MONTEREY COLLEGE OF LAW

BUSINESS ORGANIZATIONS

Midterm Examination

Fall 2015

Prof. M. Cohen

INSTRUCTIONS:

There are SIX (6) questions in this examination.

You will be given three (3) hours to complete the examination.

1. Crazy Crepes, a Venice Beach, California business founded by its sole owner, M. Chef, grew rapidly from its start. The mobile crepe cart's stunning success quickly lead other Venice Beach entrepreneurs, like Ollie's Omelets, to copy the business model. Ollie, however, quickly learned that omelets are not an all day food, and Ollie's Omelet cart could not keep pace with Crazy Crepes.

   When Chef learned Ollie's Omelet cart business was struggling, Chef came up with an idea: Chef would buy Ollie's Omelets. Chef would be the sole owner of both businesses, and hire Ollie as an employee. Ollie liked the idea of working only in the mornings, and tired of running a business, Ollie agreed to Chef's proposal. Ollie sold his Omelet cart to Chef, and became a Crazy Crepes employee. Ollie, continued to operate the Omelet cart in the mornings as if nothing had changed.

   The terms of Ollie's written employment agreement indicated that Chef had to approve all purchases, because Chef wanted to control costs by purchasing all the supplies for both mobile food carts. To leave no doubt about this fact, the written employment agreement also expressly indicated that Ollie had no authority to make any purchases without Chef's approval. Despite the agreement, Ollie decided he would not cut corners on egg supply, and on his own, without consulting or even notifying Chef, Ollie entered into a supply agreement with Farm Fresh Eggs to supply eggs for the Omelet Cart.

   As time passed, Venice Beachers grew hungrier for crepes, but their omelet appetite diminished. Chef and Ollie agreed it no longer made sense to continue operating Ollie's Omelet cart. Accordingly, Chef sold the Omelet cart and terminated Ollie's employment, on agreed terms.

   When Farm Fresh Eggs made its next delivery and found the Omelet cart was gone, it asked around and learned for the first time that Crazy Crepes owned the Omelet Cart. Under the supply agreement, Farm Fresh Eggs was owed $10,000 for eggs it had supplied to the Omelet Cart. Farm Fresh made a demand for payment to Crazy Crepes, but Chef refused, indicating Ollie had no authority to contract for supplies.

   Can Farm Fresh Eggs recover its $10,000 debt from Crazy Crepes?

2. As soon as Ollie's Omelet Cart disappeared, four other mobile food carts appeared on the Venice Beach promenade: Marty's Meatballs, Yoshi's Yakatori, Freda's Fresh Home Fried Pickles and Terry's Tiramisu. Finding himself in a sea of mobile food frenzy, Chef decided he would try to bring some order to the new food cart marketplace. He called a meeting and the five food cart pioneers, Chef, Marty, Yoshi, Freda and Terry, came up with a plan: they would each agree to "stations" on the Venice Beach promenade, and would rotate stations during the day at agreed times. To compensate for the fact that business could vary throughout the day at the different stations, the five food carts agreed to combine their revenues each day, and divide the total revenues in equal shares. But in all other respects, the five vendors continued to manage their food carts as they had in the past.

   The system worked brilliantly, and as time went by, Yoshi made enough money to open his own Yakatori restaurant in Santa Barbara, where his costs for chickens would be substantially lower than in Los Angeles. While the group was sad to see Yoshi go, they were more surprised to receive a letter from Yoshi's lawyer demanding that the group "buy-out" Yoshi's "partnership interest" and threatening to file an action in court to dissolve the group's "business" if they refused.

   How should the group respond to Yoshi's lawyer?

3. Frustrated with the Yoshi experience, the four remaining food cart fanatics decide to clarify their relationship by a written agreement, which, after seeking legal advice, they titled the "Fabu Four Food Cart Limited Partnership." The agreement indicates Chef is the General Partner, with a 52% equity interest in the partnership, and the remaining three cart vendors, Freda, Marty and Terry, are Limited Partners, each with a 16% interest in the partnership.

   Unfortunately for the fledgling limited partnership, Terry inadvertently used some bad cream in the day's Tiramisu, causing a food poisoning medical crisis near the Venice pier. It did not take long for lawsuits to appear, naming all four partners and the partnership itself.

   Assuming the sickened Tiramisu victims can prove their negligence claims:

   a. Which of the named defendants are liable to the victims?

   b. Are the partners liable to the partnership?

   c. Are the partners liable to each other?

4. Once again fed up with the legal process, the Fabu Four Food Carts, LP partners vote unanimously to "wind up" their venture, and form a new business called Fabu Four Food Carts, Inc., a corporation. Lawyers draft and file bare bones Articles of Incorporation with the Secretary of State authorizing 100 shares. An "incorporator" nominates a four-person Board of Directors, consisting of Chef, Freda, Marty and Terry, who each receive 25 shares of the authorized 100 shares. They conduct an initial Board of Directors meeting and adopt By-Laws, which create four company positions for CEO, Vice President, Secretary and Treasurer. Voting under the by-laws occurs by simple majority. The Board votes Chef to be CEO and the other three shareholders each fill in the remaining company positions. The four shareholders agree orally to draw equal salaries for their respective company positions, and to pay out any additional earnings by way of bonuses, also distributed equally among them.

   The new company rolls out to terrific success. In the first three years, Chef, Freda, Marty and Terry each receive a salary and significant bonus based on the corporate earnings. Convinced her freshly fried pickles are the driver for the company's success, Freda demands that she be paid a higher salary and bonus than the other shareholders. After a long day of work, Chef gets together with Marty and Terry, who all agree Freda's demands are unreasonable, and that they should terminate Freda's further involvement in management of the company. Marty and Terry ask Chef to "take care of it" as soon as possible.

   The next day, Chef informs Freda that a 75% majority of the Board of Directors has agreed to terminate her employment, "by consent."

   Concluding her relationship with the Board is a waste of time, Freda resolves to move up the coast and start her own fresh fried pickle business in Gorda, but she needs to get her money out of Fabu Four Food Carts, Inc. She offers to sell her shares back to the company, but Chef tells her the shares are worthless, because there is no marketplace for the shares.

   Does Freda have any legal recourse in response to the Board's actions?

5. Pleased with the nationwide success of the corporation's new business model "franchising" the food carts to vendors across the country, but tired of the squabbling, Chef convinces his fellow shareholders to list the Fabu Four Food Carts, Inc. shares for sale to the public on the New York Stock Exchange. Lawyers, accountants and investment bankers prepare the necessary filings and authorizations, and by the end of its first week trading on the public exchange, 30,000 shares of common stock were trading at $50 per share for a total market capitalization exceeding $1.5 Billion.

   With his newfound wealth, Chef decided to purchase a national poultry business. Believing strongly in the potential benefits to Fabu Four Food Carts, Inc. if the company owned its supply of chickens and eggs, Chef offered to sell his poultry business, the largest in California, to the company, fully disclosing his ownership. The Board immediately saw the value in supplying its own ingredients to franchisees pushing Crazy Crepes food carts across America, and voted unanimously to approve the transaction. Chef agreed to a "stock swap" where Fabu Four Food Carts would essentially use its stock to purchase all the outstanding shares of Chef's poultry farm, increasing Chef's shares of the Fabu Four Food Carts outstanding stock from ten percent to twenty percent. On advice of counsel, the Board hired an independent appraiser to value the poultry business. Chef agreed to recuse himself from any discussion or vote regarding the transaction at the Board of Directors meetings, and Chef also agreed to accept the independent appraiser's determination of the value of the poultry farm without further negotiation.

   The Company's Articles of Incorporation require a shareholder vote to approve any merger transaction. Accordingly, the company's attorneys prepared a proxy statement explaining management's proposal to purchase the poultry farm, describing the results of the independent appraisal of the poultry farm's value, and discussing the benefits management expected to achieve by controlling supply of its primary ingredients. The proxy did not mention Chef's ownership of the poultry farm.

   Hedge Foods, a large institutional hedge fund investor that owns 10% of Fabu Four Food Carts, Inc., discovered that Chef owned the poultry farm. Hedge Foods immediately informed management it intended to propose a "short slate" of directors to replace current board members at the next election, currently scheduled to occur within the next six months. Chef called an emergency meeting of the Board, informed the Board of the Hedge Foods threat, and advised the Board to amend the Articles of Incorporation and extend the terms of the Directors for an additional six years, which the By-Laws allowed by unanimous consent. The Directors unanimously voted to amend the Articles of Incorporation and extend their terms.

Does Hedge Foods have legal claims based on the proxy to purchase the poultry farm and the Board's action extending the terms for Directors?

6. Chef is tired of big business. He decides to open a Half Moon Bay hipster coffee hangout, Foggy Coffee & Crepes. He wants the liability shields and tax benefits he has enjoyed in his prior ventures, but without the hassle of having other business associates.

   What form of Business Organization should Chef create for his new business?

1) 16

======== **Start of Answer #1 (989 words)** ========

Sole proprietorship

As the sole owner of Ollie's Omelets and Crazy Crepes, Chef is the owner of a sole proprietorship, which means he is personally liable for 100% of his business's debts. Since Ollie is an employee, and is not a co-owner of the businesses, the arrangement between Chef and Ollie cannot be a partnership.

Agency theory

A sole proprietorship is run on the basis of agency theory, by which a principal (P) may be liable to a third party (3P) on a contract if an agent (A) of P acted on P's behalf with actual, apparently, or inherent authority in forming the contract with the 3P, or if P ratified the contract after learning of the material facts concerning its existence. In this case, since Ollie acted as an employee of Chef's at all times relevant to Farm Fresh Eggs, Ollie may be considered the agent, and Chef is the principal. Because Farm Fresh Eggs did not know that Chef was the owner of the Omelet Cart, or that anyone owned the Omelet Cart besides Ollie, Chef is an undisclosed principal with respect to Farm Fresh Eggs. Farm Fresh Eggs is the third party, and the contract at issue is the supply agreement executed between Ollie and Farm Fresh Eggs for $10,000. Whether or not Farm may recover this $10,000 from Chef as the P depends on Ollie's authority as Chef's A to enter into the contract with Farm. P is liable for any conduct engaged in by A within the scope of A's authority

+10 +1 +1

Actual authority: Actual authority exists between a P and an A when the words and conduct of P lead A to reasonably believe A had authority to act as he did. This is an objective test judged from the point of view of A. The words and conduct of Chef in this case expressly indicated that Ollie did NOT have actual authority to make purchases without Chef's approval. Since Chef did not approve the contract with Farm Fresh

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Eggs, and since Ollie formed the contract without even seeking Chef's approval -- contrary to express indications by Chef in Ollie's employment agreement -- Ollie did not have actual authority to enter into the contract with Farm Fresh Eggs. Since the contract with Farm is outside the scope of Ollie's actual authority, the Crazy Crepes is not bound by the contract under an actual authority theory.

Apparent authority: Apparent authority exists when statements made by P to the 3P (or statements made by A to the 3P with P's approval) would lead a reasonable person in the 3P's position to believe that A acted with P's approval. This test is viewed from the 3P's position, and since it is dependent on statements or approval made by P, there cannot be apparent authority where there is an undisclosed P. As stated above, Chef was an undisclosed P from Farm's point of view, to the point that Farm didn't even know Ollie no longer owned the Omelet Cart. Since Farm viewed Ollie as a principal, and had no idea that Ollie was acting as an agent, Ollie could not have had apparent authority to enter into the contract with Farm, and Crazy Crepes would not by bound by the contract under the apparent authority theory.

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Inherent authority: Inherent authority may bind P to a contract even if P expressly did not approve or forbade the actions of A, if: (1) A's act was incidental to a transaction or was within the scope of ordinary conduct for which A did have authority, and (2) the 3P reasonably believed A had authority to act (i.e.. the 3P was not on notice that A was forbidden by P to act as he did). Chef expressly forbade A from entering into a contract to purchase supplies without Chef's approval. Since Farm didn't even know that Chef existed, much less was the principal, the second prong of inherent authority is met, in that Farm believed it was dealing with Ollie as a principal, which would give him authority to enter into a purchase contract. The issue here is whether Ollie's contract with Farm was within the scope of conduct for which he did have authority from Chef. Making any kind of purchase without notification or approval of Chef certainly isn't within Ollie's scope of authority, as it was expressly forbidden. It does appear that Ollie was authorized to carry on the business of the Omelet Cart in every other way as a principal

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would, since he independently operated the cart in the mornings as if nothing had changed after Chef bought the cart. Farm could argue that since Ollie was authorized to run the Omelet business in other ways independent of Chef's input, entering into a purchase agreement for the primary ingredient of Ollie's product was incidental to the scope of Ollie's authority. Since there is no indication that Farm would have a reason to believe that Ollie's authority was limited to that of an employee rather than of a manager or owner authorized to enter into a purchase agreement, it is likely the court will find Ollie had inherent authority to enter into the contract, in which case Crazy Crepes would be bound to the contract.

excellent

Conclusion: Farm Fresh Eggs can likely recover its $10,000 debt from Crazy Crepes.

P's action against A

Even though Crazy Crepes is liable to Farm, Chef could still recover from Ollie. Since Ollie expressly did not act within the scope of the authority given to him by Chef, Ollie could be liable to Chef for any resulting damages -- in this case the $10,000 Chef will owe to Farm, and Ollie could be required to indemnify Chef for any reasonably costs and expenses incurred by liability resulting from Ollie's actions. Chef may therefore be entitled to recover expenses such as attorney's fees from Ollie for having to defend a case initiated by Farm Fresh Eggs.

+1

======== End of Answer #1 ========

2) (14)

======== **Start of Answer #2 (426 words)** ========

A general partnership is two or more people carrying on as co-owners with equal management and control, and equally sharing profits and losses. There are no formal agreements required for a general partnership to be established. Parties may establish a partnership through conduct. Absent an agreement they share the profits and losses equally. Marty's, Yoshi's, Freda's, and Terry's business had a meeting in which they came up with a plan where they would agree to stations on Venice Beach and would rotate stations during the dat at agreed times. They would compensate for the fact that business could vary throughtout the day at the different stations by combining all their respective revenues each day and dividing the total revenues in equal shares. Per their agreement they all would manage their own food carts. As such it would seem that the parties agreed to equally distribute profits, but management in their own food carts remained with each owner. The group would argue that a partnership was not created because there was nothing that indicated that they were going to share losses equally, and the management and control of each of their own carts remained with the respective owner.

+10 good! +2

If the court fnds that a partnership was formed by the parties conduct then Yoshi may dissasociated from the partnership. Where the parties shares profits (such as in this case) and losses, and agreed to a management scheme (such as stated above) the court will likely find that a partnership was formed. Under UPA once a partner decided to leave the partnership it would normally dissolve the partnership, but under RUPA a partnership may continue if the partners agree to continue the partnership and buy out the dissasociated partner's interest. If a partnership had formed then the partners could agree to continue the partnership, and considering that it was a brilliant system that was generating a lot of profit for them, it is likely that the partners would agree to continue the business. If the partners decided to continue the partnership, they could vote to buy out Yoshi's partnership interest. But in cases where a partner attempts to wrongfully dissasociate and bring forth a claim to dissolve the partnership the court will likely order

+1 +1

the partners to buy out the partner minus any good wil or legal fees that party might incur. Here, the facts state that Yoshi is threatening to dissolve the group's business the court will likely find that it is a wrongful dissolution and order a buy out without any good will or attorney fees included.

======== End of Answer #2 ========

3) (14)

======== **Start of Answer #3 (502 words)** ========

3.

Limited Partnerships

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A limited partnership must contain at least one general partner who manages the business and at least one limited partner who is usually primarily an investor. The limited partner yields the right to equal management and control in turn for being shielded from personal liability for the actions of the partnership. An LP is formed by filing a certificate with the secretary of state stating what the LP is, its address and type of business. Partners need not equally invest in the partnership, as is the case here. The economic interest of each partner is different. C is the operating manager of the business and F, M, and T, as limited partners, cannot be managers.

However, it appears from the facts that at least T continues to operate his cart. No facts are provided to state exactly what his day to day responsibilities are, but he is at least working in the business. If T is merely an employee of the FFFC, then the court is likely to determine that he has not over extended his authority as an LP. If he could be shown to be a manager of the business, then in spite of the fact that he is listed as an LP, the court would view him as a GP with the full liability associated with that role. For example, if T was responsible for purchasing, hiring other employees, bookkeeping, or other management types of duties, he could be found to be a GP. The facts do not give these details.

+1

a.

If T is merely an employee working for FFFC, then he retains his role as LP and only FFFC and C would be liable. If the court finds that he did more than just make Tiramisu, then T could be liable as well. F and M would not be liable unless they too over extended their role into management.

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b.

The whole point of LP law is that the LPs are not liable beyond their investment. If F, M, and T are determined to be LPs, then they are liable to the extend of their 16% equity interest, but nothing further. C is liable first for his 52% interest, but then he is personally liable beyond that.

+.5

c.

In a general partnership, partners are agents for each other and as such, they are liable for each other's actions and to each other. Here, the question is whether or not C, F, and M can sue T for damages caused by T's action. T appears to have two roles -- investor (LP) and employee. Employees are not liable for their actions within the scope of their work. A truck driver who gets into an accident making a delivery is not liable to his employer but his employer is liable to the 3rd party for damages. The same is true here, T, acting within the scope of his work made bad Tiramisu. He is not liable to FFFC but FFFC is liable to the 3rd parties.

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======== End of Answer #3 ========

4) (16)

======== Start of Answer #4 (1494 words) ========

Close corporation

A close corporation is a type of corporation distinguished by its small number of shareholders (less than 35 in CA), the lack of ready market to buy and sell shares in the company, and the tendency of majority shareholders to participate in the direction and governance of the corporation, usually by forming the board of directors. Fabu Four Food Carts, Inc. has only 4 shareholders, and there is no marketplace for the shares as stated by Chef. All four of the shareholders took positions on the board of directors, demonstrating participation in the management and governance of the corporation. Fabu Four Food Carts therefore constitutes a close corporation. +10 good

Because close corporations are smaller and usually family run, they carry heightened duties owed by shareholders that are not present in public corporations, so that close corporations resemble partnerships. Furthermore, the lack of available market on which shareholders could by and sell shares means that minority shareholders are given greater protection than they would otherwise receive in a public corporation. Whereas a shareholder of a public corporation who was treated unfairly or who is unhappy with the governance of the board of directors could decide to end his affiliation with the corporation by selling his shares and receiving whatever compensation he is entitled to based on the market value of the shares, the minority shareholder in a close corporation does not have this option. Often -- as is the case here -- there is NO market for selling shares provided for in the formation of the close corporation. The result is that all shareholders of a close corporation have heightened duties towards each other, and minority shareholders are given greater protections. excellent

Shareholder duties: The duties of the close corporation shareholder include the duty of strict loyalty (i.e.. complete candor, honesty, full disclosure, and no secret self-dealing), good faith, and equal opportunity. The duty of equal opportunity is also a minority

shareholder protection, which provides that any opportunity given to the majority shareholders must also be given to the minority shareholders. Freda could argue that the other board members violated their duty of strict loyalty by gathering together without providing Freda with notice of the meeting (i.e.. did not satisfy full disclosure responsibilities), and by engaging in secret self-dealing to presumably enhance their interests by terminating Freda's employment on the Board without reason.

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The secret meeting among Chef, Marty, and Terry also violated the duty of good faith towards Freda, because it dishonored the oral agreement the four shareholders entered into to draw equal salaries and equally distribute bonuses. Although Freda desired to change the terms of this agreement, she did so by presenting her proposal to the other members in good faith. Instead of meeting her demands with a good faith response, the three other board members decided to hold a secret meeting to terminate Freda's employment completely.

Finally, the secret meeting to terminate Freda's employment violated the duty of equal opportunity. Even if a minority shareholder's participation does not change the end result, the shareholders must still be offered the same opportunity to participate that the majority shareholders are entitled to. As a board member, Freda was entitled to participate in a meeting regarding whether she should be paid a higher salary, or whether she should be terminated from the board completely. The by-laws only require voting by a simple majority, and three out of the four members voted to terminate Freda's position, constituting a simple majority. If Freda had participated in the vote, her vote against termination would not have resulted in a different outcome for her. However, due to the duty of equal opportunity, Freda was still entitled to be present during the meeting that the other shareholders were entitled to be at. Failing to present Freda with this option to participate constitutes a violation of the duty of equal opportunity.

Minority shareholder protections: Aside from the duty of equal opportunity, minority shareholders in a close corporation are also protected from squeeze-out situations

according to the Wilkes test. A squeeze out occurs when, as here, majority shareholders collaborate or use their stronger voting power to the detriment of the minority shareholder, who is unable to influence the decision due to lack of voting power. In this case, the collaboration among Chef, Marty, and Terry indicates that they are essentially a voting block analogous to the power a majority shareholder would have who owned 75% of the corporation. Against this, Freda only has her 25% interest, corresponding to one vote, which is ineffective when any action can be determined by simple majority vote. The decision by the majority block to terminate Freda's position with the board of directors therefore constitutes a squeeze out.

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In a squeeze-out situation, the burden is initially placed on the majority shareholder(s) to show that the action taken was reasonably related to a legitimate interest of the company. Once this prima facie showing is met, the burden shifts to the minority (complaining) shareholder to demonstrate that there were other less harmful alternatives available to accomplishing the same purpose. The only reason given here for the decision by the majority to terminate Freda's board position is that Freda's demands for a higher salary were unreasonable. It is true that Freda did not present any reason to change the shareholders' initial oral agreement to share equally in salary and bonuses, other than that she thought her product was driving the company's success. Without clear indication that this was in fact the case, the other three directors could have concluded that it was not in the best interest of the company to give Freda a higher salary. Terminating someone who is requesting an unreasonable raise could further the company's legitimate interests both of avoiding unnecessary costs, and of creating a governance environment that facilitates reasonable decisions without having to deal with the illegitimate requests of one member.

If this argument is sufficient to meet a prima facie showing under prong 1 of the Wilkes test, the burden would shift to Freda to show the availability of less draconian alternatives. Freda could validly argue that while the company may be legitimately interested in avoiding unnecessary increases in costs, the other members could have chosen to reject her proposal for a raise, to counter with a raise of a more reasonable

amount, or to conduct further fact-finding regarding whether Freda's business was really responsible for an increase in corporate earnings, in which giving her the requested raise might be justified. However, instead of choosing any of these options, the three board members immediately took the most drastic route of terminating Freda's participation on the board completely -- an act which may have in fact harmed the corporation's interests if Freda's pickles were really the basis for increased corporate earnings.

Conclusion: Freda is likely to be successful in showing both that the other board members violated their shareholder duties, and initiated an illegitimate squeeze out. The legal recourse Freda could take in response to these violations is to petition for an involuntary dissolution.

Involuntary dissolution: An involuntary dissolution may be sought for either illegal, fraudulent, or oppressive conduct. There is no indication that the board's actions were either illegal or fraudulent. Oppressive conduct is that which substantially defeats a reasonable shareholder's expectations in contributing capital to the corporation. In this case, the close working relationships of the original 4 board members prior to incorporation, their equal division of shares, participation on the board of directors, and agreement to draw equal salaries and bonuses, could have all cause Freda to reasonably believe that she would be equally included in all decisions regarding governance of the corporation. This would include participating the decision to terminate her. It is likely that Freda would not have contributed an equal amount of capital to the corporation had she been aware that she would ultimately not be afforded an equal opportunity to participate in Board decisions. Freda therefore meets the initial requirements for involuntary dissolution of the close corporation.

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In response, the three remaining board members could oppose dissolution by offering the reasonable alternative of buying out Freda's interest. In that case, Freda and the Board would either agree to fair value in exchange for Freda's 25 shares, or the court

would determine the fair value of the shares as of the end of the business day on which Freda filed her dissolution petition. Although fair value is not the same as fair market value (since there is generally no market for shares held in a close corporation), the Board cannot discount Freda's shares based on the fact that she has a minority interest or due to the lack of marketability of the shares. Should the Board refuse to buy back Freda's shares, as indicated by Chef, then the court will proceed with an involuntary dissolution and the entire corporation will be dissolved, requiring liquidation of all corporate assets and division by each shareholder equally according to their equity interests.

======== End of Answer #4 ========

Q5 16

Does Hedge Foods (HF) have legal claims on: the proxy and the board's action?

The publicly Held Corporation

A publicly held corporation is a corporation that is listed on a stock exchange, and typically has many shareholders and is required to adhere to the strict corporate form. The SEC governs corporations and SEC rule 14 governs proxy voting. The board of directors has a duty to disclose all material facts pertaining to a proxy vote or the election will be tainted, even if it was inadvertant the material fact was undisclosed or even if the matter voted on was actually good for the corporation and the board acted in good faith. +10

The Proxy Statement and Election

A proxy statement must include all "material facts" that a reasonable investor would use to make an informed voting decision. If a proxy statment does not include all material facts, then the election will be tainted.

The board of directors decided to merge with the MC's poultry farm in order to reduce its food costs thus increasing the amount of money the corporation made. The articles of incorporation required that any merger be approved by a proxy vote by the shareholders. The statement included the independant appraisal, and discussed the value of the poultry farm and the benefits to the corporation. However, the proxy statement did not include the fact that the MC, a board member, owned the poultry farm that was being purchased or that there was a stock swap. It does not matter that chef excused himself from the vote or that the valuation of the farm came from an independant appraiser. +2 ✓

engage in a proxy battle only to increase HF's own wealth at the expense of the company.

Most likely, because courts look at the equity of the parties conduct, the court would conclude that MC and the board engaged in self-dealing conduct at the expense of a shareholder who wished to change the corporation's management under a legitimate proxy vote and order the proxy vote. MC and the board would still have the ability to convince the other shareholder's that they were the best vote. +2

Q6

MC should form an LLC 15

A limited liability company is a noncoporate entity that shields the members from liability. An LLC can be formed by one person by filing with the state the "articles of organization" which states the duration and purpose of the LLC, the member, and whether the LLC will be member managed or manager managed.

Furthermore, while the internal governance of an LLC is conditioned upon its "operating agreement," if the LLC has only one member, then that member does not even need to create an operating agreement.

MC would do well to form Half Moon Bay Hipster Coffee and Crepes as an LLC because MC, if MC follows the required corporate form necessary to operate an LLC correctly, MC will be shielded from liability for the LLC's transactions. MC can purchase property for the LLC and pay himself the profits from the LLC, yet he is the only member of the LLC and could dissolve the LLC at any time, thus acquiring the profits.

Since LLC's are a relatively new business organization, LLC's are a creature of

6) 15

======== Start of Answer #6 (696 words) ========

LLC

A limited liability corporation (LLC) is a recent, statutorily created, hybrid form of business organization that combines elements of both partnerships and corporations. Because of this hybrid form, LLC's experience the freedom to organize governance by agreement, as in a partnership, with the limited liability of a corporation. LLC's are formed by filing articles of organization, but are otherwise loosely regulated. Governance consists of a board of managers (who may or may not be members of the LLC), and members. Membership interests can be acquired in exchange for any form of consideration. The LLC's operating agreement may be written or oral, and should provide for the full operations and governance of the LLC. An LLC can consist of only one member, which allows the independence of the sole proprietorship without the personal liability. Solely based on these initial organizational principles, Chef should form his coffee business as an LLC. He can structure its governance as he desires, and he does not need to bring in partners or co-members so that he can retain sole authority to run his business as he pleases. In the event of an incident, Chef will only be personally liable if the plaintiff is able to pierce the veil of the LLC -- otherwise, only the LLC itself will incur liability.

Should Chef decide to bring in other members, he can do so by asking for a capital contribution / buy-in, or he can issue membership in exchange for other forms of consideration such as in exchange for service. That way, Chef could offer membership to someone in exchange for the person's services to the coffeeshop (such as management, serving coffee to customers, etc.). LLC member duties generally include the duty of strict loyalty (candor, honesty, full disclosure, and no secret self-dealing, as required in a partnership), good faith, and entire fairness. The doctrine of entire fairness requires that members negotiate for a fair price, with fair dealing, and offer the right of participation to other members even if their input would not influence a particular

decision. Chef could limit or modify any of these duties by agreement, except for the duty of good faith.

In the event of an involuntary dissolution, the standard is a little higher which could benefit Chef in terms of maintaining the structure of the LLC. Involuntary dissolution is analyzed according to the rule of reasonably impracticability, and will be granted either if management demonstrates unwillingness or inability to act in a way that would be consistent with the purpose for which the LLC was formed, or if continued operation is financially impracticable.

By forming this particular business organization, Chef would avoid all of the problems that troubled him throughout the last five problems. He would not be personally liable in the event of a failed or unauthorized contract, as he was in the first problem when he was the sole proprietor of Crazy Crepes. He would not be subject to a potentially unintentional partnership agreement, as he was in the second problem with the Venice Beach promenade vendors, because an LLC cannot be formed without submitting a statutory filing. Additionally, the higher standard of dissolution would prevent the threat of a buyout that Yoshi tried to levy against the potential partnership. Chef could retain his desire to be the managing member of the LLC without facing the liability that he did in the third problem as the general member of a limited partnership (who is still subject to personal liability). Since Chef would not need to bring in any other members to form an LLC, he would not have to confront requests for higher pay or be required to make a determination to terminate someone in compliance with disclosure duties, as he did in the fourth problem with the close corporation. Again, he also would not face an involuntary dissolution for action that may be determined oppressive, that would force him to buy out a disgruntled shareholder. Finally, Chef could fashion the operating agreement of the LLC to eliminate the strict voting and governance requirements imposed by statute on public corporations, thus avoiding proxy statement and election issues that came up in the fifth problem.

======== End of Answer #6 ========

END OF EXAM