

Business Law
Midterm Examination
Fall 2022
Professor J. Harvey,

Instructions:
There are 2 questions in the examination.
You will be given 3 hours to complete the examination.

Question 1

Starrvey Nutrition, a corporation founded and owned by Prof. Harvey and Prof. Starr, is the world's largest manufacturer of nutritional supplements designed specifically for sumo wrestlers. The company was founded 15 years ago and uses an original secret formula closely guarded by the company.

Despite sustained early success, Prof. Harvey and Prof. Starr are very concerned with maintaining their position as an industry leader in sumo-specific nutrition. To ensure their product is top of the line, they retain Edwin Honda as a consultant and direct Honda to spend six months traveling to sumo wrestling tournaments around the world in order to conduct field research on the nutritional practices of as many different wrestlers as possible and correlate that information with tournament results. Harvey and Starr specifically authorize Honda to purchase samples of any nutritional supplements that might provide for useful research, subject to the following limitations: (i) Honda may not purchase any supplement that uses identical ingredients to existing Starrvey supplements; and (ii) Honda must obtain specific approval from either Prof. Harvey or Prof. Starr for any purchase that will exceed \$5,000 in a single transaction. To ensure that Honda can avoid purchasing supplements that are too similar to existing Starrvey supplements, Honda is given access to the manufacturing formula and agrees to keep the information confidential.

The following day, Starrvey Nutrition issued a press release that stated: "Starrvey Nutrition is proud to announce that Edwin Honda, a nutritional industry titan, has agreed to join the company's market research team. For the next six months, Mr. Honda will oversee our efforts to ensure we are always improving our secret product formulas. Just like the champions of sumo we serve, our goal is not just to get on top but to stay there."

Over the next six months, Honda entered the following contracts, purporting each time to act on behalf of Starrvey Nutrition:

1. A contract to purchase supplements from GNC for \$4,000;
2. A contract to purchase supplements from Vitamins-R-Us for \$7,000;
3. A contract to purchase supplements from Sam's Sumo Supplies in exchange for a copy of the Starrvey supplement formula; and
4. A contract to purchase a new piece of manufacturing equipment, for \$5,000, that should allow Starrvey to streamline production and improve profit margins on all existing Starrvey products.

Is Starrvey Nutrition legally bound to any of the four contracts?

If so, which ones?

In each case, why or why not?

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Prof. J. Harvey

Question 2

Starrvey Nutrition elected not to renew the Honda contract when the six-month term expired. While Prof. Harvey and Prof. Starr appreciated his efforts, they both felt that it was important to bring a new perspective to the company's market research team.

Less than a week after Honda's contract expired, Prof. Harvey and Prof. Starr had dinner with Ken Vega, a well-known karate tournament fighter. During the meal, Vega suggested that Prof. Harvey and Prof. Starr expand their business horizons to include nutritional supplements designed for karate fighters. Over the course of the evening, the three sketched out a plan for bringing Vega on board and developing Vega's proposed new line of supplements. At the end of the night, all three agreed to meet again in two days to further develop their plan.

The next day, Prof. Harvey called Prof. Starr. While both were interested in working with Vega to develop a new product line, they worried about expanding the service offerings of Starrvey Nutrition due to a then-running national advertising campaign, which emphasized repeatedly that Starrvey Nutrition was the best choice for sumo wrestlers because it focused solely on them. Concerned that expanding their product offerings would be off-brand and conflict with the ad campaign, Prof. Harvey and Prof. Starr ultimately determined that their new venture with Vega should be separate from Starrvey Nutrition.

After Prof. Harvey and Prof. Starr discussed their concerns with Vega the following day, the three agreed to move forward with a new business venture selling nutritional supplements to karate fighters. Due to Vega's prominence in the karate industry, they decide to name the business Vega's Vitamins. They also agreed to split any earnings equally.

The trio sketched out their respective responsibilities as follows. Vega, the name and face of the company, would handle advertising and sales. Prof. Harvey, the most financially literate of the trio, would oversee product development and serve as the company's in-house bookkeeper. Prof. Starr, who felt like he had enough day-to-day responsibility already between his work as a district attorney and his role at Starrvey Nutrition, decided to limit his involvement to a financial contribution. The trio agreed that Prof. Starr would put in \$100,000; that any liability of his for business debts would be capped at that amount; and that, as a silent member of the team, he would enter into no transactions of any kind on behalf of the business. Prof. Harvey and Vega each put in \$25,000. The trio also obtained a bank line of credit, with a limit of \$1 million. All of the trio's initial cash contributions, plus \$200,000 off the line of credit, were quickly spent developing supplements, packaging, and advertising materials.

Unfortunately for the trio, Vega lost an unsanctioned street fight the day before their first major product launch and his reputation in the karate industry suffered greatly. Initial product sales were strong due to pre-orders, but demand evaporated quickly and the trio decided to close the business, with no cash left in the bank and \$200,000 still owed on the line of credit.

Two weeks later, the trio was served with a lawsuit by Caplets & Casings, a product vendor who manufactures shells for vitamins, supplements, and pharmaceutical products. Upon reading the allegations of the lawsuit, Prof. Harvey and Vega learn for the first time that Prof. Starr—who purported to be acting on behalf of Vega's Vitamins in his dealings—had signed a contract to purchase \$50,000 of supplement casings from Caplets & Casings. In his dealings with Caplets & Casings, Prof. Starr introduced himself as an "owner" of Vega's Vitamins. The signature line on the contract indicates he signed in his capacity as a "partner" of Vega's Vitamins.

What form of business entity, if any, is Vega's Vitamins? Explain your answer.

Is the Caplets & Casings contract enforceable against Vega's Vitamins? Why or why not?

Assume the Caplets & Casings contract is not enforceable against Vega's Vitamins. How

should the existing debt of Vega's Vitamins be allocated amongst the owners? Explain your answer.

Now assume instead the Caplets & Casings contract is enforceable against Vega's Vitamins and that Caplets & Casings ultimately succeeds in obtaining judgment against Harvey and Vega, who pay the judgment 50/50. What rights of indemnity and/or contribution arise, if any, and as to each—who owes indemnity or contribution to whom? Explain your answer.

END OF EXAM.

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Is Starrvey Nutrition legally bound to any of the four contracts?

If so, which ones?

In each case, why or why not?

Question 2

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Two weeks later, the trio was served with a lawsuit by Caplets & Casings, a product vendor who manufactures shells for vitamins, supplements, and pharmaceutical products. Upon reading the allegations of the lawsuit, Prof. Harvey and Vega learn for the first time that Prof. Starr—who purported to be acting on behalf of Vega’s Vitamins in his dealings—had signed a contract to purchase \$50,000 of supplement casings from Caplets & Casings. In his dealings with Caplets & Casings, Prof. Starr introduced himself as an “owner” of Vega’s Vitamins. The signature line on the contract indicates he signed in his capacity as a “partner” of Vega’s Vitamins.

What form of business entity, if any, is Vega’s Vitamins? Explain your answer.

Is the Caplets & Casings contract enforceable against Vega’s Vitamins? Why or why not?

Assume the Caplets & Casings contract is not enforceable against Vega’s Vitamins. How should the existing debt of Vega’s Vitamins be allocated amongst the owners? Explain your answer.

Now assume instead the Caplets & Casings contract *is* enforceable against Vega’s Vitamins and that Caplets & Casings ultimately succeeds in obtaining judgment against Harvey and Vega, who pay the judgment 50/50. What rights of indemnity and/or contribution arise, if any, and as to each—who owes indemnity or contribution to whom? Explain your answer.

END OF EXAM.

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GRADING CONSIDERATIONS BEGIN ON FOLLOWING PAGE.**

GRADING CONSIDERATIONS FOR QUESTION 1

Is Starrvey Nutrition legally bound to any of the four contracts?

If so, which ones?

In each case, why or why not?

The fact pattern identifies that Honda, an individual, purported to enter into four agreements on behalf of Starrvey Nutrition, a corporation. Whether Starrvey Nutrition is bound will turn, in each case, on whether Honda acted with either actual or apparent authority in purporting to bind Starrvey Nutrition to the contract.

Rules. An agent acts with actual authority where a reasonable person in his position would believe the principal wants him to act in that way. An agent acts with apparent authority when the circumstances are such that a third party—based on the objective manifestations of the principal to that third party, or the manifestations of the agent within the scope of his actual authority—would reasonably believe the agent had actual authority to act in that way.

Key Facts: Actual Authority. The fact pattern provides that Harvey and Starr specifically authorized Honda to purchase samples of any nutritional supplements that might provide for useful research, subject to the following limitations: (i) Honda may not purchase any supplement that uses identical ingredients to existing Starrvey supplements; and (ii) Honda must obtain specific approval from either Prof. Harvey or Prof. Starr for any purchase that will exceed \$5,000 in a single transaction.

Key Facts: Apparent Authority. Starrvey Nutrition issued a press release that stated: “Starrvey Nutrition is proud to announce that Edwin Honda, a nutritional industry titan, has agreed to join the company’s market research team. For the next six months, Mr. Honda will oversee our efforts to ensure we are always improving our secret product formulas. Just like the champions of sumo we serve, our goal is not just to get on top but to stay there.”

Contract to Purchase Supplements from GNC for \$4,000. Honda was specifically authorized to purchase samples of nutritional supplements for \$5,000 or less, provided they are useful for research purposes and are not too similar to existing Starrvey supplements. There are no facts suggesting that the GNC supplements are too similar to existing Starrvey supplements or would lack a research use. The price is within the authorized range. Honda appears to have had actual authority to enter this contract, and Starrvey Nutrition will accordingly be bound. (For a complete answer, students should still analyze apparent authority even if actual authority exists. Here, Starrvey Nutrition issued a press release that indicated Honda “has agreed to join the company’s market research team” and “will oversee our efforts to ensure we are always improving our secret product formulas.” This appears to be specific enough to cause a reasonable third party to believe Honda had authority to enter the contract.)

Contract to Purchase Supplements from Vitamins-R-U's for \$7,000. Honda was specifically authorized to purchase samples of nutritional supplements for \$5,000 or less, provided they are

useful for research purposes and are not too similar to existing Starrvey supplements. There are no facts suggesting that the Vitamins-R-U's supplements are too similar to existing Starrvey supplements or would lack a research use, but the price is *not* within the authorized range. Honda lacked actual authority to enter this contract because it exceeded \$5,000 in one transaction. But Starrvey Nutrition is likely still bound on the basis of apparent authority. The press release did not mention any financial limitations on Honda's authority—those appear to have been communicated only to Honda—and no facts are given regarding any upper limit on typical transactions in the industry that might otherwise give a third party some reason to doubt Honda's authority to enter the contract.

Contract to Purchase Supplements from Sam's Sumo Supplies. Honda was specifically authorized to purchase samples of nutritional supplements for \$5,000 or less, provided they are useful for research purposes and are not too similar to existing Starrvey supplements. He was also specifically instructed *not* to disclose the company's product formulas, which cuts against the notion that a reasonable person in his position would believe his principal wanted him to trade away or otherwise disclose the secret product formula. It does not appear Honda had actual authority here. In terms of apparent authority, could a reasonable third party believe that Honda had actual authority to disclose the secret formula? Seems like a stretch. Nothing in the press release specifically *says* that Honda is only authorized to purchase supplements for cash, or that he was instructed not to disclose product formulas, but the press release *does* specifically refer to the Starrvey product formulas as secret formulas. On balance, a court is unlikely to conclude that Honda had apparent authority to exchange the formula. Starrvey Nutrition is not likely to be bound to the contract.

Contract to Purchase Equipment for \$5,000. Honda was specifically authorized to purchase samples of nutritional supplements for \$5,000 or less, provided they are useful for research purposes and are not too similar to existing Starrvey supplements. The equipment at issue is not a nutritional supplement and appears to fall outside the scope of anything that a reasonable person in Honda's position would believe their principal wanted them to do. On balance, it is not likely that Honda had actual authority to enter this contract. But Starrvey Nutrition likely *is* still bound on the basis of apparent authority. The price appears to fall within a typical scope, as compared to the other transactions in which Honda was involved. Nothing in the press release indicated that Honda's services would be limited to purchasing supplements; the release provided that Honda "has agreed to join the company's market research team" and "will oversee our efforts to ensure we are always improving our secret product formulas." It *could* be reasonably argued that a third party should at least *check* before relying on Honda's authority to purchase equipment (does that qualify under the umbrella of market research?), but it appears that enough indicia of apparent authority are present to support a finding that Starrvey Nutrition is bound to the contract.

GRADING CONSIDERATIONS FOR QUESTION 2

What form of business entity, if any, is Vega's Vitamins? Explain your answer.

It appears Vega's Vitamins is a de facto general partnership. Although there are some indicia that the parties wanted to form a limited partnership, with Starr serving as a silent partner who contributes extra capital in exchange for better liability protection, there are required state filings to form a limited partnership that are not mentioned in the fact pattern. Where partners fail to take the steps required to properly form a limited partnership, their internal agreements as to limiting certain partners' liability may be enforceable as between the partners but will be unenforceable as against outsiders. Courts will treat the partnership as a general partnership.

Under RUPA, a partnership arises any time two or more persons intend to carry on as co-owners a business for profit. California case law has articulated four factors that speak to when the RUPA standard is met: (1) an agreement to share profits; (2) an agreement to share losses; (3) mutual rights of management and control; and (4) a community interest in the venture. Here, elements 1 and 4 are explicitly met. Element 2 is fairly implied from element 1 absent an agreement to the contrary. (Otherwise, losses are just negative profits.) Element 3 is met at least in part, although there are some indicators that Starr was to have a more limited role in terms of management. On balance, this would certainly qualify as a partnership.

Is the Caplets & Casings contract enforceable against Vega's Vitamins? Why or why not?

The contract in question was entered by Starr, purporting to act for Vega's Vitamins. Whether the contract is enforceable thus turns on whether Starr had actual or apparent authority to enter it on VV's behalf.

Rules. An agent acts with actual authority where a reasonable person in his position would believe the principal wants him to act in that way. An agent acts with apparent authority when the circumstances are such that a third party—based on the objective manifestations of the principal to that third party, or the manifestations of the agent within the scope of his actual authority—would reasonably believe the agent had actual authority to act in that way.

Key Facts: Actual Authority. The partners specifically agreed that Starr was to enter into no transactions of any kind on behalf of the business. No reasonable person in Starr's position would have believed VV wanted Starr to bind VV to this contract.

Key Facts: Apparent Authority. In his dealings with Caplets & Casings, Prof. Starr introduced himself as an "owner" of Vega's Vitamins. The signature line on the contract indicates he signed in his capacity as a "partner" of Vega's Vitamins. There do not appear to be any other relevant facts in terms of objective manifestations by VV that C&C could have relied on. The only evident basis upon which Starr *arguably* had apparent authority, then, was in terms of power of position. Given his status as a "partner" and "owner," a third party could well be found to have reasonably believed he had actual authority to bind the partnership in a broad range of matters

based on nothing more than his title and position. The main weakness of this argument is that even *those* representations were manifestations by Starr, and whether he had actual authority to make them in the context of a contract negotiation is debatable. (He *is* a partner and owner, but he is *not* supposed to be making deals or holding himself *out* as having authority. Whether apparent authority arises from his authorized representation that he is an owner, in context of his efforts to strike a contract well outside his actual authority, is questionable.) On balance, and particularly in light of the fact that VV is ultimately a de facto general partnership instead of a de jure limited partnership, most courts would *likely* find that VV is bound.

(The ultimate conclusion students draw is less important than the reasoning here.)

Assume the Caplets & Casings contract is not enforceable against Vega's Vitamins. How should the existing debt of Vega's Vitamins be allocated amongst the owners? Explain your answer.

If the C&C contract is *not* enforceable against VV, then the financial picture of the company is as follows.

Total assets: nothing.

Total debts to outsiders: \$200k on the line of credit.

Total unrecouped investments by insiders: \$100k by Starr, \$25k by Harvey, \$25k by Vega.

Normally, losses are borne equally in a partnership after crediting each partner with the amount of that partner's capital contributions. Absent any agreement otherwise between the partners, each would be ultimately accountable for one-third of the \$200,000 debt, with Starr having overpaid and Harvey and Vega having underpaid.

Here, however, the partners agreed amongst themselves that Starr would be a silent partner, would invest a larger amount, and would have no liability beyond his investment. While such agreements are not enforceable against outsiders, they are usually enforceable as between partners themselves. Because Starr has already contributed his maximum liability, and Harvey and Vega each contributed equally to the partnership, the remaining \$200k will be allocated one-half to Harvey and one-half to Vega.

Now assume instead the Caplets & Casings contract *is* enforceable against Vega's Vitamins and that Caplets & Casings ultimately succeeds in obtaining judgment against Harvey and Vega as individuals. What rights of indemnity and/or contribution arise, if any, and as to each—who is liable to whom?

Relevant Rules

1. If the contract *is* enforceable against VV, then Starr has created liability for his principal where he lacked the actual authority to do so.
2. Where an agent binds his principal to a contract without actual authority to do so, the agent is liable to indemnify the principal and must reimburse any losses the principal incurs.
3. A partner who is required to pay more than his pro-rata share of a partnership debt is entitled to indemnity from the partnership. A partnership required to indemnify a partner on such basis is entitled to contribution from the other partners.
4. (While perhaps less obviously relevant than the other rules, students will ideally note here that the partners' agreement amongst themselves, to limit Starr's liability to his \$100k investment, will not benefit Starr in this circumstance. The agreement was premised on his being a silent partner who would *not* enter contracts, and Starr breached *his* end of the deal.)

Here, the fact pattern provides that Starr acted as agent for VV; he bound VV to a contract he lacked actual authority to enter on VV's behalf; and Harvey and Vega were ultimately made to bear more than their pro-rata shares. Accordingly, per the rules above, Starr owes indemnity to VV as his principal; VV owes indemnity to Harvey and Vega, as partners who were required to pay more than their share; and VV is entitled to contribution from Starr in whatever amount it was required to indemnify Harvey and Vega.

1)

Principal

There are 3 kinds of principals. A disclosed principal is known to the third party their agent is contracting with, and the third party knows they are dealing with an agent. Disclosed principals are liable for any authorized contracts their agents entered into. A partially disclosed principal is where the third party knows they are dealing with an agent, however they do not know the identity of the principal. Undisclosed principals are where the third party is unaware they are dealing with an agent.

Here, Starrvey is a disclosed principal, as they have held out to the world that Honda is their agent and will be doing business on their behalf. Anyone that deals with Honda is on notice he is the agent for Starrvey.

Agency

Agency is a fiduciary duty that arises when a principal appoints an agent to act on the principal's behalf, the agent consents to act, and the agent is subject to the principals control. The agent must act primarily for the benefit of the principal. Control means that the principal has power over the manner in which the agent acts on their behalf.

Here, Starrvey Nutrition is a principal, and it has appointed an agent, Honda. Honda is going to act on behalf of Starrvey, as they have an agreement that says he will purchase supplements and do research for them. Honda is subject to Starrvey's control, as they have given him certain limitations for what he is allowed to do, this is them exercising power over the manner in which Honda acts. When Honda goes out into the world to conduct his research, he must act primarily for the benefit of Starrvey.

There is an agency relationship.

Is Starrvey Nutrition Liable for the contract with GNC?

Actual authority

An agent has actual authority to act on a principal's behalf when the manifestations of the principal to the agent would lead a reasonable person in the agent's position to think the principal wishes them so to act. Actual authority can be express or implied.

Here, Starr and Harvey have specifically authorized Honda to purchase samples of nutritional supplements. This is express actual authority, as they have told Honda this is what he is allowed to do. They have also placed limits on him, saying that he cannot purchase any supplement that uses identical ingredients to their supplements, or spend more than \$5000 in one transaction without approval. Honda entered a contract to purchase \$4000 worth of supplements from GNC. It is unclear if the GNC supplements are identical to Starrvey's, but without facts stating so it can be assumed they are different enough. He did not exceed the \$5000 limit.

Honda had actual authority to contract with GNC.

Apparent Authority

An agent has apparent authority to act when a third party reasonably assumes, based on the manifestations of the principal to the third party, that the agent has the authority to act in this way.

Starrvey had a press release that stated Honda was joining their market research team. They said Honda would be overseeing their efforts to ensure they are always improving their secret product formulas. GNC could reasonably assume that meant Honda was allowed to purchase their supplements to see if they were doing something better than Starrvey. It is unclear what the general custom in the industry would be regarding the amount spent on supplements, but \$4000 is probably not an eyebrow raising amount.

Honda has apparent authority to contract with GNC.

Starrvey will be held liable for the contract with GNC.

Will Starrvey be liable for the contract with Vitamins-R-Us (VRS)?

Actual authority

Rule supra

Here, it is again unclear whether the ingredients in VRS's supplements are identical to Starrvey's. If they are, then Honda has not followed what he was expressly authorized to do. If not then he is still within his authority. However, he purchased \$7000 worth of supplements, which is over the \$5000 limit he was told without further authorization from Starr and Harvey.

Honda does not have actual authority to contract with VRS.

Apparent authority

Rule supra

Here, VRS will similarly be like GNC when they reasonably assume that a market researcher has the authority to purchase supplements from competitors. Again, without facts detailing the industry norm, it is unclear if buying \$7000 of supplements at one time is a lot. Most likely it would not be considered something a reasonable company in VRS's shoes would note, since Honda was authorized up to \$5000, so an additional \$2000 is not too much.

Honda has apparent authority to contract with VRS.

Is Starrvey liable for the contract with Sam's Sumo Supplies (SSS)?

Actual authority

Rule supra

Here, again, it is unclear the differences in formula, but assuming that SSS accepted the formula, then it can be assumed that the ingredients in both supplements were not identical. However, Honda has not made a purchase of supplements but has made a trade with SSS for Starrvey's supplement formula. This is expressly forbidden by Starrvey, as they made Honda agree to keep the formula confidential when they showed it to him.

Honda does not have actual authority to contract with SSS.

Apparent authority

Rule Supra

SSS would be on notice that Honda is a market researcher for Starrvey, and that he is overseeing their efforts to ensure they are always improving their secret product formulas, as state in their press release. Since SSS knows that the product formulas are secret, they would know that Honda is most likely not allowed to divulge it to anyone. It would not be the norm in their industry, or any industry, to frequently divulge secret formulas just to get basic products. Any reasonable company in SSS's position would know this based on what Starrvey has released to the world.

Honda does not have apparent authority to contract with SSS.

Starrvey is not liable for the contract with SSS.

Is Starrvey liable for the contract to purchase manufacturing equipment?

Actual authority

Rule supra

Here, Honda was expressly authorized to purchase nutritional supplements. The manufacturing equipment is not a nutritional supplement, and even though it was \$5000, that limitation was for nutritional supplements only.

Honda does not have actual authority to purchase nutritional supplements.

Incidental authority

Incidental authority is a subset of actual authority that can arise when an agent performs an action without express authorization because they needed to do it to accomplish what they were actually authorized to do.

Here, Honda was a market researcher, not a manufacturer or someone who dealt with the supplements directly while they were being made. There is no way he could assume he had the authority to purchase a piece of manufacturing equipment as incident to his expressly authorized powers.

Honda did not have incidental authority.

Apparent authority

Rule supra

Here, the manufacturing equipment company (MEC), would know that Honda is part of the market research team, and that he is overseeing Starrvey's efforts to ensure they are always improving their secret product formulas. A reasonable company in MEC's position might assume that someone overseeing efforts to improve a secret formula might be in the market for a piece of equipment that streamlines their processes. It is not unreasonable to assume that making a product faster, and cheaper would fall under an effort to improve a product formula. Starrvey can argue that Honda was simply on the market research team, which means that he would be researching formulas from other products, not purchasing major equipment. They'll also argue that streamlining production and improving profit margins have nothing to do with improving the secret product formula itself, just the manufacturing of it. Both arguments have merit, but most likely the court would find that it was not

unreasonable for MEC to believe that Honda had the authority to purchase the equipment for \$5000.

Honda most likely had apparent authority to contract to buy the manufacturing equipment.

Starrvey is liable for the contract with VRS.

Ratification

A principal can authorize a transaction an agent entered into without authority, if the principal is aware of all material facts, and accepts the benefits of the deal.

Here, there are no facts regarding Starrvey's ratification of any of the contracts. But if they knew about all the material facts and still accepted the supplements, or the manufacturing equipment they would have ratified the deal, and been liable on the contract.

Starrvey has not ratified any of the contracts that were not expressly authorized.

2)

1) Vega's Vitamins (VV) is a General Partnership because despite the apparent intent to limit Professor Starr's (Starr) liability to his \$100,000, the Partnership did not file the requisite paperwork to form a Limited Partnership.

Rule: General Partnership (GP) - A general partnership is formed when two or more entities associate to operate a business for profit.

Rule: Limited Partnership (LP) - An LP is formed when one or more general partners and one or more limited partners for a partnership, AND file the requisite paperwork with the Secretary of State.

Analysis: Vega, Starr and Prof. Harvey (Harvey) associated to operate Vega's Vitamins, a business they hoped would make a profit creating a general partnership. Among themselves they agreed that Starr would be a "silent partner" and limit his involvement and liability his \$100,000 contribution. With this agreement the partners could have formed an LP but they failed to file any paperwork with the Secretary of State, an unfortunate oversight which means they did not form an LP. Thus each of them can be held jointly and severally liable for all GP debts and obligations.

Conclusion: The partners intended, but failed, to create an LP and the result is VV is a General Partnership.

2) The Caplets & Casings (CC) Contract is enforceable against VV because Starr had apparent authority from the perspective of CC.

Rule 1: Partner Binding Authority - A partner with can bind the partnership if the partner has actual or apparent authority.

Analysis: Starr is a GP, even though that was not the parties intent, and he did not have actual authority as per the partnership agreement.

Rule 2: Partner Apparent Authority - Each partner in a partnership is an agent and has apparent authority to act, unless the specific 3rd party has knowledge or reason to know (i.e. recorded deeds in land transaction) that the partner lacks authority.

Analysis: Even though internally the partners agreed that Starr did not have authority to enter into any transaction on VV's behalf, nothing in the fact pattern indicates that CC had knowledge of this fact. in fact, Starr introduced himself as an owner and partner of VV. There is no reason given that

VV had reason to know, i.e. a central FDA registry where all businesses must register their authorized agents. Starr had apparent authority when he entered the contract with CC.

Conclusion: The CC contract is enforceable because Starr had apparent authority to enter into the contract on VV's behalf.

3) The CC contract would not be enforceable against VV if CC either had knowledge or should have known that Starr did not have authority to enter into transactions of any kind on behalf of VV.

Rule: Partner Apparent Authority - Each partner in a partnership is an agent and has apparent authority to act, unless the specific 3rd party has knowledge or reason to know (i.e. recorded deeds in land transaction) that the partner lacks authority.

Analysis: If CC had knowledge, either expressly or impliedly, or had reason to know, (a letter was sent to all manufacturers of pharmaceutical, vitamin, supplement manufacturing vendors including CC and they ignored it, failed to open it, or threw it away) then the contract would not be enforceable against VV as there would not be apparent authority.

4) The existing debt should be allocated among the partners, taking into account the agreed upon limitation of liability of Starr and his subsequent breach of his obligation not enter into contracts on the behalf of VV.

Rule: On dissolution the profits, or in this case the debts of a general partnership are equally divided among the partners in proportion to there agreed profit/debt sharing model.

Rule: All general partners are jointly and severally liable for partnership debts and liabilities.

Analysis: Here the partners agreed that Starr would not have any liability beyond his initial \$100,000 contribution, which leaves Vega and Harvey with the balance of the liability for VV's debt, at least by their internal agreement. Thus the \$200,000 which is owed by VV on the credit line should be split 50/50 between Harvey and Vega. However, should the partnership not pay the \$200,000 to the bank, the bank by right can seek the balance owed from any one, two, or all three partners including Starr, jointly or severally, because the partners failed to form the LP and in a general partnership all GP's are jointly and severally liable.

As will be discussed further below, the debt owed to CC because of Starr may be treated differently.

5) Assuming Harvey and Vega split the 50/50 CC judgment the partnership has a right to contribution of \$50,000 from Starr. Harvey and Vega each have a right to \$25,000 Indemnification from the partnership.

Rule: Partner Duties: Partners have duty to act in good faith, to properly account to the partnership, not compete with the partnership, and not to usurp what should properly be partnership opportunities.

Rule: Contribution - the partnership has a right to payment from partners who do not contribute their share to expenses or debts.

Rule: Indemnification - A partner who pays more than their share of partnership debt or expenses has a right to reimbursement from the partnership.

Analysis: Because the partnership agreement did not authorize Starr to enter into any transactions the partnership has the right to seek contribution from Starr. Harvey and Vega, as the partners who did not consent to the CC contract have a right to indemnification from the partnership for the debt which they paid, but did not properly owe under the partnership agreement. Starr breached his duty as a partner to act in good faith when he entered into the CC contract and Harvey and Vega could sue Starr if he fails to contribute.

END OF EXAM
