conduct of the principal, that the agent has the actual authority of the principal to bind the principal then the agent is acting with apparent authority. Unless limited by a partnership agreement, all partners of a general partnership are agents of the partnership when they are acting in the normal course of the partnership's usual business.

Martha had apparent authority to bind the firm.

Principals are bound by the acts of their agents when the agents act with either type of authority. Here, there is a strong argument Nancy can make that Martha had the apparent authority to bind the firm to the reduced hourly rate. Martha was held out by the firm as a "partner." She was granted the title of "non-equity partner" by virtue of her employment as a senior attorney with the firm. But her business card didn't say that. Her business card said "partner." Nancy could reasonably assume that, as a partner, Martha had the actual authority to negotiate the hourly rate for the firm's services. By giving Martha business cards printed with the word "partner", the firm was holding Martha out as a full partner, and ran the risk of Martha binding them to an agreement they would not otherwise agree to.

Further, Nancy will argue that Martha *confirmed* she was a partner, acting with full authority as a partner. Negotiating hourly rates for legal services is an important part of what law firms do, so

Martha was also acting within the normal scope of the partnership's usual business. There was nothing unusual, from Nancy's point of view, about negotiating a lower hourly rate with a partner of a law firm.

The firm, on the other hand, will argue that Martha acted without actual or implied authority. Their argument is well-taken. An agent has neither actual nor implied authority when the agent is acting with the knowledge that the agreement they are making is outside the scope of their actual authority. Further, the firm will argue that the agency relationship was non-consensual. For an agency to exist, both the agent and the principal (here, the partnership) must consent to the arrangement. But the limitation of Martha's authority was never conveyed to Nancy. In fact, the firm conveyed just the opposite by sending Martha out into the world with business cards identifying her as a partner of the firm. There was no limiting language on the card, and the third party (Nancy) should not be expected to call the firm to confirm that Martha is actually a general partner and not a "non-equity partner."

Nancy has the better argument. Because Martha was acting with the apparent authority of the firm to negotiate a lower rate with Nancy, the firm is obligated to honor that rate.

Even though the firm is bound, Martha is liable to the firm for their damages.

An agent is liable to their principal when they act outside of their actual or apparent authority. Here, the firm is bound to Martha's agreement with Nancy and is unable to charge Nancy their full billing rate. Martha is now liable to the firm for the firm's damages, because although she made the agreement with Nancy with apparent authority, she did not make it with actual authority. Martha will have to reimburse the firm for the difference between the negotiated rate and the billing rate Nancy would have been subject to had Martha not signed the agreement.

2)

ABC is a general partnership, and none of the partners are shielded from liability.

In a general partnership, the partners all share in the profits and losses of the partnerships. The partners are also all responsible for contribution and indemnity for the other partners. ABC is a general partnership between Amy, Bob, and Carl. There are no facts that state otherwise, so it will be assumed for the rest of this answer that Amy, Bob, and Carl all share equally in the partnership and are entitled to equal division of profits, losses, contributions, and distributions. All of the partners have fiduciary duties to each other.

A general partnership does not contain any liability shields for its partners. The personal assets of any or all of the partners can be reached by a creditor of the partnership to satisfy debts owed by the partnership, including tort judgments. The partnership itself, if it has any assets, is also liable for debts owed by the partnership.

Amy is a general partner, a co-agent, and a tortfeaser.

A principal/agent relationship exists when the principal gives authority to an agent to act on their behalf, subject to the principal's direction and control, and both the agent and the principal consent to the agency. Principals are bound by the acts of their agents when the agents act with actual or apparent authority. In the context of a partnership, the partnership is the principal and the partners are the co-agents of the partnership. Because Amy is a general partner of ABC, she is also a co-agent.

Agents are always responsible for their own torts.

Amy was negligent and caused a car accident which seriously injured Priya. Amy is, without a doubt, liable for her own negligence and is required to pay for the damages she caused. There is no reasonable argument Amy could make to escape personal liability for her own negligence--unless, of course, it was determined at trial that she was not negligent after all. There is no tort if there is no negligence. But, the fact pattern specifically states Amy was negligent, and that her negligence was the actual and proximate cause of injuries to the other driver. I will assume, for the purposes of this answer, that the jury will decide Amy was negligent and will award damages to Priya.

Amy breached her duty of care by being negligent.

Amy, as a partner, has a fiduciary duty of care to the partnership and her partners. The duty of care requires that partners act on reliable and trustworthy information and refrain from behaving recklessly or negligently. Amy was negligent when she crashed into and injured Priya. Amy is not only liable to Priya for her negligence, she is also liable to Bob and Carl for her breach of her duty of care and they each have a claim against Amy for this breach.

ABC is liable for the torts of its agents if the agents were acting within the normal course and scope of their employment.

ABC, the partnership, is the principal. Whether or not the principal is liable for the torts of its agents is heavily fact-dependent. Here, ABC provides cell phones to all of its attorneys. As a condition of their employment, ABC requires all of its attorneys to keep their phones with them at all time and promptly respond to e-mails from clients.

Here, Amy was driving to a baseball game, though heavy traffic, and simultaneously responding to an e-mail from a client when the collision occurred. ABC will argue that Amy was not acting within the course and scope of her agency, because she was driving through heavy traffic to attend a baseball game. Driving is not a specifically assigned function of her agency, but is likely necessary to carry out her duties. Attending a baseball game is not within the scope of her agency (unless, of course, she was attending the game with a client and was acting on ABC's behalf by going--but the facts do not say this, and this assumption would be a bit of a stretch.)

On the other hand, Amy will argue that she was acting within the scope of her agency because when the collision occurred, Amy was carrying her cell phone and responding to an e-mail at the direction of her principal (ABC.)

Amy has the better argument. Even if Amy was not acting within the normal course and scope of her agency, an agent who takes a brief detour from their normal duties that are being performed under the direction and control of their duties, the principal is still liable for the torts committed by that agent. Liability is only cut off when the agent is not acting within the scope of their agency at all. If Amy had been driving after work (to any destination) but had not been responding to an e-mail at the direction of her principal, then she would have been fully outside the scope and duties of her agency and ABC would have no liability.

But because Amy was acting within the scope of her agency at her principal's direction, the principal (ABC) is liable for the tort of their agent.

Bob is also a general partner and a co-agent, but Bob was not the tortfeaser.

Bob was not negligent. Bob did not drive a car, and did not answer an e-mail while he was driving, and did not personally injure Priya by crashing into her. Bob did not breach any fiduciary duties owed to his partners, either. Bob is, however, still liable for Amy's tort. A general partner in a general partnership is responsible for indemnifying other partners and contribution toward the debts and losses of the partnership. Here, although Bob was not negligent, ABC is liable for Amy's tort. And because Bob is a general partner, he is jointly and severally liable for any judgment against the partnership. If ABC and Amy do not have sufficient resources to cover the Priya's loss, Bob will have to make contributions to ABC to satisfy ABC's liability to the judgment creditor (Priya) or pay her directly and seek reimbursement from his partners and the partnership.

Carl is liable for Amy's tort for the same reasons Bob is.

Carl is a third general partner of ABC and the liability analysis as to Carl is exactly the same as Bob's. It is important to note, though, that if Amy, Bob, and Carl all share equally in their responsibility to contribute to ABC to cover ABC's liability for Amy's negligence, then if either Bob or Carl contributes to ABC in excess of their required contribution, they are entitled to reimbursement from the other partners.

Ultimately, if Amy had the resources to do so, Amy would be required to pay 100% of the loss to Priya.

In a perfect world, where everyone had enough money to pay everyone else, Amy would pay 100% of the loss to Priya for her negligence, entiling ABC, Bob, and Carl to an offset against their tort liability, and neither Bob nor Carl would have to pay anything. It is unlikely, though, that Amy has that much money and it will ultimately be ABC's insurance policy that pays the loss. Amy, Carl, and Bob will then need to contribute more to ABC for increased insurance costs (or at least take a haircut on profits.) If Carl and Bob lost any personal property as a result of their liability for Amy's negligence, they would have a valid claim against Amy.

Sam is not a partner nor an agent of ABC and is therefore not liable to Priya or the firm.

Sam is strongly associated with ABC, but is not a partner in the firm for several reasons. To form a general partnership, two or more persons must engage in business together as co-owners of the venture, sharing in the profits and the losses of the partnership. A general partner is responsible for management and business decisions of the partnership unless specifically stated otherwise in the partnership agreement. Further, partners all owe a fiduciary duty to one another and to the partnership.

Priya will argue that Sam is also a general partner and is jointly and severally liable to her for the damages Amy caused. Priya will argue that Sam's proximity to ABC, their profit sharing agreement, and the shared office space and support staff make Sam a partner like Amy, Bob, and Carl. But here, Sam is not a general partner and Priya's argument fails.

Sam does not meet the basic requirements to be a general partner.

He is not a co-owner of the ABC firm. He *does* share in the profits of ABC, but this is a form of compensation for the close association he and ABC enjoy with each other. ABC is charging Sam rent for office space and does not provide him a cell phone. Sam is not bound to the same requirement as the other attorneys with ABC that he answer emails from clients right away.

It is true that Sam does share a receptionist with ABC, and uses their letterhead and telephone number. But Sam is not responsible for paying the debts or managing the business of ABC. Sam may discontinue his association with ABC at any time, and it would not cause a wind-up of the business. And Sam does not own any part of ABC.

Sam has no fiduciary duties to ABC, and if he did, he would be breaching them every day.

The most important fact, though, is that Sam bills his clients directly for his work. A partner has fiduciary duties to the other partners and the partnership. One of these duties is the duty of loyalty. A partner in a general partnership may not compete with the partnership. If Sam were a general partner of ABC, he would be absolutely prohibited by his fiduciary duties from billing his clients directly. All the work he did for his clients would be billed by ABC and *not* by Sam. Sam may not be a partner of ABC and then compete with ABC directly for business. And because he is billing his own clients, that's exactly what Sam is doing.

If Sam were a general partner of ABC, he would be breaching his fiduciary duties constantly. The other partners would have sued him long ago for his breaches, demanded an accounting, and sued him for the profits he took in breach of his fiduciary duties. But none of those things have happened. Here, Sam is receiving a very generous 10% of ABC's profits and has received favorable lease terms from ABC.

Sam is a strong competitor for ABC. Recognizing this, the partnership has chosen to closely associate with Sam and reap the benefits of his proximity, reputation, and image. Sam, in turn, is allowed to freely compete with ABC without breaching any fiduciary duties he would otherwise have to them and is benefiting from the office space and support staff he receives from ABC as compensation.

Because Sam does not satisfy the requirements to be a partner in the ABC firm, he is not a partner. Because Sam is not a general partner of ABC, he is not liable to Priya or anyone else for Amy's negligence.

3)

Daniel and Bill had an agency relationship, and Bill acted outside the scope of his actual and implied authority when he borrowed $50,000 in Daniel's name for a new business.

An agency exists where the principal (here, Daniel) holds out and authorizes an agent (here, Bill) to act on their behalf, under their direction and control. Agency requires the consent of both the principal and the agent.

An agent's activities will bind the principal as to any matter where the agent has the actual or apparent authority to act. An agent has actual authority to act when the principal, by his words or conduct, specifically authorizes the agent to act. Implied authority arises when the agent reasonably believes, based on the words and conduct of the principal, that he has the authority to act in a manner the principal has not specifically authorized but the agent nevertheless believes the principal has authorized. This is a fact-based inquiry, and the court must examine the words and conduct of the principal toward the agent to determine what the agent could have reasonably believed was within his implied authority to do, and what was not.

Apparent authority exists when a 3rd party reasonably believes the agent has the authority to act and bind the principal based on the conduct of the principal (and not the agent.)

The agency relationship was initially created when Daniel hired Bill to help run his store. Bill was Daniel's employee, working under Daniel's control and supervision. Bill had more authority than a typical employee, and both Daniel and Bill consented to the agency. Later, Daniel significantly expanded the agency by executing a written power of attorney granting significant power to Bill. The expansion of the agency and Bill's authority will be discussed *infra*.

Bill did not have the actual or implied authority to change the nature of the business.

Here, Bill was originally an employee of Daniel specifically tasked with working in the shop, speaking with customers about designs, assisting with the creation of flower arrangements, and managing the general operations of the store while Daniel was traveling. There were employees that needed to be paid, but Daniel left no instructions about paying them. Bill could have reasonably believed that, in addition to all his other responsibilities as Daniel's agent, he had the implied authority to pay Daniel's employees. A court would uphold this as a valid exercise of Bill's implied authority as an agent.

Later, Bill received written instructions from Daniel in the form of a power of attorney. The power of attorney gave Bill actual authority to "enter into and execute any contract for the purchase of goods or merchandise as needed for the operation of *the current business* of Bloomscapes" and to sign credit and promissory notes for the same. Nothing in this power of attorney form or Daniel's conduct in establishing the power of attorney would lead any reasonable person to believe they could unilaterally change the entire nature of the business. The Court would not find that Bill had the implied authority to deviate from Daniel's usual business of running a flower shop to starting up a new business selling gift baskets, chocolates, candles, and potpouri. The power of attorney form clearly stated that Bill only had authority to run his *existing* business. The explicit limitation, in writing, on Bill's agency would cut off his implied authority at the point where it exceeded the normal business of running a flower shop. Any acts that Bill took beyond running Daniel's flower shop were in excess of his authority, and Bill is liable to Daniel for the damages he caused.

Despite the power of attorney to sign promissory notes and credit agreements, Bill did not have the apparent authority to bind Daniel to the $50,000 bank loan.

As noted above, an agent's acts will bind the principal when the agent is acting with apparent authority. An agent acts with apparent authority when a 3rd party reasonably believes, based on the conduct of the principal, that the agent has the authority to bind him. This, too, is a fact-based inquiry and the Court will evaluate the facts from the 3rd party's point of view to decide was is reasonable and what is not.

Here, Bill walked into the bank and presented the bank manager with a written power of attorney form and announced that Daniel had given him authority to "run the business." Bill's oral pronouncement that he had the authority to "run the business", on its face, may have been initially reasonable to the bank manager. After all, the bank manager knew Daniel and knew that Daniel ran a flower shop. The bank manager may or may not have known that Bill worked at the flower shop and helped manage it in Daniel's absence. Each of these facts, taken separately or together, makes it perfectly reasonable that the bank manager reasonably and subjectively believed that Bill had authority to act as Daniel's agent in his absence. Depending on the size of the flower shop and its revenue stream, it may have been completely reasonable to the bank manager for Daniel (or his agent) to be borrowing $50,000 at a time for the normal business of a flower shop. Orchids are, apparently, expensive.

But Bill's transaction with the bank manager moves quickly from reasonable to unreasonable. Instead of borrowing $50,000 to run a flower shop, Bill signs a promissory note as Daniel's agent to buy gift baskets from Bertha's Basketville. The bank manager's knowledge of Daniel's business should have put the bank manager on heightened alert that Bill may not have been running "the business" the bank manager thought he was. From the bank manager's perspective, there was now someone who the bank manager may or may not have known purporting to borrow a large sum of money on behalf of the owner of a flower shop for a purpose other than running a flower shop. It is less reasonable for the bank manager to believe Bill was acting with Daniel's authority, and the bank's case for the apparent authority of Bill to act weakens.

The final blow to the bank manager's argument that Daniel is personally liable to the bank is the written power of attorney form. The bank manager had no reason to believe or expect that a written power of attorney form was executed by Daniel. Had Bill never brought it up, the bank manager could be forgiven for believing Bill was Daniel's agent and was borrowing money for a new business venture on behalf of Daniel. But Bill *did* bring it up, announced that Daniel had given him a power of attorney, and actually gave the written power of attorney to the bank manager to inspect.

Rather than inspecting the power of attorney, the bank manager takes Bill at his word and promptly writes the loan as requested. Had the bank manager exercised even the slightest diligence and read the power of attorney form, the bank manager would have quickly realized that Bill was acting outside the scope of his agency and that Bill did not have any authority whatsoever to borrow money to start a new business on Daniel's behalf. It is unreasonable for the bank manager to have believed, under this set of facts, that Bill had the actual authority to do the things he did. At best, the bank manager was negligent in not reading the power of attorney form, and at worst he was wilfully ignorant and intentionally exposed the bank to Bill's fraud. Because it was not reasonable for the bank manager to believe Bill had the actual authority to sign the promissory note on behalf of Daniel, Bill did not have the apparent authority necessary to bind Daniel to the $50,000 loan from the bank.

Bill breached his duty of loyalty to Daniel

An agent owes fiduciary duties to his principal. The fiduciary duties of an agent to his principal include the duty of care and the duty of loyalty. The agent must, at all times, act in the best interest of his principal and exercise the utmost care in conducting the business of the principal. Bill breached both duties here.

Bill breached his duty of care by abandoning his duties and fleeing to Wales. While he was acting as Daniel's agent, Bill was responsible for running the flower shop, paying the employees, managing the inventory, and conducting all the other necessities of Daniel's flower shop business. Instead of doing any of the things he was supposed to, Bill breached his duty of care and locked up the flower shop. He did not maintain any of the inventory, so all the flowers died. Further, all the employees that Bill was responsible for managing in Daniel's absence went unpaid and quit. Daniel still owes the wages to those employees and could find himself in trouble with the labor board, all because of Bill's actions.

Bill also breached his duty of loyalty by stealing money and merchandise from Daniel. Originally, Bill purchased the gift baskets with money borrowed in Daniel's name. Rather than acting for Daniel's benefit and selling the gift baskets, paying the bank, and hopefully turning a profit for Daniel, Bill simply absconded with all the gift baskets he purchased. Although Daniel will not ultimately be liable to the bank under these facts, it is conceivable that had Bill not stolen the baskets and fled the country and instead personalized them and sold them as he originally planned, Daniel may have ratified Bill's actions. If Daniel ratified Bill's actions, then Bill's actions were conducted with proper authority and the agency relationship would still be intact.

But because Bill breached his duties to Daniel, Bill is liable to Daniel for all of his damages. An agent who acts outside their actual authority, and who harms their principal, is liable to their principal for the harm caused. Here, Bill closed the shop allowing all the inventory to die--Bill is liable to Daniel for the $100,000 orchids and all the other flowers that died. Bill failed to timely pay Daniel's employees, so Bill is liable for any penalties or interest which have accrued as a result of Bill's breach. Finally, if Daniel is ultimately ordered to pay the bank the $50,000 that Bill borrowed in Daniel's name, Bill will be liable to Daniel for that sum as well.

Ultimate advice to Daniel: Settle with the bank and pick better agents.

Daniel could sue Bill, but Bill is currently in Wales. A lawsuit against a US citizen residing in a foreign country would be very difficult to prosecute and even more difficult to collect on if a judgment were rendered. Litigation with a bank is also expensive, and because there are significant triable issues with the bank, it would likely cost more than the $50,000 he might turn out to owe the bank for Daniel to litigate the issues only to risk losing and having to pay the $50,000 anyway. I would advise Daniel to settle with the bank, and I would advise Daniel to choose his agents more carefully in the future.

END OF EXAM