

Business Associations 2009-2010

February 2009

QUESTION 7

On January 2, Widget Corp. (“Widget”) was duly formed and incorporated in accordance with the Texas Business Organizations Code. Beth and Mike were its only officers, directors, and shareholders. On January 2, each was issued a certificate representing 50% of Widget’s shares. Just six months after Widget was incorporated, Beth and Mike decided that they wanted to govern Widget pursuant to a shareholders’ agreement. Widget’s attorney drafted a shareholders’ agreement for Beth’s signature, and Beth signed it in her capacity as Widget’s President. Among other things, the agreement (i) eliminated Widget’s board of directors, (ii) provided that Beth would be Widget’s President, (iii) provided that Beth would manage the corporation, and (iv) provided that the shareholders’ agreement would remain in place for 25 years.

On September 1, Mike sold his shares of Widget to George. Mike handed George the stock certificate Mike had received on January 2. The next day, George was surprised to learn from Beth that Widget was being managed pursuant to a shareholders’ agreement and that he would have no role in managing the corporation because Beth was the sole manager of Widget.

On November 1, George wrote Beth to request that his accountant be allowed to inspect the corporation’s books and records at a time convenient for Beth and the accountant. Beth informed George that she would not comply with his request.

On December 1, George sued Beth, Mike, and Widget seeking: (1) a declaratory judgment that the shareholders’ agreement was not properly adopted, (2) a declaratory judgment that the shareholders’ agreement contains unlawful terms, (3) an order compelling Beth to allow George’s accountant to inspect Widget’s books and records, and (4) rescission of his purchase of shares in Widget.

- 1. Was the shareholders’ agreement properly adopted? Explain fully.**
- 2. Does the shareholders’ agreement contain unlawful terms? Explain fully.**
- 3. Is George entitled to rescission? Explain fully.**
- 4. Is George’s accountant entitled to inspect Widget’s books and records? Explain fully.**

QUESTION 8

In March, Jeannie and Mollie, who both are real estate lawyers, and Herb, a licensed real estate broker, agreed to form a professional limited liability company named “Jeannie, Mollie & Herb Co.” The purpose of the company was for Jeannie and Mollie to provide legal services and for Herb to provide real estate brokerage services. Before the certificate of formation was filed, Herb informed Jeannie and Mollie that he no longer wished to go into business with them.

In May, Jeannie and Mollie filed the certificate of formation with the Texas Secretary of State to form “Jeannie & Mollie, PLLC” (“PLLC”) for the purpose of providing legal services. Jeannie and Mollie agreed that Mollie would be PLLC’s only manager.

In October, in the course of representing Zac, Mollie negligently failed to notice a lien on a piece of real property purchased by Zac. Zac was forced to pay the lien to obtain clear title to the property. Zac sued Jeannie, Mollie, and PLLC for damages arising from Mollie’s negligence.

- 1. Under the Texas Business Organizations Code, could Jeannie, Mollie, and Herb lawfully have formed a professional limited liability company named “Jeannie, Mollie and Herb Co.” as they initially planned to do? Explain fully.**

- 2. What liability, if any, do PLLC, Jeannie, and Mollie have to Zac arising from Mollie’s negligence? Explain fully.**

- 3. If Jeannie and Mollie had formed a limited liability partnership instead of PLLC, what liability, if any, would the partnership, Jeannie, and Mollie have to Zac arising from Mollie’s negligence? Explain fully.**

July 2009

QUESTION 1

Shirt Co. (“Shirt”), a Texas general partnership, was formed by Ethel and Fred. Shirt was formed for the purpose of printing T-shirts bearing funny or satirical messages and selling them via the internet. The day after Shirt was formed, the following property was purchased:

- Ethel, using her own money, purchased a vehicle. Title to the vehicle was issued to “Ethel, Partner, Shirt Co.”
- Fred, using his own money, purchased a T-shirt printing machine. The bill of sale shows “Fred” as the purchaser.
- Fred, using a check drawn on Shirt’s bank account, purchased 1,000 T-shirts from Vendor. The bill of sale shows “Fred” as the purchaser.

The week after Shirt was formed, without Ethel’s knowledge, Fred purchased 500 more T-shirts from Vendor with a check drawn on his personal account. Fred used the printing machine to print these 500 T-shirts with cartoons. Fred intends to sell these 500 T-shirts to customers via the internet and to keep the sales proceeds for himself. Fred did not have sufficient money in his checking account to cover the personal check written to Vendor and the check has been dishonored by Fred’s bank.

- 1. Who owns the vehicle, the printing machine, and the initial 1,000 T-shirts? Explain fully.**
- 2. Has Fred violated any duty to the partnership? Explain fully.**
- 3. Is Shirt liable to Vendor for the 500 T-shirts purchased by Fred using his personal check? Explain fully.**

QUESTION 2

Widget, Inc. (“Widget”) is a Texas corporation incorporated in 2006. Ten thousand (10,000) shares of Widget stock were initially authorized.

Elvis owns 500 shares of Widget stock. A number of other shareholders together own a total of 4,500 shares of Widget stock. The remaining 5,000 shares were never issued. On January 2, 2009, Widget’s Board of Directors notified all of its shareholders of its intent to: (1) give 1,000 shares of the unissued stock to Widget’s president, Veronica, as compensation, (2) give 1,000 shares of the unissued stock to Supplier in exchange for equipment, and (3) sell 3,000 shares of unissued stock to the general public. On January 4, 2009, Elvis informed Widget’s treasurer over the telephone that he did not intend to exercise a preemptive right as to the shares being issued. A week later, Elvis wrote Widget’s treasurer, stating, “I know I told you over the phone that I did not want to exercise my preemptive right. I’ve changed my mind and now want to exercise a preemptive right to purchase all of the shares of the unissued stock that I am entitled to purchase.”

On July 20, 2009, Elvis received a notice that Widget’s Board of Directors approved a plan to merge Widget into another corporation and is recommending that the shareholders approve the merger. Widgets’ shareholders received timely and proper notice under the Texas Business Organizations Code (“TBOC”) of the special shareholders’ meeting to be held for the purpose of voting on the proposed merger. Elvis is unhappy about the proposed merger, but he knows from talking with the other shareholders that it will be approved. Elvis wishes to relinquish his shares in Widget and to be paid for them.

- 1. What must Elvis show to establish that he has a preemptive right to purchase any of Widget’s unissued shares? Explain fully.**
- 2. If Elvis establishes a preemptive right, how many shares would he have the right to purchase? Explain fully.**
- 3. Can Elvis require Widget to pay him for his shares, and, if so, what statutorily required steps must he take to perfect that right? Explain fully.**

February 2010

QUESTION 7

Construction Corp. (“Construction”), a Texas corporation, was duly formed in March 2006 and is in the business of constructing commercial buildings. Ralph is a Construction shareholder, but not an officer or employee. Steve is Construction’s president.

Tim owns a number of retail stores. Tim and Ralph are friends and Tim is aware that Ralph is a Construction shareholder. In February 2008, Tim asked Ralph if Construction was interested in building Tim’s newest store in Texas. Tim told Ralph that he (Tim) wished to avoid problems that could arise due to a contractor failing to pay for materials and supplies. Tim asked Ralph if Construction was “financially capable” of undertaking the project. Ralph answered that he believed Construction was financially sound and told Tim to call Steve for further information.

Tim called Steve and told Steve that, in order to determine if Construction was financially sound, he (Tim) would like to see a copy of Construction’s current financial statement. Steve faxed Tim financial statements indicating that all of Construction’s accounts payable were current (which was not true) and that made it appear that Construction had conducted profitable operations in 2007 (which was not true). Steve knew the financial statements were incorrect, but believed that Construction could pay its debt and return to profitability if it could obtain the lucrative contract with Tim.

Tim contracted with Construction to build his new store and agreed to make regular payments to Construction for its work. On several occasions while work was on-going, Steve used funds received from Tim to pay his own salary and some personal expenses, rather than paying suppliers. About half-way through the work, a company from which Construction was leasing equipment repossessed all of Construction’s equipment because Construction had not made the lease payments. The repossession of its equipment made it impossible for Construction to complete the job. Tim was forced to hire another company to complete the job, at substantial additional cost. Tim sued Ralph and Steve for fraud.

- 1. Is Ralph liable to Tim? Explain fully.**
- 2. Is Steve liable to Tim? Explain fully.**

QUESTION 8

In January 2010, Pam, Beth, and Jane formed a Texas general partnership to open a retail store to sell Valentine's Day gifts. The written partnership agreement provides that: (1) the three partners will share profits and losses equally; (2) the partnership will borrow \$20,000 from Investor to purchase fixtures for the store; (3) each partner will deposit \$10,000 into the partnership account to purchase inventory for the store; and (4) the store will close and the partnership will dissolve on February 28, 2010.

After the partnership agreement was signed, the partnership borrowed \$20,000 from Investor and used it to purchase fixtures for the store, as agreed. Each partner also made her required contribution, and the partnership used that \$30,000 to purchase the initial inventory. Before opening the store, the partnership incurred an additional \$7,000 debt to Donna Designer ("Donna") for her help in decorating the store.

Additionally, in January 2010, Pam used \$3,000 of her own money to pay store expenses, which the partners all agreed would be repaid to Pam.

Sales at the store were slow. Although Valentine's Day has passed, the store still has a substantial amount of inventory valued at \$5,000, and fixtures valued at \$10,000. The store has not made a profit and does not have any money in its bank account. Donna and Investor both are demanding that they be paid the money they are owed. Beth does not have any more money to put into the partnership, but she believes the partnership can eventually turn a profit and pay its debts if it remains in existence. Pam and Jane have funds they could make available to the partnership but are not as optimistic as Beth about achieving profitability by continuing in business. The partners will meet tomorrow to discuss their options.

- 1. Can the partners avoid dissolving the partnership on February 28, 2010? Explain fully.**

- 2. Assuming the partnership will be dissolved and wound up, (a) what steps must the partners take to wind up the partnership, and (b) what are the rights and obligations of the partners toward the creditors and each other in disposing of the assets and satisfying the partnership's liabilities? Explain fully.**

July 2010

QUESTION 5

Beth and Mike want to go into business together making and selling cupcakes and other desserts.

They want to name their company “The Best Cupcakes.” They will have retail stores in Dallas and Collin counties, Texas, with the store in Dallas county being their principal store.

They are trying to decide whether to form a general partnership, a limited liability partnership, or a limited liability company, and they seek advice on the relative advantages and disadvantages of doing business under one or the other of these forms of entity.

- 1. What are the advantages and disadvantages of forming their business as a partnership, as a limited liability partnership, or as a limited liability company? Explain fully.**

- 2. What are the steps required for Beth and Mike to create and lawfully commence “The Best Cupcakes” as a general partnership, a limited liability partnership, or a limited liability company? Explain fully.**

QUESTION 6

Walt and Kate designed an innovative software program they wanted to sell to the general public. They duly formed WK Solutions, Inc. (“WK”), and after a period of great success, they sold shares of stock in WK to the general public. Walt, Kate, and three other people who were instrumental in WK’s success served on WK’s board of directors.

A few months after WK’s initial public offering, Pirate Software Co. (“Pirate”) began selling a software program that was identical to WK’s innovative software program. WK’s board of directors considered suing Pirate for copyright infringement, but decided that WK’s money would be better spent purchasing advertising to compete against Pirate rather than paying lawyer fees to sue Pirate. After reading in the newspaper about Pirate’s infringement and WK’s decision not to sue Pirate, Rick purchased 1000 shares of WK stock and, the next day, filed a derivative action against Pirate for infringement of WK’s copyright.

In the meantime, completely independent of their relationship to WK, Walt and Kate developed a digital information storage device they believed they could market successfully. In order to limit ownership to themselves, they want to consider forming a close corporation.

- 1. What is a derivative action and upon what grounds, if any, may the board of directors of WK have the-suit dismissed? Explain fully.**

- 2. What steps must Walt and Kate take to form a close corporation, what information must they furnish in the process, and, in light of their desire to limit ownership to themselves, what are the benefits of a close corporation over an ordinary corporation? Explain fully.**