

Business Associations
Final Examination
Fall, 2008

Instructions:

This is a closed book, 3 hour examination, consisting of 4 questions, the first 3 worth 20 points each, the last one worth 10. Your 3 best quizzes, plus your 10 point research paper, plus your 5 point research paper, totals 100 possible points.

Good luck, and have a safe and happy holiday season.

QUESTION ONE

SplatterCorp is a duly organized corporation in Massachusetts. Its Articles of Incorporation states that it was organized for the purpose of providing fun toys, which children could either throw at walls or eat (or both). The toys are organic and non-toxic, and easily wash off walls and furnishings. It was authorized to issue 200,000 shares of stock. It was established in 2001 by James Gremlin, who was initially chosen president (he was also the sole shareholder, sole director, and only employee). James owned 900 shares. In the middle of 2003, he brought in Jane Splain, because business was beginning to really grow (get it?). To entice her, he gave her a pretty good starting salary (\$50,000), a nice title (Executive Vice President) and 100 shares of stock in the corporation. James retained his 900 shares. Jane had the responsibility of making sure that the office was running smoothly, while James was out and about, building the edible toys from his botanical gardens (the land on which he grew the botanical elements in the toys he co-owned with his brother, Rufus), and visiting local toy and grocery stores, trying to drum up business.

In late 2005, James also brought his son Francis and daughter Emily into the business. James learned from Rufus how to plow fields and mix chemicals in the lab, while Emily learned how to run the business operations smoothly. This she learned from Jane, who was an excellent teacher.

One fateful day last year, the following things happened.

First, some background. It was a warm morning, but that was to be expected in July. It had rained a little the night before, and the roads were still a little slick, and it was also very foggy. James was driving the company-owned SUV, and his 2 children were passengers (they still lived at home with mom and dad). Emily told her father that they needed staples and other office supplies for the office, so James pulled into Staples, and Francis hopped out to run into the store to get them. James left the SUV running.

Francis never made it into the store. He was hit and seriously injured by a teenager who had stolen a car from a local unlicensed carpenter, whose name is Max Beaumont. The teenager ran away on foot. Seeing this, James jumped out of the car to assist his son, and

Emily followed. The SUV, left running and unattended, rolled right through the Staples plate glass window, injuring Bill Johansen, who had just gotten fired from Staples less than 2 minutes earlier, for allegedly calling in sick. (The truth of the matter is that Bill was a salesperson, always on the road, and the calls came from his neighbor, who detested Bill and wanted to get him fired) . Francis and Bill were taken to the hospital, in separate ambulances. The ambulance Francis was riding in got into an accident with a Fedex truck on the way to the hospital emergency room, and it can be proved that Francis broke his right arm as a result of that collision. Clearly, it was not Francis' day. James and Emily called Jane, who picked them up to bring them to the office.

En route, James informed Jane that she had done a wonderful job training Emily, such a good job, in fact, that her services were no longer needed. So he fired her. He then asked her to stop at a local coffee shop, where he promised to buy Jane and Emily a coffee, and the donut of their choice. Emily chose a chocolate coconut cruller. Jane chose a jelly. While in the store, James was bumped by a customer who was leaving with his order. This customer, Fred Frolic, spilled his hot coffee on James, burning him badly, but not too badly.

It gets worse.

After they got to the office, Jane cleaned out her desk and left, but not before vowing to "see [James] in court." Emily moved into Jane's office, and immediately began ordering needed supplies, but also ordering champagne and flowers for herself, to celebrate her promotion. She gave the company credit card number to vendors.

At the hospital, Francis was treated by Dr. William Malfoyle, who managed to turn two badly bruised ankles (and the aforementioned broken arm) and a very sore hip into an appendectomy and an amputation of one of Francis's legs. Jeesh.

Two more things. It turns out that, unbeknownst to James, Rufus used pesticides on the organic crops, so they could not actually be sold as "organic," which was a big selling point to customers. (Apparently, Jane knew this, and tattled to the Boston Globe after she was fired.) And James (or Jane, or Emily, or whoever was responsible for doing so), not only didn't keep proper corporate minutes over the last five years, they also forgot to file annual reports and renew the corporate liability insurance, which lapsed last month.

THOROUGHLY DISCUSS ALL POSSIBLE CAUSES OF ACTION.

QUESTION TWO

PrintCo, a large conglomerate with offices worldwide which was incorporated (in the state of Newbraska) in late 1997 (the company is engaged mainly in shipping and publishing), had on its Board of Directors six people, Tom, Simka, Eve, Benny, ex-President Clinton, and Gerry Moneybags. Tom, Simka, Eve, and Betty each held the title of Executive Vice President. Tom was president. Tom and Benny were high school and

college buddies, who married their high school and college sweethearts, Simka and Eve, respectively. Each of the four owned 25 shares of stock in the corporation (Clinton and Moneybags did not own any of the stock). The Articles of Incorporation had a provision requiring any shareholder who wanted to transfer stock within 10 years of the date of incorporation had to first offer the stock to the corporation (the "right of first refusal").

Gerry Moneybags was on the board because his employer, Fleet Bank, required that he be put on the board as a condition of granting a \$1,000,000 loan to the corporation over the previous year. (Tom, Simka, Eve, and Benny orally agreed to act as sureties on the loan). President Clinton was on the board because the honorarium was high (\$100,000), and because the corporation wanted to be able to boast about its impressive Board of Directors. Over the last three years, the following occurred:

1. In 2006, Tom and Simka were divorced, and as part of the division of their marital assets, Simka gave Tom 23 of her shares of stock, and Tom gave her the house in the Poconos. Soon thereafter, the shareholders had a vote, and they ousted Simka as director and Executive Vice President.
2. In 2001, Benny hired his son, Greg, as marketing director of the firm, at an annual salary of \$150,000, for a ten year term. The contract was in writing, signed by Benny as director. Greg never made it out of college, by the way.
3. In early 2007, Eve sold one share of stock to her friend Betty's daughter, Wilma. Wilma hates Greg, because he jilted her at the altar a few years back, if that matters to you.
4. In 2002, President Clinton injured his back during a PrintCo golf outing. In addition, he assisted the company in hiring his former aide, George Stephanopolous, whose job it was to lobby Congress for legislation beneficial to PrintCo's interests. Stephanopolous duly registered as a lobbyist and incorporated himself.
5. In 2007, the shareholders voted to split off the shipping business into a separate corporation, whose stock was solely owned by PrintCo. The new shipping corporation, ShipShape, Inc., had many of the same (but not all, by any means, see Simka, supra) members on its board as PrintCo.
6. Later that year, the captain of one of the ShipShape oil tankers ran aground in Puget Sound, causing all sorts of environmental disasters. The captain was allegedly drunk at the time.
7. Six months ago, Jimmy Carter was elected to the PrintCo Board of Directors.
8. In 2008, the IRS audited ShipShape, and discovered a deficiency of \$1,250,000 in unpaid withholding and FICA taxes.

9. Finally, in March, 2000, (I apologize for not mentioning this earlier) the board of PrintCo voted to issue itself stock options, at the current market price (which was \$10 per share), in lieu of voting to increase their fees for acting as Directors. They did this with knowledge of impending favorable legislation which would be a boon to the company, because they had firm beliefs in Stephanopolous' continued influence in the halls of Congress.

Two weeks ago, attorney James Dullblade bought 5 shares of PrintCo stock from his (now) girlfriend, Simka, found out all that was going on, and filed a derivative lawsuit on behalf of the corporation.

THOROUGHLY DISCUSS THE RIGHTS AND LIABILITIES OF THE PARTIES.

QUESTION THREE

Tom, Bob and Fred worked on the loading dock in a local Lowe's warehouse. They had a lot of free time between loading and unloading deliveries, and they were always brainstorming about new ideas, something that would make them rich beyond their wildest dreams, or at least rich enough to quit their jobs and go fishing all day.

One day, they were tinkering with the platforms used to bridge the gap between the warehouse floor and the truck they were unloading or loading. A driver named Steve (who worked for a local contractor named Ed) who was at the dock to pick up a refrigerator for Ed's wife helped Tom grab the heavy metal platform to put it in place, but his finger got caught underneath the platform before it was placed between his truck and the loading dock, and it was crushed. Tom drove him to the hospital, in a hurry. Too much of a hurry, as a matter of fact, because the roads were icy, and Tom lost control of the car, smashing into Dolores Pumpnickel's car. Steve was hurt even further. Dolores died. Tom suffered whiplash.

Prior to that, Tom, Bob, and Fred came up with this brilliant idea to make the platform, which is usually made of very heavy steel and is thus extremely cumbersome to maneuver, out of a high grade polymer plastic. Actually, truth be told, they did not come up with the idea. One of the truckers, who had a bad back (and a Ph.D. in mechanical engineering) told them about it. It was his idea. He told them he was going to present the idea to their foreman, Nancy. I believe he actually did. I also believe that Nancy ignored him.

On the weekends, they built their prototype, going through reiteration after reiteration. Then they began testing it at work, much to the disgruntlement of the incoming drivers who wished to load or unload packages at the warehouse. Tom, Bob, and Fred were just too busy tinkering to help unload anything.

The new platform really seemed to work, so they went to an attorney, who patented the concept for them. Then they went to another attorney, fresh out of law school, named Moe Dribble, and he had them form a limited partnership, named the XYZ Limited partnership. Moe said it combined the best of both worlds, because it would limit their tax liability and their personal liability. Impressed, Tom agreed to be named general partner.

Tom got fired the next day. He said it was because he told Nancy's supervisor that Nancy was having an affair with one of the salesman, which was against written company policy. The other two men quit their jobs on the same day, even though it was in their contract that if they should leave, they had to give two weeks' notice. Lowe's lost \$3,000 worth of orders because there was no one to load the goods onto the trucks.

The patented platforms, called "E-Z Load" were an instant hit. XYZ Limited Partnership made an awful lot of money. But it soon became apparent that the new "E-Z Load" platforms were prone to cracking in low temperatures, and this resulted in many, many accidents and injuries in the winter months of 2004. One driver in particular, Gerry Fielding, was unloading a heavy crate of computers when the platform cracked in two. This caused the computers to (a) fall on top of him and kill him, and (b) push against his parked truck, which caused the truck's emergency brake to malfunction, which caused the truck to roll away from the dock, and right over a small girl named Debby (a child of one of the factory workers), who was playing in the snow outside. Both Debby and her pathetic attempt at a snowman were crushed.

THOROUGHLY DISCUSS THE RIGHTS AND LIABILITIES OF THE PARTIES.

QUESTION FOUR

Craig and Sue, husband and wife, came up with a great idea. Chocolate flavored, non-toxic (supposedly), clear nail polish. Their thinking was that people are always biting their nails, so they at least ought to be a tad edible. And, being clear, it would be ideal for both genders, of all ages. They went to see their favorite attorney, Moe Dribble (remember him?). This is what he ended up doing for them.

First, he duly formed a corporation, BMN, Inc. Then he duly formed a limited partnership, TBF Industries. Naming BMN, Inc. as general partner of the limited partnership. Craig and Sue were named as limited partners of TBF Industries, and each received 100 shares of stock of BMN, Inc. Craig was named the president of BMN, Inc., and Sue was named treasurer. Both were named to the corporation's board of directors. Craig and Sue were skeptical at first, but they trusted Moe. He was, after all, their attorney. He said it was to limit their liability in case something bad should happen.

Which it did. Three things, to be exact.

First, it turns out the nail polish, which sold like hotcakes when they were introduced, posed a health hazard to small children, who were painting their nails and then biting them, and then becoming violently ill. Apparently, their little tummies lacked the enzymes necessary to properly digest the polymer in the nail polish. TBF's contracts with its Chinese supplier (Chang Industries, Inc.) specifically required the enzyme to be added in the manufacturing process, but that never happened.

Second, Bigbank, Inc. loaned \$1 Million to TBF Industries to get the venture up and running. Moe acted as counsel to the lender in the transaction, but forgot to have Craig and Sue sign as sureties on the loan.

Third, when the lawsuits started appearing inevitable, Moe refused to turn over his files, because Craig and Sue never paid him for his services rendered in establishing either the corporation or the limited partnership.

THOROUGHLY DISCUSS THE RIGHTS AND LIABILITIES OF THE PARTIES.