Business Organizations II

Final Examination

Spring 2023

Professor P. Stirling
Professor H. Mendola
Prof. E. Wagner

Instructions:

There are Three (3) questions in the examination.

You will be given 3 hours to complete the examination.

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Question 1

After years of perfecting their homemade craft beer recipes, a group of friends: Frank, Franny, and Fred, from California have decided to take their passion for brewing to the next level and start a business. Frank, Franny, and Fred have chosen to form a corporation to take advantage of the limited liability protection and potential for growth through the sale of shares. The friends hired Adam Attorney to incorporate their business under the name "Brewski Bros". Adam Attorney properly prepared all necessary documents to incorporate the business but carelessly failed to file them with the Secretary of State.

Frank, Franny, and Fred believed they had formed their corporation and continued operating as if their enterprise had been properly incorporated, including entering into a 3-year lease with Lenny Landlord in the name of Brewski Bros.

Due to mismanagement, Brewski Bros went out of business 6 months into operation and had to break the lease. Lenny Landlord wants to go after Frank, Franny, and Fred personally.

Please discuss the following:

1. What are the legal requirements for forming a corporation in California?
2. What type of enterprise is Brewski Bros?
3. Will Lenny Landlord be able to successfully sue Frank, Franny, and Fred personally for breaking the lease?

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QUESTION 2

The Hercules Corporation is a corporation that owns a number of outdoor fitness obstacle courses. The appeal of Hercules Co. gyms and courses was the unique experience where you feel like you are exercising in another world. With 10 shareholders total, Zeus owns 20% of the shares, while the other shareholders own between 5% - 10% of the rest of the shares.

Hercules Co. has a very popular outdoor course that is surrounded by apartment complexes. Zeus, who is also the president and director of the Hercules Co., has owned the apartment complexes since before he became a shareholder, president, and director of the corporation. He also disclosed to the Board when he purchased shares that he was the owner, and the Board did not see a problem with it.

The apartment complexes are out of date and are being overshadowed by the Hercules Corporation's outdoor facility. Zeus would rather sell the property and give the corporation a chance to claim the property and expand the outdoor facilities. Zeus schedules a meeting with the Board to discuss his idea to expand the corporation's business.

Zeus discloses that he believes the fair market value of his property is approximately $1.25 million, and wants to sell the property to the corporation so they can expand upon their very popular outdoor course. Zeus also estimated that the after purchasing the property, developing the property, and opening the course, the corporation would make a profit of approximately $2 million within the next year. Trusting Zeus and liking the idea of making a profit, the Board approved the transaction and appointed Hades, another shareholder and director, to close on the property.

Zeus sold the property through an agent, who worked directly with Hades on closing the property. The agent appraised the property and discovered the value of the property increased to $1.5 million. The agent brought this to the attention of Zeus who said, "Shouldn't be a big deal. I told them the price was approximate and they will still make a profit." The agent subsequently told Hades that the value of the property increased to $1.5 million, and they could not sell for any less. Hades, thinking that the extra $250 they'd be spending wasn't a big issue, agreed to purchase the property.

Hercules Corporation proceeded with the expansion project, but ran into some unexpected issues developing the property, which cost them an extra $250,000. After the development of the property was complete, the Hercules Corporation only profited $1 million from the transaction, resulting in a $750,000 loss.

A derivative suit was filed against Hercules Corporation's Board of directors for breach of their fiduciary duties.

Will the directors of the Board, Zeus, and/or Hades be protected from liability by the Business Judgment Rule? Discuss.

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Question Three

The Viking Company of California (Viking) operates a landscape and construction business. The company is owned by three brothers, Ragnar, Floki and Ivar, who are equal shareholders. The are also the directors of the company. Business is very good and the company has a lot of cash on its balance sheet. It also carries a large and expensive insurance policy to cover the risks in its business.

The brothers realize that there is a brisk market in the sales of used construction equipment. They form the Freya Company (Freya) as a wholly-owned subsidiary of Viking with only the minimum amount of capital required to incorporate and issue $3,000 in capital stock to themselves (1,000 shares each). They are also the directors of Freya. Freya uses the same address as Viking. They hire Bjorn to run the business. Bjorn told them he had "a lot of experience" with rebuilding equipment, but did not provide any references, nor did they ask for any. The advertisements for Freya state that the company is fully-bonded and insured.

During their first board meeting, the directors of Freya decide, even though it is a high-risk business, to delay obtaining an insurance policy for any liability as the premiums are so high. They decide to wait to see if the business grows. The notes/resolutions of the meeting are printed on Viking letterhead, and signed by the three, all using the title "director" with no other designation. The bylaws are a copy of Viking's with just the Company name changed.

The first week Freya is open, Bjorn fixes up a tractor and sells it to Eric, a sole proprietor/farmer. Two days later, the tractor breaks and Eric is injured and unable to work for an extended period. Eric files a personal injury suit against Viking. Viking counters that it is not liable as it is a completely separate company and that the proper party is Freya. Eric also sues Bjorn.

What might the court decide?

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SLO/HYB
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Answer Outline:

1. What are the legal requirements for forming a corporation in California?
   a. **Organizing a Corporation**
      i. First step is filing a certificate of incorporation in a designated office in the stat in which the organizers have chosen to corporate
         1. Must state the classes of stock and number of shares of each class
         2. Only stock that has been authorized in the certificate can be issued
         3. Stock that has been authorized but unissued is called: unissued stock
         4. Authorized stock that has been issued is known as issued stock or outstanding stock
         5. If a corporation repurchases stock that it has previously issued, that is treasury stock or authorized and issued but not outstanding stock
         6. The power to issue stock
      ii. The corporation must then issue stock to get its business up and running
      iii. The power to issue stock is normally vested in the board
      iv. The board is normally elected by the shareholders and until stock is issued there are no shareholders
         1. Under the laws of some states the corporation's incorporator's have the powers of directors until the directors are elected and the powers of shareholders until stock is issued
            a. Under this approach the incorporators will adopt by-laws and elect initial directors to serve until the first annual meeting of shareholders
         2. Under DE law: the initial directors can be named in the corporation's certificate of incorporation
      v. Once directors are named, there is an organization meeting and there's an operative corporation.
2. What type of enterprise is Brewski Bros?
   a. **Consequences of Defective Incorporation**
      i. **De Jure Corporation**
         1. A corporation that is organized in compliance with the requirements of the relevant statute
         2. A de jure corporation's status cannot be attacked either by private parties or by the state in a quo warranto proceeding
         3. Most courts hold that perfect compliance with the statutory requirements for incorporation is not required to attain de jure status
         4. SUBSTANTIAL COMPLIANCE will suffice
            a. If the noncompliance is deemed "insubstantial" then an enterprise that fails to meet all requirements for incorporation may still be a de jure corporation
         5. Some Courts:
            a. Find that for a corporation to reach de jure status they must have exact compliance with all mandatory statutory requirements but the failure to

comply with requirements that are only "directory" will not preclude de jure status
   b. Whether a requirement is mandatory or directory is a matter of statutory interpretation

ii. **De Facto Corporation**
   1. Happens when the steps taken to incorporate the enterprise were insufficient to result in a de jure corporation with respect to a challenge by the state in a quo warranto proceeding but were sufficient to treat the enterprise as a corporation with respect to third parties
   2. There must have been a colorable attempt to incorporate and some exercise of corporate privileges
   3. THREE REQUIREMENTS:
      a. A statute in existence by which incorporation was legally possible
      b. A colorable attempt to comply with the statute
      c. Some actual use or exercise of corporate privileges

3. <u>Will Lenny Landlord be able to successfully sue Frank, Franny, and Fred personally for breaking the lease?</u>

a. **Estoppel**
   i. In cases where neither a de jure nor a de factor corporation have been formed, the courts have held that a third party who has dealt with an enterprise on the basis that it is a corporation is estopped from denying the enterprise's corporation status
   ii. This one is murky and has a cluster of several different rules
      1. May only be applied to a specific transaction which is different from de facto
      2. Because a decision on estoppel relies heavily on the plaintiff's conduct – it may have very limited precedential effects based on the same theory and other different plaintiffs and plaintiff's conduct

<u>Q2 Answer Outline</u>

I. Director's Liability
   a. Business Judgment Rule:
      i. Director's decision not challenged if director:
         1. Acted in good faith;
         2. Acted with care of a reasonably prudent person in the same circumstances; and
         3. acted in the best interests of the corporation
      ii. Here, the directors did not take any other steps to analyze the transaction.
      iii. The directors should have taken better precautions when entering into a transaction that directly benefitted a director on the board.
      iv. The business judgment rule will not likely protect the directors here.

II. Zeus
   a. Business Judgment Rule:
      i. Zeus might be protected by the BJR if he reasonably acted under the circumstances.
         1. Arguably acted reasonably by going to the Board and disclosing the circumstances.

ii. Acted with care?
1. Zeus arguably did not take the steps necessary when making his business proposal.
2. He should have had more than an approximate figure.

iii. Best Interests of the Corporation?
1. Zeus was arguably acting within his best interests when proposing this transaction to the corporation.
2. It appears that Zeus was likely going to sell the property anyway, so this could arguably be in the best interests of the corporation, because he went to them first before selling the property.

b. Is Zeus protected because the Board approved the transaction?
i. Unlikely.
ii. A director must disclose all material facts to disinterest members of the board, and the transaction must be fair.
iii. Once Zeus found out about the value of the property increasing, he should have gone to the Board instead of assuming that the Board would be okay with it.
iv. In hindsight, if this were presented, then the board would have sustained less damages, and this was just a bad investment.

III. Hades
a. BJR
i. Unlikely that Hades will be protected, since he should have used reasonable care in entering into the transaction. He could have performed research on the market, gone to the board before entering.

ANSWER 3(OUTLINE)

20% Organization (Similar headings – boldfaced below)

20% Issue (Spot all issues)

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

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

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

Introduction

1. Nature of Organizations
2. Viking and Freya are both corporations. Bjorn is an agent of Freya.

3. A corporation is a legal entity and can be held liable on its own.

What might the court decide?

1. Is Bjorn liable?
   a. Bjorn is an employee of Freya and is therefore an agent of Freya which is the principal.
   b. Under respondeat superior, the principal/employer is responsible for the actions of its employees acting in the ordinary course and scope of their employment.
   c. The facts do not indicate that Bjorn was acting outside the scope of his employment.
   d. While he may not have been qualified, the principal did not inquire further about his training or experience.
   e. ***Accordingly, Freya is liable for the actions of Bjorn, and Bjorn should be dismissed as a party to the action.***
2. Can Viking, as sole shareholder, be held liable for the actions of its subsidiary, Freya?
   a. Normally, the shareholders of a corporation are not personally liable for the actions of the corporation.
   b. If corporate separateness is maintained and all proper corporate formalities are observed, a parent corporation/shareholder, will not be liable for the actions of its subsidiary.
   c. In this case, Viking's directors were also the directors of Freya. While this arrangement does not in and of itself illustrate a lack of separateness, the actions of Freya's directors appear to have disregarded the separateness of the two entities. In holding the board of directors' meeting, the directors used Viking letterhead and signed without indicating their correct titles (directors of Freya). As such it is questionable whether the directors were acting in their roles for Freya or for Viking.
   d. California law allows a court to look beyond the liability limits of the shareholders and "pierce the corporate veil" if the subsidiary is a mere instrumentality or alter ego of its shareholder.
   e. In California, two conditions must be met before the alter ego doctrine will be invoked. First, there must be such a unity of interest and ownership between the corporation and its equitable owner that the separate personalities of the corporation and the shareholder do not in reality exist. Second, there must be an inequitable result if the acts in question are treated as those of the corporation alone.
   f. In this case, the directors are the same in both the parent and subsidiary and the directors do not appear to observe corporate separateness as evidenced by the form of their meeting notes and resolutions, such that it is not clear who is making decisions for Freya. In addition, the address is the same for both companies.
   g. Whether the company is adequately capitalized for its corporate undertaking is also a factor in determining a unity of interest. In this case, Freya was clearly undercapitalized and under-insured for the type of business planned.
   h. As there is a unity of interest and ownership, the two companies do not have separate personalities.

i. As to the second prong of the test, if Freya is held solely liable as a separate company, there will be very little cash and no insurance to award Eric for his damages and thus an inequitable conclusion.

j. ***Accordingly, there will be an inequitable result if Freya's actions are treated as those of Freya's alone. As such, Freya is the alter ego of Viking and Viking should be liable.***

3. In addition to the test noted above, did Viking and its directors use Freya to perpetuate the violation of a statutory or other positive legal duty, or dishonest and unjust act in contravention of the plaintiff's rights?
   a. While normally not necessary to pierce the corporate veil, a plaintiff can demonstrate a fraud or wrongdoing on the part of the parent/shareholder as an overall element of injustice or unfairness.
   b. In this case, the directors decided to forego insurance for the company, but then proceeded to advertise it as fully bonded and insured. By not insuring Freya, they also enabled Viking to benefit from reduced cash outflow in financing its subsidiary.
   c. As a result, Freya would have no funds to pay Eric's damages.
   d. Courts will disregard the corporate form and pierce the corporate veil in order to hold the shareholders liable whenever necessary to prevent fraud or achieve equity.
   e. ***Accordingly, the court may pierce Freya's corporate veil to hold its shareholder liable.***

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great organization

1. Legal Requirements for Forming a Corporation in California

Issue: What is a Corporation?

Rule: A corporation is a legal entity or person, so it is separate from its owners, the shareholders. It is usually filed with a written instrument called the certificate of incorporation. There are three major organs within a corporation: the board of directors; the shareholders; and executives. There are two primary instruments that designate the corporation's function and form found in the articles of incorporation (same thing as certificate) and corporate bylaws. These instruments work together in state, federal, and soft law to delegate the rules governing corporate officers/organs and other important functions. excellent

In California, a corporate statute must be followed to introduce a legally formed corporation. The corporation must have a name that is not used by an already founded corporation; there must be stocks issued and readily available for shareholders (depending on the type of corporation will depend on the number of shareholders that will be expected; there must be an established board of directors that the shareholders appointed and voted into the board; and there must be executives to help exercise corporate activity and privilege. There must be corrected filed tax information, and there must be movement and access to creating/fulfilling the purpose of the corporation.

There are also characteristics a corporation must follow upon formation: freely transferable ownership represented as shares of stock; entity status where the corporation may sue or be sued and own real property in its own name; centralized management; continuance of existence; and limited liability. good!

2. <u>What Type of Enterprise is Brewski Bros?</u>

Issue: Is Brewski Bros a de jure corporation, a de facto corporation, or an incorporation by estoppel?

Rule(s):

A de jure corporation is a corporation that made substantial efforts to comply with a relevant statute of formation of a corporation. If the non-compliance was unsubstantial, then the corporation could qualify as a de jure corporation.

A de facto corporation has three elements: 1. a statute exists that makes the corporation creation possible; 2. colorable efforts were made to comply with the relevant statute short of perfect compliance; and 3. actual corporate authority or privilege was exercised.

An incorporation by estoppel is when a third party deals with the corporation in a capacity that the enterprise may be estopped from denying its status as a corporation.

Analysis: Here, Brewski Bros reasonably made substantial efforts in compliance with the relevant statute because Frank, Franny, and Fred hired an attorney to make sure their corporation was legitimate and properly formed. Unfortunately for Brewski Bros, their attorney failed to submit the necessary documents to the Secretary of State.

Since failure to submit the documents to the Secretary of State is needless to say, short of perfect compliance, it must be determined how close Fred, Franny, and Frank were to establishing their corporation and how much those efforts would be deemed substantial. According to the state of California, there is no "Brewski Bros" at this time; however, that does not mean that Frank, Franny, and Fred automatically lose their corporate status, especially if they can prove substantial efforts were made in compliance to the relevant statute.

excellent & thorough analysis

Hiring an attorney who did not do their job well does not reasonable put Fred, Frank, and Franny in a position where they took substantial or colorable efforts and fell short of perfection. According the prompt, all the owners did besides hire an attorney was name the brewery. Given the few efforts that were made on behalf of the owners, it is unlikely that Brewski Bros would qualify for either de jure or de facto incorporation.

However, since Brewski Bros did deal with a third party acting as an incorporated enterprise and exercised corporate privilege when they dealt with Lenny Landlord to have a place of business to operate the brewery, this would qualify Brewski Bros as an incorporation by estoppel because Brewski Bros acted in the capacity as a formed corporation to a third party.

There are no exceptions here because Lenny could not have known that Brewski Bros was not formally recognized by the state as a corporation because the owners themselves did not know about the lack of filing with the state. Therefore, the owners were acting the best interest of Brewski Bros from the information they were given and reasonably believed.

Conclusion: Therefore, Brewski Bros is an enterprise by estoppel.

3. <u>Will Lenny by Successful in a Personal Liability Suit Against the Owners?</u>

Issue(s):

What is the liability standard of owners of a corporation?

What is piercing the corporate veil, and does it apply here?

Are there any exceptions?

Rule(s):

Corporate Limited Liability: Managers, owners, and shareholders are not typically held liable for corporation obligations. This is one of the main characteristics of a corporation.

Piercing the Corporate Veil: Since managers and shareholders are not typically held for personal liability for corporate obligations that are straightforwards such as an agent acting on behalf of a principle and identifying the principle, unless the manager has personally committed or directed commission of a tortious act. A court may pierce a corporate veil if there is fraudulent activity of a corporation or the corporation is a mere instrumentality of another corporation following the alter ego theory.

Analysis: Lenny would be able to sue the owners personally if Fred, Frank, and Franny acted in a deceptive manner that was purposeful to deceive or defraud Lenny when they signed the lease agreement or at any time while the lease was signed, or if Brewski Bros is a subsidiary of a parent company that uses Brewski Bros as a front or "puppet" for the parent company's initiatives.

The example of Brewski Bros being a subsidiary company to a parent company is largely unlikely to be proven because nothing in the facts indicate the Brewski Bros is a mere instrumentality, efforts were made to make this passion project into fruition. Therefore, Lenny may not personally sue the owners for acting as a subsidiary.

The example of personal commission of a tortious act would also be difficult to prove because, although the owners did break the lease, they did not so anything related to a tortious misconduct. They did not threaten or batter Lenny into letting them out of the contract. They simply could not pay the lease agreement amount anymore because Brewski Bros was going under for due to mismanagement. Therefore, Lenny could not sue the owners personally for their own tortious conduct.

The final example of fraud is where Lenny has the more leverage, arguably because Brewski Bros was never formally operating as a fully formed corporation in the eyes of the state. If Lenny can prove that Frank, Fred, and Franny were acting in a fraudulent manner to deceive Lenny into entering a lease agreement with a corporate brewery, then Lenny could be successful in a personal liability suit. However, the facts indicate that "Fred, Franny, and Frank believed they had form their corporation and continued operating as if their enterprise had been properly incorporated." The owners had reasonable judgements on the situation because they were never informed of any other alternative that their documents necessary for incorporation had not been filed to the state. Therefore, fraudulent behavior would not be likely to prevail in a ruling for Lenny.

There are no exceptions here because an exception to the rule would be if both the owners and Lenny knew that the corporation had not been fully formed, and Lenny agreed to enter into the lease agreement with them anyway. If that had happened, then Lenny would again not be able to sue for personal liability against the owners.

Conclusion: Lenny would not be successful in suing Frank, Fred, or Franny for personal liability for breaking the lease agreement.

END OF EXAM

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-good / clear organization
-model answer

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Question 1:

Issue: Whether the business judgment rule applies to the initial decision by the **board** to purchase the property?

Rule: Normally, directors of an organization are held to the standard of care of that as a fiduciary. However, courts are unwilling to second-guess every business decision of a director. As a result, the courts have constructed the business judgment rule presumption that presumes the director acted reasonably and within their fiduciary duty. The Business Judgment Rule has four requirements in order to be invoked. First, there must have been a decision made. Second, the director must have engaged in a reasonable decision making process, reasonable at the time of the decision in light of the attendant circumstances. Third, the decision must have been made in good faith. Fourth, the director must not have had a personal interest in the transaction. If one of these elements is not met, then the standard of care applied is that of reasonability of the decision, in light of the attendant circumstances at the time the decision was made, and considering equity.

excellent rule

Sub-issue: Was a decision made?

Rule: A decision is an affirmative choice.

Analysis: Here, the directors will argue that the choice to purchase the property was a decision because they approved the transaction between Zeus and the corporation.

Conclusion: There was a decision made.

Sub-issue: Did the directors engage in a reasonable decision making process?

excellent!

Analysis: Here, the directors will argue that they engaged in a "reasonable decision making process" because they evaluated the claim of Zeus that the value of the property was only $1.25 million, based on their trust for him and based on having a meeting with Zeus to discuss the details of the transaction. The shareholders (bringing the derivative suit -- the Plaintiffs) will argue however, that this does not represent a "reasonable decision making process" what-so-ever. A reasonable process, in light of the circumstances of purchasing a property, would require that the board have engaged in *some* evaluation of the property. A reasonable decision making process would involve the board potentially hiring an appraiser to look at the value of the property, having the property inspected, evaluating the property themselves, or engaging with the prospect of making the purchase beyond "trusting" Zeus. Further, the attendant circumstances of the purchase involve a potentially self-interested transaction, and as such, the board should have a heightened level of scrutiny to evaluate whether the corporation is receiving a fair deal. In the absence of any facts to the contrary, it appears that the board barely employed any decision making process at all.

Conclusion: As a result, the board will not be found to have engaged in a reasonable decision making process surrounding the purchase of the property.

Sub-issue: Whether the decision was made in good faith.

Rule: Good faith requires that an individual approach another with honesty and truthfulness.

Analysis: Here, the board appears to have been dealing with the interests of the corporation in good faith. While their decision making process may have been lacking, there are no facts indicating that they intended to benefit themselves, or others, instead of benefitting the corporation by making the purchase. Plaintiffs may argue that the decision was not made in good faith because Zeus, as the largest shareholder was involved in the transaction; however, this is not necessarily determinative because a self-interested transaction may be incidentally self-interested, while still made in good faith.

Conclusion: The decision was made in good faith.

Sub-issue: Whether the decision maker had a personal interest in the transaction.

Here, there does not appear to be any indication that the board had a personal interest in the transaction, because it does not appear that the board members would have benefitted personally from the transaction. The facts provide that the board honestly believed/trusted Zeus, and that the decision to make the property purchase would benefit the corporation as a whole. The facts indicated that the board was interested in making a profit, which is for the benefit of the corporation.

Conclusion: The board will be found to have not had a personal interest in the transaction.

Board BJR Conclusion: Having failed the requirement to have employed a reasonable decision making process, the board will not be shielded from liability based on the Business Judgment Rule.

Issue: Whether the business judgment rule applies to the initial decision by the **Hades** to continue with the property purchase?

Rule: See above for BJR rule.

Sub-Issue: Did Hades make a decision?

Rule: See above.

Analysis: Here, Plaintiffs will argue that Hades in fact did not "make" a decision, but rather, in light of the change in circumstances, did not do anything but only allowed the already made decision to continue. Plaintiffs will argue that a decision must be an affirmative choice to perform some kind of act, whereas here, he merely let the already made decision of the board continue. Hades, by contrast, will argue that he made the choice to do nothing and made the choice to inform the board of their changed position.

Conclusion: Hades will be found to have not made a decision.

Sub-Issue: Did Hades engage in a reasonable decision making process?

Rule: See above.

Analysis: Here, Hades will argue that he utilized a reasonable decision making process when he took in the information from the agent, and allowed the sale to continue. He will argue that the circumstances surrounding the particular decision dictate the degree of diligence inheres to a decision making process. Thus, he will argue that the increase of $250,000 is reasonably small, and as such, did not require much to evaluate its merits, beyond his own consideration. Plaintiffs will respond that a reasonable decision making process requires that he have done *something* other than consult himself, such as reporting the increase to the board.

Conclusion: Hades did not employ a reasonable decision making process.

Sub-Issue: Was Hades acting in good faith?

Analysis: Here, Hades will argue that he acted in good faith by believing that the purchase, despite the change in price, still represented a good choice for the corporation.

Conclusion: the decision was made in good faith.

Sub-Issue: Did Hades have a self interest in the transaction?

Rule: See above.

Analysis: Here, Hades will argue that he did not have a self-interest in the transaction because he did not benefit personally from the transaction, but was only involved in the closing of the property, rather than having derived any benefit, independent of his role on the board, from the transaction.

Conclusion: Hades will be shown to have not been self interested in the transaction.

Hades BJR Conclusion: Hades will be shown to not have made a decision, and also not to have employed a reasonable decision making process. Thus, the BJR does not shield Hades from liability.

Issue: Whether the business judgment rule applies to Zeus decision to sell the property?

Rule: See BJR rule above.

Here, Plaintiffs will argue that his decision to sell the property to the business does not fall within the purview of the business judgment rule because Zeus made the decision to sell the property as a distinct decision from his role as a director. The facts provide that he decided to sell the property because they were "out of date" and would rather the corporation utilize the property. Further, Plaintiffs will argue that the decision to purchase the property was not made by Zeus at all, but rather that "the Board approved" the transaction. Indeed, Zeus is the largest shareholder in the corporation, but his share was still just a minority of shares (20%), and thus, the remainder of the board must have voted to make a decision. Thus, the Plaintiffs will argue that Zeus's portion of the transaction is outside of the BJR presumption, as he was merely functioning as an independent seller. Zeus, on the otherhand, will argue that his decision does fall within the BJR presumption, because he was still a director at the time of the transaction, and as a result, still owed the corporation a fiduciary duty, and therefore should still be shielded from liability as a director for the conduct during the transaction.

Conclusion: The BJR will apply to Zeus because he was involved in the decision to sell the property, even though he sold it as an individual to the corporation.

Sub-issue: Did Zeus make a decision?

Rule: See above.

Analysis: Here, Zeus will argue that he made a decision to sell the property to the corporation because he offered the corporation the opportunity to purchase the property. The Plaintiffs will argue (as above) that Zeus did not make a decision as a business director, but rather as a third party, and thus the decision is outside of the scope of BJR.

Conclusion: The court will find that Zeus made a decision as a director.

Sub-Issue: Did Zeus employ a reasonable decision making process?

Rule: See above.

Analysis: Here, Zeus will argue that he employed some reasonable process, because he evaluated the nature of the property, and decided that it would benefit the corporation to make the purchase when he decided to sell the property. The Plaintiffs will argue that Zeus should have more fully investigated the value of the property, which is an indicia of a lack of reasonable business practice.

Conclusion: Zeus will be found to have employed a reasonable decision making process.

Sub-issue: Did Zeus act in good faith?

Rule: See above.

Analysis: Here, Zeus will argue that he acted in good faith by offering the property to sale. He believed that the property would allow the expansion of the business into the neighboring area, was close to the existing infrastructure, so as to make logistics easy and reasonable. Plaintiff will argue that Zeus only sold the property so that he could benefit himself, however, Zeus will point out that he actually under valued the property in the transaction, and that if he was acting in bad-faith, he would have asked for a greater amount of money.

Sub-issue: Was Zeus self interested?

Rule: See above.

Analysis: Here, Plaintiffs will argue that Zeus was self interested in the transaction because he stood to gain from selling the property to the corporation. Zeus, on the other hand, will point to the fact that he almost sold the property at a value less than the actual value of the property. This fact, however, does not remove the nature of the transaction as self-interested, because Zeus still stood to gain as an individual, rather than as a director of the corporation.

Zeus-Decision to Sell Conclusion: As a result of the self interested nature of the transaction, Zeus will not be afforded the protected by the BJR.

Issue: Whether the business judgment rule applies to Zeus's decision to not inform the board of the change in position?

Rule: See BJR rule above.

Sub-Issue:

Sub-Issue: Did Zeus make a decision?

Rule: See above.

Analysis: Here, Zeus will argue that he did make a decision to ignore the increase price information from the agent. He will argue that a decision to do nothing, still qualifies as some kind of decision, because he evaluated the change in position, but chose not to do anything. The Plaintiff will argue that this does not represent a decision to do anything, because a choice requires an affirmative decision, rather than a failure to act.

Conclusion: Zeus will be found to have not made a decision because he did not act, but instead, did nothing with the information.

Sub-Issue: Did Zeus engage in a reasonable decision making process?

Rule: See above.

Analysis: Here, Zeus will argue that his decision making process (to do nothing) was reasonable because he took in the information from the Agent, and weighed the circumstances that the board knew that the price was approximate, and that a profit would still occur. He will argue that he, having known the board, evaluated the current conditions in an appropriate way. The Plaintiffs will argue that this was not a reasonable process because the price increase was significant (20%) and that a simple remedy, appropriate to the circumstances, would have been to call the board for their input on the process.

Conclusion: Zeus did not employ a reasonable decision making process because he failed to employ any decision making process rather than his own consideration.

Sub-Issue: Was Zeus acting in good faith?

Analysis: Here, Zeus will argue that the decision to continue with the purchase was made in good faith because he was informed of the increase by the agent, who is presumably an independent third party, and trusted that the increase was fair to the corporation. The Plaintiffs will argue that this is not in good faith because Zeus stood to gain an additional $250,000, and chose not to inform the board on the basis of Zeus' potentially increased profit from the transaction.

Conclusion: Absent facts to the contrary, the transaction appears to have been made in good faith.

Sub-Issue: Did Zeus have a self interest in the transaction?

Rule: See above.

Analysis: Here, with particular respect to the decision to allow the transaction to continue, Zeus still had a self interest in the transaction because he stood to benefit an additional $250,000 from the new information from the Agent. Zeus will argue that he was not self interested because the agent was an independent party, and he was passive in receiving a modest profit. The Plaintiff will counter, however, that the increase in the rate is, in fact, a self interested transaction because Zeus stood to gain a sizable increase in the amount of profit, regardless of the origin on the information of the increased value.

Conclusion: Zeus will be shown to have been self interested in the transaction.

Zeus BJR Conclusion: Zeus will be shown to not have made a decision, and also not to have employed a reasonable decision making process. Thus, the BJR does not shield Zeus from liability.

Overall conclusion: Neither the directors, Zeus, and/or Hades, will be shielded from liability by the Business Judgment Rule.

END OF EXAM

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3)

WHETHER VIKING CAN BE HELD LIABLE

On its face, Freya appears to be a company distinct from Viking. If this were the case, Viking would not be held liable for Freya's responsibilities. However, to Freya's connection to Viking, lack of insurance, and potential undercapitalization, the court will analyze whether Eric can pierce Freya's corporate veil, and hold Viking liable.

excellent issue statement

Piercing the corporate veil is a theory under which the court will allow a plaintiff to seek relief from the people or entities behind a company. It breaks the liability protections that were in place. This can happen in a few different scenarios, and the main four are: when fraud has taken place, when the entity is undercapitalize (meaning they did not have a sufficient amount of money for the transactions they were engaged in), if the corporation is an alter ego of another entity, or if it would be fundamentally unfair to allow the liability protections to stay in place.

Alter Ego

great!

An alter ego is a company that appears to be a separate company, but is in fact just a facet of the larger company above it. There are many factors the court can look at when determining whether one company is the alter ego of another. These factors include commingling of funds between the companies, shared management, use of insignia of the other company, shared accounts, the amount of control the other company asserts, capitalization, where their funds come from, and whether the company can make its own separate decisions, amongst others.

great use of facts & applying them in analysis

- Here, the directors of both companies are identical. This fact supports that Freya is an alter ego of Viking.

- Freya only has the minimal amount of capital to qualify for incorporation, and the funds came from Viking. This fact supports that Freya is an alter ego of Viking.

- Freya uses the same address as Viking and does not appear to have separate and distinct facilities. This fact supports that Freya is an alter ego of Viking.

- Freya's documents from their board meeting are printed on letterhead using the insignia of Viking. This fact supports that Freya is an alter ego of Viking.

- Freya's bylaws are a copy of Vikings, and not distinct or original. This fact supports that Freya is an alter ego of Viking.

Considering these facts, there is very little to suggest that Freya is in any way a genuinely separate entity or subsidiary. The court should decide that Freya is an alter ego of Viking.

Undercapitalization

If a subsidiary of another company is undercapitalized, this can create an opportunity for the court to allow the corporate veil to be pierced. Here, Freya was incorporated with the minimum funds that would allow it to be eligible for incorporation. This indicates that more capital may be allocated to the company by Viking at a later date, indicating a close relationship, and also creates a situation where they would be less likely to compensate claimants for debts or tort liabilities.

The court would most likely find Freya to be undercapitalized and this would be a factor in allowing the veil to be pierced.

Fraud

Instances of fraud can also create a an opportunity for the corporate veil to be pierced. Fraud is difficult to prove, in part because it requires some understanding of the state of mind of those who committed the fraud, including their intent. Because of this, fraud would likely be one of the most difficult ways for Eric to pierce the corporate veil, but it is worth considering, especially if Eric were to fail on the other approaches.

Here, Freya ran advertisements for the business. These advertisements included the statement that the company is fully bonded and insured. In fact, at Freya's first board meeting, the directors (Ragnar, Floki, and Ivar) decided not to purchase insurance. They found that the premiums would be too high, and instead decided to wait to see if their business would be successful. This is an issue regardless of whether they continued to run ads after reaching this decision, but it would be a stronger argument for Eric to make if they continued running new ads with this claim after deciding not to get insurance.

This creates an uncomfortable situation for Viking, as the only way this statement would be true is if they intended Viking, which was insured, to be liable for claims against Freya.

It is possible that Eric could mount an argument that brings this into question. Either Viking would have to accept liability for Freya, or they would have to admit that this was a misleading and dishonest statement. While they could claim it was accidental and lacked intent, this would be difficult given the circumstances. If Eric could establish a reliance on the statement relating to insurance, he may be successful in piercing the corporate veil through a fraud claim.

Unfairness

The court can also allow the corporate veil to be pierced if not doing so would be unjust and unfair. Here, this is an unlikely theory for Eric to pursue due to the strength of other, more specific arguments, however, there may be an argument here.

If all of the other arguments failed, the corporation may look at the misleading advertising statement, in addition to the other issues with the company mentioned in the alter ego and undercapitalization sections and determine that the circumstances would lead to an injustice if Eric was unable to recover.

This would be a last effort in this situation because facts indicate a stronger argument ✓ elsewhere.

Conclusion

✓ good!

The court could find Viking liable to Eric under the alter ego theory, almost certainly. The court could likely find Viking liable due to undercapitalization or fraud, as well. If all else failed, the court could still allow Eric to seek relief from Viking due to the patently unfair circumstances in light of Viking's business dealings.

WHETHER BJORN CAN BE HELD LIABLE

In addition to pursuing action against Viking, Eric is also seeking relief from Bjorn.

When Bjorn was hired he claimed he was highly experienced in rebuilding equipment. The facts are silent as to whether this is in fact true, and even if they are true, this does not mean that Bjorn is in fact competent. The fact that Freya/Viking hired Bjorn without references indicates a negligent hiring process. It does not appear that there were any checks on the quality of his work. There is also little information to make a determination on whether he actually did anything wrong while rebuilding the tractor. The facts do not give any indication as to what actually failed on the tractor, it may have been a defective part from another company. If the failure was determined to be Bjorn's fault, no facts indicate that Bjorn committed a deliberate tort (which gives potential for him to be held exclusively liable), but it is possible he was negligent.

The facts indicate that Bjorn is an employee of Freya, and not an independent contractor. Under the theory of respondant superior, the employer can generally be held liable for negligence of an employee, and typically, the injured party cannot recover for the same harm from multiple parties (there are exceptions to this, but none apply here).

It is possible that Eric could recover from Bjorn, but not from Bjorn and Viking. Eric would likely not benefit from seeking recovery exclusively from Bjorn. Eric's probability of recovery is significantly stronger from Viking as that company has both capital and insurance.

Most likely, any express or implied warranty would flow from Freya and Viking, not Bjorn. This would make recovery unlikely, unless Bjorn's actions in someway have a causal connection to the failure, that allow Viking and Freya to eschew liability.

Conclusion

If, for some reason, Eric's claims against Viking failed, and the failure of the tractor was traced to Bjorn's negligence, it is possible that he could recover from Bjorn.

↳ not correct

↳ Bjorn = agent of Freya

- Bjorn is not proper party

- B acted w/in scope of employment

END OF EXAM

- Freya is proper party & we pierce F's veil to hold V financially liable