**Alternate Case Problems**

*Chapter 19*

**The Entrepreneur’s Options**

**19-1. Limited Liability Companies.** Michael Collins entered into a three-year employment contract with E-Magine, LLC. E-Magine was in business for only a brief time, during which it incurred considerable losses. In terminating operations, which ceased before the term of the contract with Collins expired, E-Magine also terminated Collins’s services. In exchange for a payment of $24,240, Collins signed a “final payment agreement,” which purported to be a settlement of any claims that he might have against E-Magine. Collins filed a suit in a New York state court against E-Magine, its members and managers, and others, alleging, among other things, breach of his employment contract. Collins claimed that signing the “final payment agreement” was the only means for him to obtain what he was owed for past sales commissions and asked the court to impose personal liability on the members and managers of E-Magine for breach of contract. Should the court grant this request? Why or why not? [*Collins v. E-Magine, LLC,* 291 A.D.2d 350, 739 N.Y.S.2d 121 (1 Dept. 2002)]

**19-2. The Franchise Contract.** On August 23, 1995, Climaco Guzman entered into a commercial janitorial services franchise agreement with Jan-Pro Cleaning Systems, Inc., in Rhode Island for a franchise fee of $3,285. In the agreement, Jan-Pro promised to furnish Guzman with “one (1) or more customer account(s) . . . amounting to $8,000.00 gross volume per year. . . . No portion of the franchise fee is refundable except and to the extent that the Franchisor, within 120 business days following the date of execution of the Franchise Agreement, fails to provide accounts." By February 19, Guzman had not received any accounts and demanded a full refund. Jan-Pro then promised "two accounts grossing $12,000 per year in income." Despite its assurances, Jan-Pro did not have the ability to furnish accounts that met the requirements. In September, Guzman filed a suit in a Rhode Island state court against Jan-Pro, alleging, in part, fraudulent misrepresentation. Should the court rule in Guzman’s favor? Why or why not? [*Guzman v. Jan-Pro Cleaning Systems, Inc.,* 839 A.2d 504 (R.I. 2003)]

**19-3. Joint Ventures.** In 1993, TOG Acquisition Co. attempted to acquire the Orleander Group, a manufacturer of bicycle accessories, but failed for lack of financing. Orleander then granted to Herrick Co. an exclusive right to negotiate for the sale of the business. In August, representatives of TOG, Herrick, and SCS Communications, Inc., signed a letter under which they agreed “to work together to acquire the business of the Orleander Group.” The “letter agreement” provided that the parties would contribute “equal amounts of capital” and that all of the terms of the acquisition required the approval of each party. On November 19, TOG and SCS told Herrick that it was out of the deal and, ten days later, acquired Orleander without Herrick. Herrick filed a suit in a federal district court against SCS and others, alleging, among other things, that the “letter agreement” was a contract to establish a joint venture, which TOG and SCS had breached. The defendants filed a motion for summary judgment. In whose favor should the court rule? Why? [*SCS Communications, Inc. v. Herrick Co.,* 360 F.3d 329 (2d Cir. 2004)]

**19-4. Limited Liability Companies.** Westbury Properties, Inc., and others (collectively the Westbury group) owned, managed, and developed real property. Jerry Stoker and The Stoker Group, Inc. (the Stokers), also developed real property. The Westbury group entered into agreements with the Stokers concerning a large tract of property in Houston County, Georgia. The parties formed limited liability companies (LLCs), including Bellemeade, LLC, (the LLC group) to develop various parcels of the tract for residential purposes. The operating agreements provided that “no Member shall be accountable to the [LLC] or to any other Member with respect to [any other] business or activity even if the business or activity competes with the [LLC’s] business.” The Westbury group entered into agreements with other parties to develop other parcels within the tract in competition with the LLC group. The Stokers filed a suit in a Georgia state court against the Westbury group, alleging, among other things, breach of fiduciary duty. What duties do the members of an LLC owe each other? Under what principle might the terms of an operating agreement alter these duties? In whose favor should the court rule? Discuss. [*Stoker v. Bellemeade, LLC*, 272 Ga.App. 817, 615 S.E.2d 1 (Ga.App. 2005)]

**19–5.** **Limited Liability Companies.** A limited liability company (LLC) owned a Manhattan apartment building that was sold. The owners of 25 percent of the membership interests in the LLC filed a lawsuit on behalf of the company (the LLC)—called a derivative suit—claiming that those in majority control of the LLC sold the building for less than its market value and personally profited from the deal. The trial court dismissed the suit, holding that the plaintiffs individually could not bring a derivative suit “to redress wrongs suffered by the corporation” because such actions were permitted only for corporations and could not be brought for an LLC. The appellate court reversed, holding that derivative suits on behalf of LLCs are permitted. That decision was appealed. A key problem was that the state law governing LLCs did not address the issue. How should such matters logically be resolved? Are the minority owners in an LLC at the mercy of the decisions of the majority owners? Discuss fully. [*Tzolis v. Wolff,* 10 N.Y.3d 100, 884 N.E.2d 1005 (2008)]

**19–6. Sole Proprietorship.** Julie Anne Gaskill is an oral and maxillofacial surgeon in Bowling Green, Kentucky. Her medical practice is a sole proprietorship consisting of her as the sole surgeon, with office staff. She sees every patient, exercises all professional judgment and skill, and manages the business. When Gaskill and her spouse, John Robbins, initiated divorce proceedings in a Kentucky state court, her accountant estimated the value of the practice at $221,610, excluding goodwill. Robbins’s accountant estimated the value at $669,075, including goodwill. Goodwill is the ability or reputation of a business to draw customers, get them to return, and contribute to future profitability. How can a sole proprietor’s reputation, skill, and relationships with customers be valued? Could these qualities be divided into “personal” and “enterprise” goodwill, with some goodwill associated with the business and some solely due to the personal qualities of the proprietor? If so, what might comprise each type? Is this an effective method for valuing Gaskill’s practice? Discuss. [*Gaskill v. Robbins,* 282 S.W.3d 306 (Ky. 2009)]

**19–7.** **Limited Partnership.** James Carpenter contracted with Austin Estates, LP, to buy property in Texas. Carpenter asked Sandra McBeth to invest in the deal. He admitted that a dispute had arisen with the city of Austin over water for the property, but he assured her that it would not be a significant obstacle. McBeth agreed to invest $800,000 to hold open the option to buy the property. She became a limited partner in StoneLake Ranch, LP. Carpenter acted as the firm’s general partner. Despite his statements to McBeth, the purchase was delayed due to the water dispute. Unable to complete the purchase in a timely manner, Carpenter paid the $800,000 to Austin Estates without notifying McBeth. Later, Carpenter and others—*excluding* McBeth—bought the property and sold it at a profit. McBeth filed a suit in a Texas state court against Carpenter. What is the nature of the fiduciary duty that a general partner owes a limited partner? Did Carpenter breach that duty in this case? Explain. [*McBeth v. Carpenter,* 565 F.3d 171 (5th Cir. 2009)]

**19–8. Franchise Disclosure.** Peaberry Coffee, Inc., owned and operated about twenty company stores in the Denver area. The company began a franchise program and prepared a disclosure document as required by the Federal Trade Commission (FTC). Peaberry sold ten franchises, and each franchisee received a disclosure document. Later, when the franchises did not do well, the franchisees sued Peaberry, claiming that its FTC disclosure document had been fraudulent. Specifically, the franchisees claimed that Peaberry had not disclosed that most of the company stores were unprofitable and that its parent company had suffered significant financial losses over the years. In addition, Peaberry had included, in the franchisees’ information packets, an article from the *Denver Business Journal* in which an executive had said that Peaberry was profitable. The FTC disclosure document had also contained an exculpatory clause (see Chapter 13), which said that the buyers should not rely on any material that was not in the franchise contract itself. Can a franchisor disclaim the relevance of the information it provides to franchisees? Why or why not? [*Colorado Coffee Bean, LLC v. Peaberry Coffee, Inc.,* \_\_ P.3d \_\_, 2010 WL 3031448 (Colo.App. 2010)]

**19–9. Partnership Dissolution.** George Chaney and William Dickerson were partners in Bowen’s Mill Landing, which purchased a large piece of land in the 1980s. The partners had planned to develop the property, but nothing was ever done. Chaney died in 1990, and his wife inherited his interest. When she died in 2004, her two sons, John and Dewey Lynch, inherited the half-interest in the partnership. Dickerson died in 1995, and his daughter, Billie Thompson, inherited his half-interest. In 2006, the Lynches filed a petition for partition, asking that a commission be appointed to make a fair division of the land, giving the Lynches half and Thompson half. In 2007, the commission reported on how to divide the land into two parts. Thompson objected that the land belonged to Bowen’s Mill Landing and could not be divided. The trial court ordered Thompson to “effectuate the dissolution of any partnership entity and . . . to wind up the business and affairs of any partnership” so that the land could be divided. Thompson appealed. Can the court order the partnership to dissolve? Why or why not? [*Thompson v. Lynch,* 990 A.2d 432 (Del. 2010)]

**19-10. A Question of Ethics**

In August 2004, Ralph Vilardo contacted Travel Center, Inc., in Cincinnati, Ohio, to buy a trip to Florida for his family to celebrate his fiftieth wedding anniversary in December. Vilardo paid $6,900 to David Sheets, the sole proprietor of Travel Center. Vilardo also paid $195 to Sheets for a separate trip to Florida in February 2005. Sheets assured Vilardo that everything was set, but in fact no arrangements were made. Later, two unauthorized charges for travel services totaling $1,182.35 appeared on Vilardo’s credit-card statement. Vilardo filed a suit in an Ohio state court against Sheets and his business, alleging, among other things fraud and state consumer law violations. Vilardo served Sheets and Travel Center with copies of the complaint, the summons, a request for admissions, and other documents filed with the court, including a motion for summary judgment. Responses to each of these filings were subject to certain time limits. Sheets responded once on his own behalf with a denial of all of Vilardo’s claims. Travel Center did not respond. [*Vilardo v. Sheets,* \_\_ Ohio App.3d \_\_, \_\_ N.E.2d \_\_, 2006 WL 1843585 (12 Dist. 2006)]

**1.** Almost four months after Vilardo filed his complaint, Sheets decided that he was unable to adequately represent himself and retained an attorney who asked the court for more time. Should the court grant this request? Why or why not? Ultimately, what should the court rule in this case?

**2.** Sheets admitted that “Travel Center, Inc.” was a sole proprietorship, He also argued that liability might be imposed on his business but not on himself. How would you rule with respect to this argument? Why?Would there be anything unethical about allowing Sheets to avoid liability on this basis? Explain.