

HYBRID

Business Organizations I (Agency and Partnership)

Fall 2023 Exam

Professor: P. Stirling

Instructions:

Time Allotted: Three (3) Hours

Allocate your time according to the points for each question:

Question 1: 125 points

Question 2: 125 points

Question 3: 50 points

**Question 1: 125 points**

Derwood has a landscape design and garden tool repair shop, Moonscapes. He is the sole owner and the business is a sole proprietorship. He hires Gomer and the employment agreement states that Gomer will work in the shop to both talk to customers about designs and to repair garden tools, as well as manage the general operations when Derwood is traveling (there are maintenance workers that need to be paid). As Derwood is also a rodeo clown, he travels often. In order to keep the business running, he provides Gomer with a power of attorney that allows Gomer to act on Derwood's behalf and to "enter into and execute any contract for the purchase of goods or merchandise as needed for the operation of the current business of Moonscapes, or to sign any credit or promissory note in connection with the operation of the current business of Moonscapes on my behalf."

While Derwood is performing at the world rodeo finals in Manaus, Brazil, Gomer comes up with an idea for selling specialty personalized flower baskets. He goes to the bank and tells them he has power of attorney from Derwood "to run the business." The bank manager knows Derwood and does not bother to look at the power of attorney. Gomer signs a promissory note for \$50,000 to purchase the baskets from Bertha's Basketville. Gomer takes delivery of the baskets and decides he could make more money personalizing them himself and selling them online. That evening, he leaves the store closed and locked (he is the only employee with a key so no other staff can enter) and flies to Cambria, Wales to create his online business. When Derwood returns one week later, the store is still locked, and he receives notice that the bank has not been repaid and no employees paid so they all quit.

What would you advise Derwood regarding his position with the bank, Gomer's actions, and the legal recourse (if any) he can take against Gomer?

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**Question 2: 125 points**

Ragnar, Lagartha, and Floki orally agreed to start RLF (“RLF”), a business to manufacture and sell Pickled Herring. Ragnar contributed \$100,000 to RLF, stating to Lagartha and Floki that he wanted to limit his personal liability to that amount. Lagartha, who had technical expertise at pickling fish, contributed \$50,000 to RLF. Floki contributed no money to RLF but agreed to act as salesperson. Ragnar, Lagartha, and Floki agreed that Lagartha would be responsible for pickling herrings, and that Floki alone would handle all fish sales.

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

Thereafter, Ragnar became concerned about how Lagartha and Floki were managing RLF. He contacted Zeta, Inc. (“Zeta”), RLF’s fish supplier. He told Zeta’s president, “Don’t allow Floki to order fish; he’s not our technical person. That’s Lagartha’s job.” Floki later placed an order for several expensive amounts of fish (including some fish other than herring such as Colombian dogfish) with Zeta. RLF refused to pay for the fish, and Zeta sued RLF for breach of contract. Not long afterwards, RLF went out of business, owing its creditors over \$500,000.

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

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**Question 3: 50 points**

Before Ragnar, Lagartha and Floki begin their partnership, they ask you to draft a simple partnership agreement (they plan to be a general partnership). Please provide a minimum of 10 clauses you will include in the agreement. Please provide full sentences.

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## 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

Nature of the business: No facts indicate that there are any other owners of Moonscapes, nor that it is incorporated, so this would be a sole proprietorship owned by Derwood.

#### Nature of the relationship

- An agency relationship exists when one party, the agent, consents to act on behalf of, and under the control of another, the principal.
- In this case, Gomer agreed to employment by Moonscapes and to act on behalf of Derwood. *Accordingly, Gomer is an agent of the principal, Derwood.*
- As an agent, Gomer owes particular duties to the principal, including fiduciary duties such as a duty of loyalty, a duty of care and a duty to obey or follow instructions.

#### Does Derwood have any recourse with regard to the loan payable to the bank?

- Derwood expressly empowered Gomer to act on his behalf by providing a power of attorney that included the signing of promissory notes.
  - The power of attorney was limited, however, to the business of the shop, which did not include purchasing and selling baskets.
- *As such, Gomer violated his fiduciary duty to Derwood by entering into a transaction for which he had no authority.*
- Be that as it may, a principal is responsible for the act of the agent taken in the course of employment. As such, it would appear that Derwood is responsible for the loan signed on his behalf by Gomer.
  - The bank manager may argue that Gomer had apparent authority to sign the loan document. Apparent authority arises when a principal holds an agent out as having a certain level of authority. Derwood may argue, however, that Gomer's authority was not apparent, but rather express by way of the power of attorney. The manager did not read the power of attorney which would have informed the bank that Gomer was not authorized to obtain the loan unrelated to the business of Moonscapes, and thus the loan agreement itself was invalid. *Derwood can therefore argue that he is not responsible for the loan as it was invalid.*

#### Does Derwood have any legal recourse against Gomer?

- An agent has various fiduciary and other duties to the principal, such as the duties of care, loyalty and to follow instructions.

- In this case, Gomer was empowered to sign promissory notes, but only related to the business of the shop which did not include baskets.
- Gomer would not be able to argue that he had implied authority to obtain the loan and purchase baskets. Implied authority includes ancillary actions that the agent may logically conclude are within his/her power as part of the overall authority. Had Gomer signed the loan to purchase repair parts, implied authority may have been present. In this case, however, the shop did not sell baskets, nor was the loan related to necessary parts.
- *Accordingly, Gomer violated his fiduciary duty of care and acted outside of the course of his employment, and thus Derwood would not be responsible for the purchase of the baskets.*
  - Secondly, Gomer was responsible for running the shop in Derwood's absence which included opening and closing the shop and managing the other employees. As such Gomer violated his fiduciary duty of care to Derwood to keep the business running. Gomer may have a legal complaint for loss of business for the days the shop was not operating.
  - Thirdly, Gomer decided to take the baskets and start his own business. Such an action would be a violation of his duty of loyalty to Derwood. It should be noted, however, that Gomer may argue that Moonscapes was not in the business of selling baskets so there would be no violation of a duty of loyalty. Regardless, Gomer was an employee and has absconded with the baskets that were the property of the shop, and in doing so has not only committed criminal theft, but also a violation of his duty of loyalty to the principal.
  - Finally, with regard to the question of whether Derwood can succeed in pursuing legal action against Gomer for the above noted issues, the facts indicate that Gomer has left the country. Unless Gomer returns, any legal action may be procedurally challenging.
  - *In summary, Derwood should argue that he is not responsible for the loan as it was an invalid transaction for which he gave no express approval. Derwood does have legal recourse for the lost revenue for the days Gomer failed to open the shop.*

## **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. Nature of Organization
2. RLF is a general partnership under definition
3. Partnerships are business for profit and if no agreement, profits are split

### **1. How should RLF's Debt be Allocated?**

1. Just like profits, without agreement, debts are split equally.
2. R wanted to limit his liability. However, absent a formal agreement, R is going to be considered a general partner.
  - a. Also R has active management (general managerial position, apparent equal voting rights), R was the one to call Zeta (Z) and tell them not to accept orders from F.
  - 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 R, L, and F 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 R and \$50,000 to L and zero to F since partners generally have no right to salary or compensation for services; (3) any remaining profits equally to R, L, F.***

## 2. Is Bjorn likely to Succeed in its Lawsuit against RLF?

1. Validity of the Agreement: Bjorn (B) must show that EL 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 F so L 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 L'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 RLF held L out to be a sales representative in the first instance. There was likely no good basis that B had to rely on any authority from RLF. However, given that L herself is a managing partner, B likely could argue that L'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 RLF.
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, L engaged in a transaction with her sister who owned B. The terms were apparently very favorable

to B. This could be viewed as self-dealing because it promoted L'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, L's deal with B 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 L informed her partners. The other partners have a very strong argument to bring a claim against L for these breaches of duty.

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

### **3. Is Zeta likely to Succeed in its Lawsuit against RLF?**

#### **1. Validity of the Agreement**

- Zeta's (Z) claim on this contract again hinges on the authority of F to enter into it. In this instance, F has the express authority to enter into sales contracts. However, this contract was for components being purchased by F, which is outside his express authority.
- Implied authority: Z may argue that components are necessary to production and later sales, which gives F 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.
- Apparent authority: Z will argue that RLF has held F 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 R, L and F.

#### **2. Actual notice to Z of Lack of F's authority**

- Z's main issue is that R called and gave actual notice that F could not enter into this contract. This would destroy any reasonable reliance that Z had. R told Z that L was the technical person, not F. As such, Z should have seen that this was outside the scope of F's authority. But F is still a general partner in the company.
- 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. R alone tried to limit what F could do. Z may argue that it knew this wasn't a proper action by R and more reasonably relied on F.
- RLF will argue that Z at least should have investigated further once given notice that F may not have authority and failure to follow through made their reliance on his apparent authority unreasonable. RLF will argue that this contract is invalid and will not bind RLF for this persuasive reason.

#### **3. Effect of R's Notice on F's Duties**

- R might also claim that F's activities outside his scope of duty were not in good faith.



- The argument is that acting in an area in which F knows nothing about shows a lack of obedience to his agency limits and lack of good faith in honoring partnership agreements on authority.
- But R didn't act with the consent of E. As such, there is no indication that the majority of management is at odds with F's decision to enter the contract. This appears to be solely the reservation of D with E and F.
- ***In the end, there was likely no breach of duty and any potential liability from this contract would flow to all, not just F.***

### Answer 3

1. Name of the partnership
2. Purpose and type of the partnership
3. Partners identified
4. Contributions by each partner.
5. Liability (joint and several)
6. Meeting frequency
7. Powers of partner 1
8. Powers of partner 2
9. Powers of partner 3
10. Impact of one partner leaving.

1)

**Issue(s):**

Is Derwood (the Principal) responsible for the loan Gomer (Agent) took out on his behalf with the bank? Who is responsible for paying the employees? What legal recourse does Derwood have? ✓

**Agency:**

Agency deals with a consensual relationship where an individual (the Agent) agrees to act on another (the Principal) behalf and they are subject to their control. Here, Derwood (D) is the Principal because he is the sole owner of the sole proprietorship, Moonscapes. D and Gomer (G) enter into an employment agreement, so G is acting as an agent for D. ✓  
The elements of agency are fulfilled.

**Duties of Principal to Agent:**

In the Principal-Agent relationship, there are certain duties each as to one another. For example, the P has a duty to indemnify the A for losses they incur that may not be their fault necessarily. The P also has a duty to compensate the A. The P has a duty of care, which means they need to provide safe working conditions for the A. Note, the duty of care here will be evaluated in terms of the A's level of skill. The P also have a duty of loyal by which they look out to safe guard the A against any physical or pecuniary losses. ✓

Since D is the P, these are the duties he owes to G. The fact pattern does not tell us anything that D has done in breach of these duties. We are focused mainly on G's breach of his agency which will be discussed below.

**Duties of Agent to Principal:**

In the Principal-Agent relationship, the A owes the P a duty to indemnify against losses (this applies when P is negligent), a duty of good conduct (meaning to obey the instructions/orders of the P), a duty of loyal (not to act adversely or compete against the ✓

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P), a duty of care to look out for P's business in an ethical manner, and a duty of good faith and fair dealing (GFFD) meaning not to act in a self dealing fashion.

Overall, the A has a fiduciary duty, the highest level of care to the P and items such as the duty of care and loyal are part of this fiduciary responsibility.

**Authority:**

A acting on behalf of the P can have different types of authority, as listed below:

*Expressed:*

What is expressly stated or written, it can be both in CA. However, if the dealing entails something that must be in written per the law, such as falling under the Statue of Frauds (SOF), then the A's expressed authority needs to be in writing as well under the equal dignity rule. Here, we are not dealing with something like real property that falls under the SOF, so it did not have to be in writing but is per the Employee Agreement, so G has "expressed" authority. ✓

*Implied:*

Implied deals with delegated authority--which needs approval by the P. And, with authority that is actually necessary for the A to carry out tasks on P's behalf, so what has P customarily let A do, etc. and this is proved by circumstantial evidence. ✓

*Apparent:*

This type of authority is looked at from the perspective of the third party (3P), what is their impression of the type of authority that the P gave to the A. ✓

**Employment Agreement (EA) & Power of Attorney (POA):**

The EA specifies that G was hired to: (1) talk to customers about design; (2) repair garden tools; (3) manage general operations while D travels as a rodeo clown (meaning pay the

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maintenance workers); and (4) enter into and execute any contract for the purchase of goods or merchandise as needed for operation of the CURRENT business.

D leaves for Brazil. While away G has an idea for selling specialty personalized flower baskets. There are several things to address about this, but first, D may argue that the baskets are NOT goods or merchandise that were needed and they are not part of the CURRENT business items that Moonscapes sells, so G was not authorized and in breach of the EA and he is liable for their cost.

G, if he returns from Wales, will argue that the baskets are clearly merchandise and goods and are part of landscape needs and the CURRENT business of Moonscape is landscape.

However, G, operating under POA, went and secured a loan for this purchase. A POA is an instrument that provides an individual to act on and make decisions on behalf of someone in matters of business, finance, health, etc. Here, the POA relates to business. In the state of CA, to serve as POA you must be 18 years of age, have the requisite mental capacity, and the paper work needs to be signed by the POA and notary or in the presence of two other individuals who also sign acknowledging said POA. There is nothing in the fact pattern that tells us that the POA instrument is invalid, so we will assume it is fine. The issue is that the POA authorizes G to enter into any contract (K) for purchases of goods and merchandise as needed for CURRENT operations.

Again, D will argue that the basket were not related to current operations and were not needed.

If the Court can determine by the facts that the baskets did not fit within the CURRENT needs and operations of Moonscape, they will find G in breach of the POA agreement and the EA.

### **The Bank & the Bank Loan:**

G goes to the local bank and tells them he is POA for D and has authority to "run the



business." The bank manager, who knows D does not bother to look at the POA agreement and gives G the loan and G signs the promissory note.

D will argue that the POA agreement does not state G has the authority to "run the business" but to enter into and execute any contract for purchase of goods or merchandise as needed for CURRENT operations and so this is in breach and violates the expressed authority that D gave to G as his agent. ✓

Moreover, D will argue that the bank failed in its duty as a financial institution by not looking at the POA documentation, so the Bank is liable for the \$50K loan, not him.

The Bank may argue that because they knew D and G had said he had POA to run the business that they thought G was acting under apparent authority as D's agent and could take out the loan.

D has a strong case against the Bank since they did not look at loan documents properly before authorizing and dispersing the loan, so the Court may hold he does not have to pay it and the Bank is actually liable. ✓

### **Gomer & Bank Loan:**

As noted above, an A has certain duties to the P and they breach them, P may not be liable.

Here, G, after taking out the \$50K loan from the bank decides he can make more money personalizing the baskets himself and selling them online. He essentially commits theft and fraud and takes the money that he supposedly got on loan on behalf of D and takes off with it. This is not a proper duty of care for the business's/P's resources, this is not a proper duty of accounting for the loan resource, G is not operating in good faith and fair dealing with the loan proceeds because he is essentially self dealing, and in some ways this is also a breach in the duty of loyalty because he is now competing with D. He is also ✓

using D's property (the loan) for his own use. Because of this G is in violation of the employment agreement.

Between the Bank's lack of thoroughness in administering the loan and G's actions, the Court will hold that D is not responsible for the loan. However, it may be difficult for the Bank or even D if they choose to go after G since he is no longer in the United States. If he returns and found, D and the bank have a better chance of holding him legally liable and accountable.

### Payment of Maintenance Employees:

The maintenance employees are also agents of Derwood and his duty as the principal is to pay them. Though G also violated the duty to obey because he did not pay the employees, locked the door and left, D will still be expected to compensate them appropriately.

### Conclusion:

If the Court finds that G was not honest about his scope of authority under the power of attorney agreement, he will be held liable for the bank loan. G broke his fiduciary duties. Further, the Court will also find that the Bank itself is liable because they failed to check the POA document. G won't be brought to "liability" justice until if and when he returns to the States. The Court will hold that Derwood is liable for compensation to the maintenance workers at Moonscape.

O 16  
I 16  
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80  
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- Excellent  
- Derwood may also have an action against G for damages/costs due to the staff quitting

2)

### Partnership Formation

A partnership is formed when two or more people act in <sup>business</sup> co-ownership for profit. This is usually shown by some outward manifestation, statement, or agreement. However, it can be formed unintentionally based on conduct. Here, there is an oral agreement between Ragnar, Lagartha, and Floki to start the business together. They indicate their intent to be co-owners and to make profit. This provides the necessary foundation for creation of a partnership. ✓

### Capital Contributions

Each partner may contribute capital investment into the partnership. By doing so, they become an equity partner. The specifics of equity and other partnership responsibilities may be outlined in a written partnership agreement, or they may be based on circumstances. Here, the agreement was oral, and there was nothing specified as to any relative equity stake. Therefore, it would be necessary to look at the circumstances of the partnership to determine the share of each partner and their relative equity.

Ragnar contributed \$100,000, and Lagartha contributed \$50,000. Ragnar stated his intent to limit his liability to only his \$100,000 contribution. Lagartha brought technical expertise at pickling fish, the purpose of the partnership. Floki contributed no money. ✓

### Non-Equity Partner

A non-equity partner is one who has a relationship with the partnership, and may be called a partner and vested with responsibilities, but who has provided no capital and thus has no equity stake. When a partnership is dissolved, a non-equity partner is not entitled to any share of the capital or the surplus. Because he contributed no money, Floki will be considered a non-equity partner. He may still act on behalf of the partnership, and benefit ✓

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from the partnership, but in the event of dissolution his benefit will be significantly less than the equity partners.

## Goodwill

Although Floki did not contribute financial equity, the business did grow and quickly became successful, largely because of Floki's personal effectiveness. When an individual's efforts, personality, relationships, and reputation contribute to the growth of a partnership, they are generating Goodwill. Goodwill can be quantified to an equivalent dollar amount. The Goodwill generated by Floki as an effective salesperson will help to establish his rights to a portion of partnership proceeds in the event of a dissolution. ✓

## Limited Partnership

A partner is a limited partner when they have no direct management control over the partnership. A limited partner may invest in the equity of the partnership, and have their personal liability limited to that investment. This is distinct from a limited liability partnership, where partners still act with general control but all have their legal liability limited. A limited liability partnership requires articles of incorporation filed with the appropriate party, and there is nothing of that sort here. This is simply a limited partnership, based on Ragnar's express statement that he intends for his own liability to be limited to his \$100,000. A limited partner may not interfere or take on any management control of day-to-day operations, but may demand an accounting, tour, review, etc. of the partnership interests.

When a limited partner takes on any general partnership responsibility--decision-making, acting with authority on behalf of the partnership, etc.--they become a general partner unless they go to specific lengths to withdraw that general partner authority. Here, if Ragnar was a limited partner upon his initial \$100,000 equity investment, he gave up that status when he, along with Floki, "contacted Bjorn and informed it that Lagartha had no

✓ can only be true limited partner if the partnership is registered as an LP



authority to enter into sales contracts." That action constitutes an exercise of authority as a decision-maker and manager of the operations of the business, something that only general partners can do, and from which limited partners are prohibited from doing. Therefore, Ragnar ceased to be a limited partner and became a general partner, when he took on that management role.

Ragnar's involvement didn't end there. Even if this one action would not constitute a complete switch from a limited partner to a general partner, his subsequent behavior certainly did. After becoming concerned about how Lagartha and Floki were managing RLF he contacted Zeta and told their president not to sell to Floki. After these actions he would no longer be able to claim that he was a limited partner, or that his liability was limited to his initial investment.

### **Obligations of General Partners**

General partners owe the partnership the same duties that an agent would owe to a principal. These include the duty of loyalty, duty of care, duty of disclosure, duty of obedience, and duty of good faith and fair dealing. When RLF opened, the duties of the two general partners, Lagartha and Floki, were clearly defined. Lagartha would be responsible for pickling herring, and Floki would be responsible for sales. At the time of formation, Ragnar was a limited partner. Later, Ragnar became a general partner when he assumed responsibility for day-to-day operations by contacting Bjorn about business matters.

### **Scope of Employment/Agency/Partnership**

The scope of employment (or responsibilities of each partner) may be defined by written agreement, by industry norms, by past conduct, or by manifestation of the parties. Here, scope of employment was defined by the initial oral agreement that Lagartha would be responsible for pickling, and Floki for sales.

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## **Powers of General Partners**

Although the scope of employment was defined to limit Lagartha's and Floki's responsibilities, all general partners have equal management authority and control over the partnership. They are co-equal managers and decision-makers. Therefore, Lagartha was acting within her power as a general partner when she contracted with Bjorn. Whether she was in breach of her duties to the partnership is another issue entirely. ✓

## **Duties of Partners**

Partners owe the partnership and their fellow partners a Duty of Care, of Loyalty, of Good Faith and Fair Dealing, and of Disclosure. Lagartha breached several of these duties when she made the deal with Bjorn. ✓

### **Duty of Care**

The Duty of Care owed by a partner includes the duty to act with the best interests of the partnership and partners in mind. Lagartha breached this duty when she made a deal that she knew would not be profitable for the partnership. ✓

### **Duty of Loyalty**

The Duty of Loyalty owed by a partner includes the duty not to compete, and to place the benefit of the partnership ahead of other business considerations. Here, Lagartha failed to uphold her duty of loyalty to the partnership because she entered into an agreement that greatly favored Bjorn. In particular, the fact that Lagartha's sister owns Bjorn shows the conflicting loyalty and provides further evidence that Lagartha breached her duty of loyalty to RLF. ✓

### **Duty of Good Faith and Fair Dealing**

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The Duty of Good Faith and Fair Dealing can be summarized as the responsibility of partners not to take advantage of the partnership or one another in a detrimental way. Here, Lagartha used the buying power of RLF, based on its equity and its successes as a business, to benefit her sister's business to RLF's detriment. Bjorn stands to profit significantly from the sale at reduced price, and RLF could not sell at that price for a profit. This is not only disloyal, it is a breach of the good faith owed by a partner to the partnership.

### **Duty of Disclosure**

A partner also has a Duty of Disclosure to the partnership and to the other partners. This includes an obligation to disclose any conflicts of interest, any other business investments, and any other information that is pertinent to making business decisions and commitments for the partnership. Here, Lagartha breached this duty twice. First, she failed to disclose that Bjorn was owned by her sister, a basic conflict of interest that she had a duty to disclose to her partners. Second, she failed to disclose when she made the deal with Bjorn.

Even though she was not expressly authorized to enter into a sales agreement on behalf of the partnership, her role as a general partner did provide her with the power to do this. However, she still had the basic obligation to disclose her activities to the partnership, which she failed to do. By not disclosing her relationship with Bjorn (owned by her sister), or the deal that she made with them, Lagartha breached her Duty of Disclosure to the partnership.

### **Types of Authority**

There are three main types of authority within an agency or partnership relationship: express, implied, and apparent. In addition, general partners have a co-equal authority to manage the business of the partnership unless there is some written agreement to the



contrary. Here, any agreement to limit Lagartha and Floki to certain activities was oral only, not in writing. Also, Ragnar had indicated his desire to be a limited partner in the beginning at the formation of the partnership, so he would not have initially been in a position to tell Lagartha and Floki how to limit their activities, as that would fall within the purview of a general partner, not a limited partner.

*R cannot act alone -  
need 2 majority for this.*

Implied authority is based on when the actor has a reasonable good-faith belief that they are authorized to act based on manifestation of the principal (in this case, the partnership), past actions, or silence by the principal in the face of action by the agent. Here, Ragnar told Zeta to not allow Floki to order fish. However, there is nothing to indicate that he ever told Floki this. Just as Lagartha had authority as a general partner even though she was only supposed to handle pickling, so too Floki had authority as a general partner to place an order. Without a written agreement, or some clear manifestation by the other partners, this would not change. ✓

### **Lagartha's Authority to enter sales contracts - disagreements/majority rule**

When a partnership has a disagreement in how to handle operations, the majority vote will rule. Here, the partners were in disagreement about Lagartha's authority. After she entered into a written sales contract, both Ragnar and Floki contacted Bjorn to inform them that Lagartha could not enter sales contracts. Because they represent a 2/3 majority within the partnership, they are able to dictate this change in authority. However, that does not change the circumstances of the initial contract with Bjorn. If Lagartha acted with proper authority in that initial written sales contract, then the partnership is still bound. They would not be bound by any future contracts with Bjorn or any other business that was entered into by Lagartha. ✓

### **Floki's Authority to place order**

Floki did not have express nor apparent authority to place an order with Zeta. For express authority, he would have needed some written agreement or clear manifestation from the other partners. He did have his authority as a non-equity general partner, however. He also did not have apparent authority. Apparent authority requires a reasonable good-faith belief on the part of the third party. Here, Ragnar gave Zeta notice that Floki was not allowed to buy fish. Although this may not have been enough to completely destroy Floki's authority as a general partner, it certainly reduced the possibility of apparent authority since Zeta would be on notice. Zeta may have still known of general partner authority by Floki. ✓

### 1. Allocation of RLF Debt

When a partnership is dissolved, there is a certain order that must be followed in the disbursement of assets to creditors and partners. Here, when RLF went out of business it owed creditors more than \$500,000.

The first step in the dissolution will be to value up all of the assets including cash held by RLF. If any of these assets are not particularly viable for sale and one of the partners intends to stay in business, they may be able to keep that asset so long as an in-kind division is made where equivalent value is given to the other partners and creditors. Here, depending on the total value available in the assets this may not even be an option. ✓

Once all of the assets have been totaled up, it will be necessary to divide them in priority order. First, the creditors of the partnership will be paid. This means that the full \$500,000+ in debt must be resolved first before any other disbursements can be made. Second, the capital contributions of the partners will be reimbursed. This means that Ragnar will be entitled next to the \$100,000 that he contributed, and Lagartha to her \$50,000. Floki will not be entitled to any capital reimbursement because he contributed none. Finally, any surplus will be divided among the partners according to their equity share. Here, Ragnar has an equity share of  $\frac{2}{3}$ , and Lagartha has the remaining  $\frac{1}{3}$ . ✓

Because Floki was a non-equity partner, he will probably get nothing from the surplus. However, he may be able to argue (or negotiate) for a small portion of the surplus based on the Goodwill that he generated during his time as salesperson, when he was primarily responsible for the successful growth of the business. ✓

## 2. Bjorn Lawsuit

Bjorn is suing RLF for breach of contract. Here, they will argue that Lagartha had express authority as a general partner and therefore co-equal manager of the business operations. Using this authority, she entered into a valid contract with Bjorn. Although she had agreed to a deal that was not profitable to RLF, Bjorn will argue that they acted in good faith when entering that agreement. In addition to the express authority, Bjorn will argue that she had apparent authority. Bjorn had a reasonable good-faith belief that Lagartha was authorized to make such a contract, and it was only later that Bjorn learned from RLF that they could not contract with Lagartha anymore. ✓

Because Lagartha acted within her express and apparent authority as a partner in entering the contract, Bjorn has a strong claim that there was a breach of contract and that they can demand specific performance. ✓

In response, RLF will argue that the contract is unconscionable. Because Bjorn was owned by Lagartha's sister, and the price was "extremely favorable" to Bjorn, there is a strong argument that there was an inappropriate and undue influence on the contract process that put RLF at a disadvantage. *a bit too strong. not against public pol. by cfr.*

If RLF can show that there was some collusion or intentional undue influence exercised by Bjorn over Lagartha in entering into the contract, they may be able to defend against Bjorn's claim. However, the burden to prove this will be on RLF, and if they cannot show unconstitutionality or undue influence, then Bjorn would succeed in its lawsuit. RLF may claim that Lagartha did not have authority based on the partnership agreement, however ✓



they will still have to show that Bjorn knew of this or otherwise acted without good faith. It would be reasonable for a court to presume that Bjorn believed Lagartha had authority if there was nothing to show otherwise. ✓

### 3. Zeta Lawsuit

When Floki placed the order for several expensive amounts of fish, Zeta was already on notice that Floki was not allowed to purchase fish. However, Zeta will argue that Ragnar did not have the sole authority to dictate this. Floki was still a general partner, and Ragnar was acting of his own accord, not in cooperation with another partner. Without Lagartha's participation, Ragnar was not acting with majority power to dictate what Floki could and could not do. ✓

RLF will argue that Floki was not supposed to purchase fish, only sell them, however there was nothing in the original partnership agreement that limited who could buy fish for pickling. Lagartha was the acknowledged expert in this area, but not the only one designated with purchasing authority. Zeta will argue that this shows that Floki had authority as a general partner, and that Ragnar's effort to limit Floki's apparent authority was negligible and ineffective. ✓

RLF will counter this by pointing out that the entire purpose of RLF, their stated and publicly known business, was to manufacture and sell Pickled Herring. They were not in the business of collecting Colombian dogfish or investing in expensive fish. Zeta was already RLF's regular fish supplier, so they should have known that Floki's order was well outside the normal expectations for RLF's business. This, combined with Ragnar's instruction to not allow Floki to order fish, would be highly influential in deciding the lawsuit. This would be even more the case if Lagartha were the one who had traditionally and regularly handled the herring purchases. ✓

RLF will argue that Zeta should have known that this was not an appropriate type of contract for RLF, and that Floki did not have apparent authority because Zeta was on notice not to allow him to make such purchases. Therefore, Zeta's lawsuit will most likely not succeed in its lawsuit.

even though R didn't have sole authority to notify Zeta?

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well done. Strong arguments



3)

To: Ragnar, Lagartha, Floki

From: Philip Davis

Re: Draft of Partnership Agreement for RLF

The following are my recommendations for your partnership agreement.

1. We agree to act as co-owners for profit in the form of a general partnership; each member of the partnership shall have co-equal authority to make management and operational decisions on behalf of the partnership. The purpose of this partnership shall be to manufacture and sell Pickled Herring. ✓
2. We agree to act with a Duty of Loyalty and Care to each other and to the partnership, including an obligation not to compete with the partnership within the scope of the partnership business, and to act for the sole benefit of the partnership within that scope. ✓
3. We agree to act with Good Faith and Fair Dealing to each other and to the partnership, and to not take advantage of the partnership relationship or each other for personal gain. ✓
4. We agree to fully Disclose all obligations, debts, transactions, and contracts entered into on behalf of the partnership; recovery of any debt owed by the partnership shall be limited to partnership assets unless there is a court order to the contrary. Debts and obligations not properly disclosed shall be the sole responsibility of the partner who incurred them. ✓
5. We agree that each partner shall be jointly and severally liable for any negligence, torts, or illegal acts done by the partnership. ✓

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6. Each partner shall have an equity share in the partnership equivalent to their capital contribution as a percentage of all contributions by all partners. ✓
7. Each partner shall have the authority to act on behalf of the partnership, in the capacity as agents to the partnership in its role as principal, with all of the duties and responsibilities therein, including the duties of good faith and fair dealing, loyalty, care, disclosure, and non-compete. Any change in the authority of one or more partners must be agreed upon in writing by the affected partner(s) or by a majority vote of all partners. Specific responsibilities of the partners shall be as follows: Lagartha will be responsible for pickling herrings, and Floki will be solely responsible for sales. ✓
8. Any activity by the partners done within the scope of the partnership shall be considered to be on behalf of the partnership and subject to the conditions stated in this agreement; any activity by the partners that is outside the scope of the partnership shall have no bearing on, nor incur liability on behalf of, this partnership. ✓
9. Any partner may dissociate from the partnership by a statement in writing, upon which that partner shall be entitled to a full accounting of their capital contribution and pro rata partnership surplus asset valuation. The partnership reserves the right to pay a dissociating partner in-kind for the equivalent value of any assets that the partnership prefers to retain. The partnership shall continue for the remaining partner(s) in the event of any dissociation, whether at-will, by judicial order, or by death or retirement. ✓
10. This partnership is formed with the full knowledge and assent of each member of the partnership to the obligations and responsibilities outlined by this agreement. ✓
11. This partnership agreement shall be governed by the laws of the State of California. ✓

excellent!  
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**END OF EXAM**