

Business Organizations

Final Examination

Spring 2022

Professor P. Stirling

Instructions:

There are 2 questions in the examination.

You will be given 3 hours to complete the examination.

Business Organizations
Spring 2022
Professor: P. Stirling

QUESTION 1

Alfred, Beth, and Charles orally agreed to start ABC Computers (“ABC”), a business to manufacture and sell computers. Alfred contributed \$100,000 to ABC, stating to Beth and Charles that he wanted to limit his personal liability to that amount. Beth, who had technical expertise, contributed \$50,000 to ABC. Charles contributed no money to ABC but agreed to act as salesperson. Alfred, Beth, and Charles agreed that Beth would be responsible for designing the computers, and that Charles alone would handle all computer sales.

ABC opened and quickly became successful, primarily due to Charles’ effective sales techniques. Subsequently, without the knowledge or consent of Alfred or Charles, Beth entered into a written sales contract in ABC’s name with Deco, Inc. (“Deco”) to sell computers manufactured by ABC at a price that was extremely favorable to Deco. Beth’s sister owned Deco. When Alfred and Charles became aware of the contract, they contacted Deco and informed it that Beth had no authority to enter into sales contracts, and that ABC could not profitably sell computers at the price agreed to by Beth. ABC refused to deliver the computers, and Deco sued ABC for breach of contract.

Thereafter, Alfred became concerned about how Beth and Charles were managing ABC. He contacted Zeta, Inc. (“Zeta”), ABC’s components supplier. He told Zeta’s president, “Don’t allow Charles to order components; he’s not our technical person. That’s Beth’s job.” Charles later placed an order for several expensive components with Zeta. ABC refused to pay for the components, and Zeta sued ABC for breach of contract. Not long afterwards, ABC went out of business, owing its creditors over \$500,000.

1. How should ABC’s debt be allocated? Discuss.
2. Is Deco likely to succeed in its lawsuit against ABC? Discuss.
3. Is Zeta likely to succeed in its lawsuit against ABC? Discuss

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QUESTION 2

Acme Inc. is a corporation that has been profitable for several years and now holds \$20 million cash on its balance sheet. Acme's board of directors consists of Brown (Acme's Chief Executive Officer), Chase (Acme's Chief Financial Officer), and ten other non-employee ("outside") directors. Acme's board of directors recently met to consider the best course of action with regard to the cash on its balance sheet. At this meeting, Brown and Chase strongly recommended that Acme use the cash to pay a dividend to its shareholders. The board then heard a report from an outside consulting firm regarding the favorable prospects for Acme's expansion into a new line of business. After a lengthy discussion, the ten outside directors voted in favor of a resolution not to declare a dividend and instead to hold the accumulated cash for the corporation's future use. Brown and Chase voted against this resolution. The entire board of directors also voted unanimously to make a \$100,000 cash contribution to a private university.

Brown is a graduate of this university and a member of its board of trustees. The other Acme board members knew these facts at the time the board unanimously authorized the contribution. One of Acme's many shareholders, Davis, is upset about the board's decision not to declare a dividend. He sent a letter to Acme's board demanding inspection of Acme's records relating to this decision.

Another Acme shareholder, Evan, filed a lawsuit against Acme and its board seeking orders that Acme pay a dividend to its shareholders and be enjoined from contributing \$100,000 to the university.

1. Did Acme's outside directors possess the authority to reject Brown's and Chase's recommendation to pay a dividend from cash on the balance sheet? Discuss.
2. Does Davis have a right to inspect Acme's records relating to the board meeting described above? Discuss.
3. Is Evan likely to prevail in his suit for an order that the corporation pay a dividend? Discuss.
4. Is Evan likely to prevail in his suit to enjoin Acme from paying \$100,000 to the private university? Discuss.

Business Organizations
Spring 2022
Professors Lyons & Stirling

ANSWER 1 (OUTLINE)

20% Organization (Similar headings – boldfaced below)

20% Issue (Spot all issues)

20% Rules (Name all rules – underlined 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 Organization
2. Corporations require formal articles of organization so ABC is a partnership
3. Partnerships are business for profit and if no agreement, profits are split

1. How should ABC's Debt be Allocated?

1. Just like profits, without agreement, debts are split equally.
2. A wanted to limit his liability. However, absent a formal agreement, A is going to be considered a general partner.
 - a. Also A has active management (general managerial position, apparent equal voting rights), A was the one to call Zeta (Z) and tell them not to accept orders from C.
 - b. Limited partners, those with limited liability, generally have no managerial functions.
 - c. Under agency law, any contract or tortious action entered into in the scope of the partnership is deemed to be partnership debt, and all partners are jointly and severally liable.
3. Therefore, any contracts that were properly entered into and authorized by a partner having authority are partnership debts that A, B and C will be jointly and severally liable for as individuals.
4. *Therefore, the order of payment is: (1) all debt creditors, (2) all capital contributions from each partner, which would be \$100,000 to A and \$50,000 to B and zero to C since*

partners generally have no right to salary or compensation for services; (3) any remaining profits equally to A, B, C.

2. Is Deco likely to Succeed in its Lawsuit against ABC?

1. Validity of the Agreement: Deco (D) must show that B was authorized to enter the contract.
 - a. All partners are authorized agents of the partnership but the nature of authority may vary.
 - b. Express authority exists when the arrangement expressly states what an agent may do, but sales were expressly reserved to C so B doesn't have express authorities.
 - c. Implied authority exists when the function is 1) necessary to carry out other responsibilities, 2) one that has been done in the past dealings without objection, or 3) normal custom for someone with the position of the agent. Sales are not necessary to B's technical design responsibilities, and she has never sold before.
 - d. Apparent authority exists when the company cloaks the agent with authority to do certain things and later withdraws or limits that authority without notifying a customer who is still relying on that authority. In this case, there is no indication that ABC held B out to be a sales representative in the first instance. There was likely no good basis that D had to rely on any authority from ABC. However, given that B herself is a managing partner, D likely could argue that B's actions were sufficient to show that the corporation had given her authority to act. As such, they will argue that it was reasonable to rely on this without any other notice. This would bind ABC.
2. ***Failing to perform on the contract is a breach of duty and the partnership, as well as the individual partners, will be obligated to pay as described above.***
3. Breach of Duty of Good Faith and Loyalty
 - a. Partners have fiduciary duties to each other that are described as the utmost duty of good faith and loyalty.
 - b. Duty of Loyalty means a partner must not engage in self-dealing, usurping business opportunities, or competing against the company. In this instance, B engaged in a transaction with her sister who owned D. The terms were apparently very favorable to D. This could be viewed as self-dealing because it promoted B's familial interest with her sister and was not in the best interest of the company.
 - c. Duty of Good Faith requires that partners act in a way that solely benefits and is advantageous to the partnership. Again, B's deal with D didn't garner the profits that it should have. Furthermore, this duty requires disclosure of conflicts of interest to the other non-interested partners so that they can either cleanse the transaction through ratification or disapprove it. There is no indication that B informed her partners. The other partners have a very strong argument to bring a claim against B for these breaches in duty.

4. *Therefore, the entire liability for the breached contract would be on B, which would deviate from the normal liability scheme described above, and D could only succeed against B.*

3. Is Zeta likely to Succeed in its Lawsuit against ABC?

1. Validity of the Agreement

- a. Zeta's (Z) claim on this contract again hinges on the authority of C to enter into it. In this instance, C has the express authority to enter into sales contracts. However, this contract was for components being purchased by C, which is outside his express authority.
- b. Implied authority: Z may argue that components are necessary to production and later sales, which gives C implied authority to enter into contracts. Plus, it is reasonable to assume that a partner who can sell can also buy. This reasonable assumption lends credence to a claim of apparent authority.
- c. Apparent authority: Z will argue that ABC has held C out as a person whose sole responsibility is to contract, and it reasonably relied on that representation. Z will argue, therefore, that any resulting contract liability would be distributed among the partnership and A, B and C.

2. Actual notice to Z of Lack of C's authority

- a. Z's main issue is that A called and gave actual notice that C could not enter into this contract. This would destroy any reasonable reliance that Z had. A told Z that B was the technical person, not C. As such, Z should have seen that his was outside the scope of C's authority. But C is still a general partner in the company.
- b. Z could rightly assume that one partner doesn't have the sole authority to terminate the management authority of another partner. Management functions are only transferable and alterable upon a unanimous vote of the partnership. A alone tried to limit what C could do. Z may argue that it knew this wasn't a proper action by A and more reasonably relied on C.
- c. ABC will argue that Z at least should have investigated further once given notice that C may not have authority and failure to follow through made their reliance on his apparent authority unreasonable. ABC will argue that this contract is invalid and will not bind ABC for this persuasive reason.

3. Effect of A's Notice on C's Duties

- a. A might also claim that C's activities outside his scope of duty were not in good faith.
- b. The argument is that acting in an area in which C knows nothing about shows a lack of obedience to his agency limits and lack of good faith in honoring partnership agreements on authority.
- c. But A didn't act with the consent of B. As such, there is no indication that the majority of management is at odds with C's decision to enter the contract. This appears to be solely the reservation of A with B and C.

- d. In the end, there was likely no breach of duty and any potential liability from this contract would flow to all, not just C.*

ANSWER 2 (OUTLINE)

20% Organization (Similar headings – boldfaced below)

20% Issue (Spot all issues)

20% Rules (Name all rules – underlined below)

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

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

Introduction

1. A corporation is an entity distinct from its owners, the shareholders.
2. A corporation can sue or be sued.
3. Acme Inc. is a corporation and can sue and be sued.

1. Did Acme’s outside directors possess the authority to reject Brown’s and Chase’s recommendation to pay a dividend from cash on the balance sheet? Discuss.

1. The board of directors in a corporation manages the internal affairs of the corporation.
 - a. To make decisions, the board must either call a meeting with the required quorum and vote on the matter, decide using unanimous written consent, or they must ratify the matter after the fact with proper board approval.
 - b. A board meeting either occurs annually, at which the time and place and date are set out in the articles or bylaws, or through a special meeting, which requires at least two days’ notice stating the time, date, and place of the meeting (or in accordance with bylaws). It is unclear whether this was an annual meeting or a special meeting, but assuming that the proper notice was given if it was a special meeting, the next issue is whether the decision was properly voted on.
 - c. A director can be an officer or shareholder, but they are not required to be.

2. Acme's board of directors recently met to consider what to do with their cash on their balance sheet. For the board to make a valid decision, there must be a quorum.
 - a. Unless the bylaws state otherwise, a quorum is a majority of the directors on the board. Here, there are twelve directors, including Brown and Chase. All of the directors were present at the meeting, and thus had a proper quorum.
 - b. For a proper vote, there must be a majority of the quorum voting in favor of the decision. Brown and Chase recommended that Acme pay a dividend to its shareholders, however, ten of the outside directors voted in favor of a resolution to not declare a dividend and instead hold the cash for the corporation's future use. This vote was ten out of twelve directors, and thus was a proper board approval. Therefore, this decision by the outside directors was proper. The fact that they were outside directors does not affect their ability to vote.
3. The decision as to whether or not to declare a dividend is in the complete discretion of the board, subject to limitation rules pertaining to the corporation's solvency.
 - a. A dividend is a distribution that is given to shareholders who have rights to dividends. The board may not permit a dividend distribution if either the corporation would not be able to pay their debts as they come due, or if the corporation's assets are lower than their liabilities and equity, including the preference payment required to be given to preferred shares upon dissolution.
 - b. Here, the board decided not to distribute dividends and thus the limitation rules do not apply. The decision not to distribute dividends was in the board's sole discretion, absent an abuse of discretion.
4. ***Therefore, the decision was proper and the directors possessed the authority to reject Brown and Chase's recommendation to pay a dividend from cash on the balance sheet. Although Acme had \$20 million on its balance sheet, the board was not required to distribute a dividend.***

2. Does Davis have a right to inspect Acme's records relating to the board meeting described above? Discuss.

1. Right to Inspect
 - a. A shareholder has an unqualified right to inspect the corporation's books and records in regard to the bylaws and articles, the communications that the board has made to the shareholders in the last three years, the annual report that the corporation files in the last three years, the minutes at shareholder meetings, and other ordinary records pertaining to their rights as a shareholder.
 - b. A shareholder, with five days written notice, may request to inspect other books and records relating to the finances and other records of the corporation upon a showing of a proper purpose. This proper purpose must be related to their rights and duties as a shareholder. Typically, after showing a proper purpose, the board should approve the request. Either the shareholder may inspect the records or have an attorney inspect the records for them.

2. Types of Records

a. Board minutes

- i. As described above, board minutes from the meeting likely relate to Davis' rights as a shareholder.
- ii. Having minutes from the board meeting where the board decided to not declare a dividend can be offered as proof that the directors possibly violated their duties as directors.

b. Other records related to board meeting

- i. A shareholder has a right to bring a derivative suit on behalf of the corporation if they satisfy the required procedures and the court finds that the suit should go forward.
- ii. But shareholders do not have a right to demand a dividend distribution. Therefore, if Davis is simply upset about the dividend distribution, then getting additional records, beyond the minutes, may not relate to his rights as a shareholder.

3. *Therefore, if Davis does in fact show a proper purpose (abuse of discretion or violation of fiduciary duties), then he must make a written demand to the board with five days' notice, and could have the right to all records relating to the board meeting, but at the least, has rights to the board meeting minutes.*

3. Is Evan likely to prevail in his suit for an order that the corporation pay a dividend? Discuss.

1. A shareholder may sue a corporation either in a direct action in order to obtain judgment personally or a derivative suit in which the shareholder sues to vindicate a claim on behalf of the corporation.

2. Direct Action

- a. Evan would be suing in a direct action because he is suing on behalf of his right to receive a dividend.
- b. But the decision as to whether or not to declare a dividend is in the complete discretion of the board, subject to limitation rules pertaining to the corporation's solvency.
- c. The board may not permit a dividend distribution if either 1) the corporation would not be able to pay their debts as they come due, or if 2) the corporation's assets are lower than their liabilities and equity, including the preference payment required to be given to preferred shares upon dissolution.
- d. Here, Acme Inc.'s cash on its balance sheet amounts to \$20 million so Acme Inc. likely would be able to distribute a cash dividend to its shareholders. However, as described, this decision is within the board's discretion and the board decided to not make distributions. Therefore, Evan would likely fail in his suit against the corporation for not making a distribution.

3. Derivative Action: In a derivative suit, the corporation collects the judgment.

- a. Shareholder: To file a derivative action, the shareholder must be a shareholder at the time of commencement of the suit, and a shareholder at the time of the alleged wrongful conduct or a shareholder by operation of law. Here, Evan is currently a shareholder. Further, it appears that Evan was a shareholder when the decision was made to not distribute dividends. Therefore, standing is satisfied.
 - b. Notice Requirements: A shareholder must make a written demand on the board to bring suit on behalf of the corporation. The shareholder must then wait 90 days before bringing the suit unless the shareholder can show that the corporation will suffer irreparable injury or the board has already objected to bringing suit.
 - c. Duty of Care: Evan may assert in a derivative action that the directors violated their duty of care in making the decision to not distribute dividends. Each director has a duty of care to act in good faith, act as a reasonably prudent person would under the circumstances, and act in a manner that a reasonable director would believe is in the best interest of the corporation. Where there is no indication that there is a lack of good faith or self-dealing or conflicts of interest, the burden is on the shareholder to prove that this duty was breached.
 - d. Business judgment rule: The board made a reasonable inquiry into the facts related to making the decision to not distribute the funds, there was no bad faith or conflict of interest, or self-dealing. Under the BJR, the burden was on Evan to prove the duty of care standard was breached. He likely cannot prove that it was breached, especially because the decision to declare a dividend is in the board's discretion. The ten outside directors could reasonably rely on this outside consulting firm in making the reasonable decision that the corporation should instead hold the accumulated cash for the corporation's future use, including expanding to a new line of business. Further, it states that there was a lengthy discussion before the directors decided to not vote in favor of the distribution which indicates reasonable diligence in their decision-making procedures.
4. ***Therefore, Evan's suit will likely not succeed against the board for the dividend decision.***

4. Is Evan likely to prevail in his suit to enjoin Acme from paying \$100,000 to the private university? Discuss.

1. Derivative action: Evan would be bringing the suit on behalf of the corporation due to the directors' breach of their fiduciary duty. The board makes the managerial decisions as to the internal affairs of the corporation. Therefore, this decision was solely in the board's discretion and Evan does not have a personal direct suit against Acme Inc. The derivative action would be for the benefit of the corporation.
2. Duty of Loyalty: Evan may assert that the board breached its duty of loyalty to the corporation when it decided to give a cash contribution to a private University that Brown graduated from and is a member of the board of trustees. Each director of the board owes a duty of loyalty to the corporation to act in the corporation's best interests.

- a. A breach of the duty of loyalty may occur where a director engages in self-dealing.
 - b. Self-dealing occurs where the corporation enters into a transaction where a person or entity on the other side of the transaction is a director, or a director's family member, someone the director has a personal or professional relationship with or an organization in which the director is a director, shareholder, or officer.
 - c. Here, the private university that Acme gave the money to was a university in which Brown graduated and is a member of the board of trustees. Therefore, there may be a duty of loyalty violation.
 - d. Where there is a self-dealing transaction, the director that is interested, here Brown, may satisfy his duty of loyalty by disclosing all material facts fully and adequately to the board and the board votes in a proper board vote to engage in the transaction. The quorum required for the board vote excludes any interested directors and there must be a proper vote based on disinterested directors. In the alternative, the interested director may fully and adequately disclose the information to the shareholders who must conduct a proper vote with the disinterested shareholders voting in favor of the transaction with more votes in favor than against.
 - e. Acme board members knew of these facts at the time that the board unanimously authorized the contribution. Therefore, Brown may have fully and adequately disclosed his interests in the contribution before the board voted. However, Brown was not permitted to vote in the transaction because he was an interested director. However, without Brown counted in the quorum or in the vote, the quorum would have been 11 out of 12 directors for a proper quorum - more than the majority. Further, the vote required would be a majority of the disinterested directors. Here, all 11 of the disinterested directors voted in favor of the contribution. Therefore, there is an adequate vote in favor of the transaction.
 - f. Therefore, if the fact that Brown actually voted in the transaction does not defeat the validity of the vote, the contribution was validly approved. Further, Brown did not violate his duty of loyalty to the corporation because Brown disclosed the facts of his interest and board voted with the proper amount of disinterested votes. Further, the terms appear fair to the corporation.
 - g. Therefore, Evan likely will not prevail in a suit against the Acme directors for paying \$100,000 to the private university.
3. Duty of Care
- a. Evan may also assert a derivative action on behalf of the corporation alleging that the directors violated their fiduciary duty of care to the corporation in giving the distribution to the university.
 - b. But there is no indication that there was a lack of good faith on behalf of the board of directors.

- c. It appears reasonable to give \$100,000 to the university under the circumstances as it is a small amount compared to the \$20 million that Acme has on its balance sheet.
 - d. All of the directors voted unanimously which indicates that a director would reasonably believe that this decision was in the best interests of the corporation.
 - e. Therefore, the duty of care was likely not breached.
4. Improper Distribution
- a. Evan may also assert that the \$100,000 contribution was an improper distribution due to the solvency standards described above.
 - b. However, as indicated, \$100,000 out of \$20 million cash on the balance sheet does not appear to be enough money that would make the corporation unable to pay its debts as they come due.
 - c. Further, it likely will not make it so the corporation's liabilities outweigh its assets, including the preferences required upon dissolution.
 - d. Therefore, Evan likely will not succeed in asserting that the distribution to the corporation was an improper distribution.
5. ***Therefore, Evan is unlikely to succeed in enjoining Acme from making this contribution.***

CONSTITUTIONAL LAW
FINAL EXAMINATION
Spring 2022

VICTORIA MIRANDA
BILL SCHRIER
Hon. JOHN SOMERS
MICHELLE A. WELSH
Hon. DAVID ZULFA

EXAM INSTRUCTIONS

You will have three hours to complete this exam. There are two essay questions to be answered in Questions 1 and 2; Question 3 consists of two short answer questions and 15 Multistate Bar Exam-type (MBE) questions. Each question will count for 1/3 of your exam grade.

Unless expressly stated, assume that there are no Federal or State statutes on the subjects addressed.

Your answer should demonstrate your ability to analyze the facts in the question, to tell the difference between material facts and immaterial facts, and to discern the points of law and fact upon which the case turns. Your answer should show that you know and understand the pertinent principles and theories of law, their qualifications and limitations, and their relationships to each other.

Your answer should evidence your ability to apply the law to the given facts and to reason in a logical, lawyer-like manner from the premises you adopt to a sound conclusion. Do not merely show that you remember legal principles. Instead, try to demonstrate your proficiency in using and applying them.

If your answer contains only a statement of your conclusions, you will receive little credit. State fully the reasons that support your conclusions, and discuss all points thoroughly.

Your answer should be complete, but you should not volunteer information or discuss legal doctrines that are not pertinent to the solution of the problem.

Question No. 1

The Suncity Council amended its nuisance abatement ordinance to declare that overnight sleeping or camping in a City park is a nuisance subject to abatement by the City. The ordinance also authorized City employees to designate a restricted area to create a zone around any public property where an abatement is taking place. No person is authorized to enter the restricted area without authorization from a City employee at the site, and unlawful entry is punishable as a criminal misdemeanor.

Suncity Employees set up a 100 foot “restricted Zone” in a City Park around a wooded area that was used as an encampment by homeless people. The Employees proceeded to remove the encampment as an abatement of a nuisance authorized under the City’s ordinance.

Anna, a local advocate for unhoused people, organized a protest at the site, but Police prevented her from entering the “restricted zone” surrounding the camp and from accessing or contacting any of its residents. Also, Anna could not view the City’s abatement activity from outside of the restricted zone, nor could the people on site see her, because of the distance and the woods surrounding the Camp. Anna asked a City Employees at the site for permission to enter and speak with those in the camp, including Ben, a camp resident who she knew from prior visits; the permit was denied. Anna brought a lawsuit against Suncity alleging that the Ordinance is unconstitutional on its face for violating her rights to free speech and association under the First Amendment.

Ben, a resident of the encampment, refused to leave and remained in his tent in the Camp. Police were called and arrested Ben. He was charged with a misdemeanor for violating the City’s ordinance by being inside a restricted abatement zone.

The court determined that both Anna and Ben have standing, so standing need not be addressed.

1. Analyze the Constitutional issues that Anna will raise in her lawsuit, and Suncity’s response. State how the Court will rule.
2. Analyze the Constitutional issues Ben will raise in defense in his criminal prosecution and District Attorney’s response. State how the Court will rule.

Question No. 2

The City of Columbia designated its City Hall Flag Poles as one of several “public forums” for all applicants” and encourages private groups to hold flag raising events “to foster diversity and build and strengthen connections among Columbia’s many communities.” Over the course of twelve years, the City approved 284 such flag raisings by private organizations, with zero denials. Approved flag raisings include ethnic and other cultural celebrations, commemoration of independence or other historic events in other countries and the celebration of certain causes such as “gay pride.”

Camp Constitution is a Christian civic organization. The organization’s mission is to enhance understanding of the country’s Judeo-Christian heritage, the American heritage of courage and ingenuity, and the genius of the United States Constitution. Camp Constitution applied to the City’s Property Management Department to raise its flag to commemorate the historical and social contributions of the Christian community in connection with observance of Constitution Day and Citizenship Day. The City denied the request expressly because Camp Constitution’s proposed flag was called “Christian” on the application form, but other than the Latin cross on the flag itself, there is nothing to identify the flag as a “Christian” flag. The City stated that the application was declined because it was a religious flag and the City has a past practice of refraining from flying non-secular flags on the City Hall property.

The City’s Flag Raising Policy states “At no time will the City of Columbia display flags deemed to be inappropriate or offensive in nature or those supporting discrimination, prejudice, or religious movements. A determination to be made at the Commissioner’s discretion and there are no separate guidelines or criteria for the Commissioner to use to make any such determination.”

Camp Constitution sued the City for preliminary and permanent injunctive relief, declaratory relief and damages on the grounds that the City’s denial of Camp Constitution’s flag raising request violated their First Amendment rights under the Constitution.

What arguments will Camp Constitution raise in support of their claim?
What will the Court decide?

Question No. 3

Please write a short answer to questions A and B. Each question is worth 25 points.

A. A State enacted a statute authorizing only non-profit agencies to advertise on programs televised on the community access cable channel. The statute was challenged as unconstitutional by a local for-profit home care agency which televised a weekly program on home healthcare alternatives which included advocating hiring home health aides from its agency. What arguments will be made by the parties and how will the court rule?

B. The legislature of State X passes a law to improve declining student test scores and standardize curricula for K-12 students. The law provides that all students must receive an “acceptable” primary and secondary education, and sets standards for that curriculum for all students. The law provides that parents may homeschool their children or enroll them in private school, but that to do so they must demonstrate to the County Superintendent of Schools Office curriculum director that the education to be provided meets the state’s criteria. If it does not do so, the director may deny their application to homeschool or enroll their children in private school, and require them to be enrolled in public school. The director’s decision is final and not subject to any review.

Several parents whose applications to enroll their children in private school have been denied sue the curriculum director, asking the court to overturn the decision and allow them to enroll their children in private schools. What constitutional issues will they likely raise in their lawsuit, and how do you believe the court should rule? Briefly discuss.

C. Please answer the 15 Multistate Bar Exam (MBE) embedded in Exemplify. Read each question carefully and choose the best answer even though more than one answer may be “correct”. Review your answers for accuracy before you finish.

Answer Outline Constitutional Law

Spring 2022

M.Welsh/D. Zulfa/ B. Schrier

Question 1:

Question 1 addresses freedom of speech issues in a public forum (arguably content based and directed at speech, requiring strict scrutiny, and if it is content neutral, arguably not reasonable time, place and manner regulations) as well as a "buffer zone" issue, and denial of public access to view government activity, plus the denial of a permit for access under the ordinance which gives total discretion to a City employee at the site to grant or deny permits. Also, freedom of association issues are raised by denying public access to residents of the homeless encampment (and vice versa) and denying protesters' rights to associate to effectively express their views inside the zone. The homeless party, Ben, also raises the possible collateral bar rule for violating the ordinance rather than challenging it first, which could prevent his raising free speech and association violations as a defense; but the ordinance is arguably overbroad and vague on its face and violation may not be a bar. He may also raise due process issue by having to leave the area without notice or a hearing (but that is really a first semester subject, so will be just for extra credit). Let me know if you think edits are needed for clarity or substantively.

Question 2 but it addresses freedom of speech issues in a public forum (arguably content based and directed at speech, requiring strict scrutiny, and if it is content neutral, arguably not reasonable time, place and manner regulations) as well as a "buffer zone" issue, and denial of public access to view police activity, plus the denial of a permit for access under the ordinance which gives total discretion to a City employee at the site to grant or deny permits. Also, freedom of association issues are raised by denying public access to residents of the homeless encampment (and vice versa) and denying protesters' rights to associate to effectively express their views inside the zone. The homeless party, Ben, also raises the possible collateral bar rule for violating the ordinance rather than challenging it first, which could prevent his raising free speech and association violations as a defense; but the ordinance is arguably overbroad and vague on its face and violation may not be a bar. He may also raise due process issue by having to leave the area without notice or a hearing (but that is really a first semester subject, so maybe just for extra credit).

1)

1. How should ABC's debt be allocated?

First, it must be determined how the nature of this organization between Alfred, Beth and Charles was created. The facts state that there were no formal written agreements between the three parties. Corporations require that articles of incorporations must be filed with the state. Since that facts do indicate that this was the case, it is likely that a general partnership existed. A partnership exist when two or more people agree to run a business for profit. In this case, Alfred, Beth and Charles formed "ABC" to sell computers for profit. Without a formal written agreement to show how profits and losses would be shared, it can be assumed that both would be equally spread amongst all partners equally.

Alfred will argue that he expressed to both Beth and Charles that he wanted to limit his personal liability when he contributed the \$100,000 to the start up of ABC. Beth and Charles will argue that even though he expressed his desire to be a limited partner he took an active role in the company, as shown when he took it upon himself to contact Zeta, a components supplier and told their president "Don't allow Charles to order components." By talking with Zeta it show that Alfred took a more active role in the company and that he was equally responsible for the partnership as Beth and Charles.

Therefore, because Alfred, Beth and Charles all took up active rolls in running ABC, they have an equal general partnership and profit sharing as well as all debts will be shared and will all be jointly liable for the debt to the creditors.

2. Is Deco likely to succeed in its lawsuit against ABC?

Beth entered into a written sales contract with Deco. The contract was to sell computers manufactured by ABC at a price that was extremely favorable to Deco. When Beth's partners learned of this deal, ^{no they informed Deco} they informed her that she had no authority to enter into a sales contract since that was not her agreed upon role in the partnership, and that ABC could not profitably sell computers at that agreed to by Beth. This issue in this case is whether Deco had a valid written contract with ABC when Beth entered into a written sales contract acting as ABC's agent, and if Beth breached her duty of loyalty to the partnership. ✓

The rule regarding agency is that in a general partnership, all partners are authorized agents of the business. Expressed authority means that an arrangement was expressly stated what an agent can and cannot do. Here, there is no indication that Beth was authorized to enter into a sales contract with Deco. Actual authority may be expressed by written or oral communication from the principal or implied, based on reasonable interpretation of the facts, it is clear that Beth did not have actual authority. The facts also show that Charles was to handle all computer sales alone, and that Beth's role was to be responsible for designing computers. ✓

Deco will argue that ABC was a general partnership and that all members have apparent authority to enter into sales contracts. ✓

Accordingly, Beth was acting as ABC's agent when contracted with Deco and because ABC failed to perform the contract and breached. ABC will be subject to breach of contract damages. ✓

Beth also owed a fiduciary duty to her partnership. Each partner must act in the best interest of the partnership and each partner has a duty of loyalty. ✓

here, Beth entered into a contract with Deco, which was her sister's company. This contract was extremely favorable to Deco and would cause ABC not to profit from the deal. The contract was beneficial to Deco and Beth's sister at the expense of the partnership. Beth could be liable for breach of duty because it was a self-dealing action that her sister's company benefitted from the contract with ABC and it would not profit for ABC. A self-dealing transaction would be allowed if it was objectively fair to the corporation, but since it was at ABC's detriment that exception would not excuse Beth.

Also, because Beth's action of self-dealing, she breached her duty of loyalty to the partnership. The partnership will argue that Beth should be held personally liable to Deco for damages.

good. 3/33

3. Is Zeta likely to succeed in its lawsuit against ABC?

The issue in this case is whether Zeta had a valid contract with ABC for several expensive components.

In this case, Charles had expressed authority to enter into sales contracts, since the facts show that he agreed to act as a salesperson.

Zeta will argue that because Charles was ABC's salesperson when he ordered the components, they reasonably relied on that representation. However, Alfred did call and give actual notice to "not allow Charles to order components, he's not our technical person." Zeta was put on notice that the order was outside of Charles' authority. Zeta will argue that it was a confusing conversation with Alfred and that they reasonably relied on the contract with Charles.

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Accordingly, ABC will be subject to breach of contract damages if the court sides with Zeta that the contract was valid and enforceable. If the court believes that Zeta had ample

notice that Charles did not have the authority to enter into that contract, then the contract would be invalid and ABC would not be liable to the contract. 31/33

2)

Introduction

A corporation is a separate legal entity from its owners and shareholders. The board of directors, officers and shareholders have different rights and responsibilities. At issue presently, are the decisions made by Acme's board of directors and how they effected shareholders. Shareholders were denied dividends but the board of directors looked to the future and made the decision to use excess cash to expand into new projects and donate to a private university. This left shareholders with a couple of courses of action. They could verify the information from the director meeting, and they could sue derivatively to force the corporation to pay dividends, and enjoin from making donations. The shareholders' success depends on whether the directors and officers breached their duties and acted outside of their authority.

1. Did Acme's outside directors possess the authority to reject Brown's and Chase's recommendation to pay a dividend from cash on the balance sheet?

Board of Director Authority / Quorum

The issue is whether the outside directors could vote against a dividend payout which would have benefited the shareholders, without shareholder approval. In a corporation, the board of directors is not only responsible for the 'big picture' but they can appoint officers and managers, and vote on major corporate transactions. A board of directors can have inside and outside directors. Inside directors can be corporate officers such as the Chief Executive Officer (CEO) and the Chief Financial Officer (CFO). Acme's board of directors was comprised of two inside directors, Brown (CEO) and Chase (CFO). Officers who also serve as directors typically owe a greater duty of loyalty. Acme's

remaining board members were outside directors. Outside directors are less interested in the daily management of the corporation's affairs.

Typically the authority of the board of directors is specified in the corporate by-laws. By-laws are the rules or guidelines for internal governance and can only be amended with shareholder approval. Generally a board of directors manages the business and votes on issues such as dividend payments. All board meetings require a quorum of board members in attendance and a majority of board members to ratify an action item. Acme had an excess of cash on its balance sheet (\$20 million) and met to consider the best course of action. Brown and Chase made the recommendation to pay dividends to shareholders. The board was also presented with a plan to expand into a new line of business. All of the board members were in attendance (quorum satisfied) and all ten outside board members voted in favor of using the excess of cash for the corporation's future use. Acme's board complied with corporate governance and acted with the correct authority to reject the dividend action item in favor of the expansion into new lines of business. ✓

25/25

2. Does Davis have a right to inspect Acme's records?

Shareholder Information Rights / Proper Use

The issue is what degree shareholders, like Davis, have access to meeting minutes and corporate documents. Shareholders have many rights and informational rights is an important one. A shareholder can demand to inspect for any proper purpose the corporation's stock ledger, list of stockholders, other books and records including minutes from board member meetings. Shareholders must show that they are requesting the documents for the proper purpose. This means they must be reasonably related to such person's interest as a stockholder and not simply 'fishing' through corporate information. ✓

Davis is one of many Acme shareholders, so that element is satisfied. He is upset about

the board's decision not to declare a dividend which would satisfy the element of proper purpose. Davis had the right to inspect Acme's records relating to the board meeting concerning dividends because he is a current shareholder concerned with the decision that occurred at an Acme board meeting. ✓
25/25

3. Evan's lawsuit against Acme for dividends

Shareholder Derivative Suits

The issue is whether Evan can bring a lawsuit against Acme for declining to payout dividends to shareholders and if he will be successful. A plaintiff shareholder can bring a suit against the corporation and its board when it feels they have taken actions not in the best interest of the corporation. This is called a derivative suit and the injured party is the corporation (not the individual or class of shareholders which is a direct suit). The plaintiff shareholder recovers on behalf of the corporation but if successful may recover attorney fees and expenses. To bring a derivative suit, the plaintiff shareholder must meet certain elements: 1) shareholder must have standing (be a shareholder at the time of action or omissions), 2) shareholder must continue to be a shareholder through entry of judgment, 3) shareholder must fairly and adequately represent the interest of the corporation, and 4) shareholder must make written demand upon the corporation, giving them 90 days to respond. There are no facts to indicate that Evan did not properly meet the requirements for filing a derivative suit against Acme because he is a current and active Acme shareholder and would represent the interest of the corporation. ✓

Duty of Care / Business Judgment Rule

After determining that Evan had proper standing to file a derivative suit on Acme, the next issue is whether the suit will be successful. To determine the success of the suit, the court will look to the actions of the board in declining to pay dividends. The duty of care

requires that directors act as a reasonably prudent director, with skill, knowledge in making decisions on behalf of the corporation. In addition, *In re. Caremark International Inc. Derivative Litigation*, held that directors of a corporation have a duty to make a good-faith effort to ensure that an adequate internal corporate information and reporting system exists. Evan will assert that the directors breached their duty of care by voting against the action to pay dividends to shareholders. The directors will argue that they were acting as reasonably prudent directors and did not breach the duty of care because they elected for future growth of the corporation instead of instant payouts to shareholders.

The business judgment rule (BJR) is the ^{good} presumption that directors are acting with due care, on an informed basis, in good faith with the honest belief that the action was taken in the best interest of the company. To rebut ^{good} this presumption, plaintiff shareholders have to show that the decision was uninformed, there was a conflict of interest, or a lack of good faith (fraud/illegality). Evan will attempt to rebut this presumption by claiming their decision was uninformed. Acme will assert that their decision was informed because they heard from both Chase and Brown in favor of the dividend and also heard from an outside (disinterested) consulting firm regarding favorable prospects for expansion. It is likely that the court will find that the board acted with the duty of care and within the parameters of the business judgment rule when it voted to decline dividends. Evan will not be successful.

discretion of board to determine.
2/15

4. Evan's lawsuit to enjoin Acme from paying \$100k to the private university

Business Judgment Rule

The issues is whether Brown as a graduate and member of the board of trustees of the university had a conflict of interest that would rebut the business judgment rule. The business judgment rule (BJR) is the presumption that directors are acting with due care, on an informed basis, in good faith with the honest belief that the action was taken in the

best interest of the company. While BJR can be rebutted for a showing of bad faith or self-dealing, Acme will assert that Brown stood nothing to gain by the cash donation to his alma mater, and therefore it was not true self-dealing. ✓

Duty of Loyalty

Evan will go on to assert that Brown breached his duty of loyalty as an officer and director because of his conflict of interest with the university. The duty of loyalty is a fiduciary duty to the corporation and the shareholders. Directors and officers in their dealings with the corporation must act in the best interest of the corporation and without personal conflict. The duty of loyalty forbids directors from a) entering into conflicting interest transactions, b) usurping a corporate opportunity, c) competing with the corporation, and d) trading on inside information. The only issue which would apply in Evan's suit against Acme is Brown's role as graduate and member of the university board of trustees, which Evan would assert is a conflict of interest. A conflict of interest occurs when a) the director is a party to the action, b) has a beneficial interest in the transaction or is so closely linked to it that the director's judgment would be reasonably affected or c) is involved with either entity (as a director, employee or owner) and the transaction would normally be brought before the board of directors because of its importance to the corporation. Acme will assert in its defense that Brown's role as a graduate and member of the university board of trustees is a conflict of interest but that breach of loyalty can be rectified by full disclosure to the board and ratification by a majority of disinterested directors after full disclosure of all relevant facts. Acme will be successful in proving Brown's duty of loyalty because all the board members were aware of the conflict and unanimously authorized the contribution. ✓

Evan will not likely succeed in his suit to enjoin Acme from contributing \$100k to the university because he will be unable to prove that the board acted outside the business judgment rule or breached that Brown breached the duty of loyalty. ✓

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END OF EXAM