

PART I

Guide for Instructors and Answers to Chapter Review Questions

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CHAPTER 1

Agency Concepts and Definitions

THEME

Because agency law is so fundamental to the transaction of business by corporations and all other types of business organizations, this first chapter provides an overview of agency concepts and an introduction to agency law as it relates to business organizations.

CHAPTER GOAL

The goal of this chapter is for students to become familiar with the following terms and topics concerning agency law:

- *Agency, agent, and principal*, and other basic terms concerning the agency relationship
- Elements of an agency agreement
- Differences between an employee and an independent contractor
- Power-of-attorney purposes
- Agency agreement creation
- Liability of the principal for the acts of the agent
- Agent's liability to third parties when acting in his or her capacity as an agent
- Agency relationship termination
- The individuals and/or entities that act as principal(s) and agent(s) for each of the various types of business organizations

SUGGESTED APPROACH

Class discussions concerning this chapter may involve several examples of agency relationships with which students may be familiar or involved in. They can be asked about different situations in which they have acted for another or had another act on their behalf, then examine the circumstances to determine if an agency relationship existed.

LECTURE NOTES

Agency Concepts and Definitions

1. When one person acts on behalf of another or on behalf of a business organization, an agency relationship is formed.
2. The *agent* is the person acting on behalf of the *principal*.
3. A *general agent* has authority to transact all business of the principal, all business of a particular kind, all business at a particular place, or all acts connected with a particular employment or business.
4. A *special agent* has authority to do one or more specific acts in accordance with instructions from the principal.
5. If an employer has the right to control the manner in which an agent performs his or her work, that agent is likely an employee and not an independent contractor.
6. A *power of attorney* is created by a written document that authorizes another (the attorney in fact) to act as one's agent. A power of attorney is usually required to transfer real estate on behalf of another.
7. A *durable power of attorney* provides that the authority granted to the attorney in fact will continue even after the incapacity of the person granting the power of attorney.

Agency Creation

8. The elements of an agency relationship include the following:
 - Consent of the parties
 - Capacity of the parties to act
 - No required written agreement
 - No required exchange of consideration
 - Formation of the agency for a proper purpose

9. An agency agreement can be created by the following:
 - Express agreement (either verbal or written)
 - Implied agreement (the intent and actions of the parties)
 - The conduct of the principal and agent
 - Ratification
 - Estoppel

Agency Relationship

10. The *agent's authority* is the agent's power to act on behalf of the principal in accordance with the principal's consent.
11. The agent may have *actual authority* or *apparent authority*.
12. The agent's actual authority may be:
 - Express authority
 - Implied authority
 - Authority incidental to express authority
 - Authority implied because of emergency
13. Apparent authority to do a specific act can be created by the actions of the principal—either by written or spoken word, or by the principal's conduct.
14. The elements of apparent agency include: (1) acts or conduct of the principal causing a third party to believe the agent has authority to act on behalf of the principal; (2) reliance on that belief by a third party.
15. The agent and principal owe certain duties to each other.

Principal's Liability to Third Parties

16. The principal is usually liable for acts conducted by an authorized agent.
17. The principal is liable under contracts made on the principal's behalf by an authorized agent.
18. Under the doctrine of *respondeat superior*, an employer is responsible for the torts

committed by his or her employee while the employee is acting in the scope of his or her employment by the principal.

Agent's Liability to Third Parties

19. Agents are personally liable for their torts. Under certain circumstances, the principal may also be liable for torts committed by the agent.

Agency Termination

20. The agency may be terminated pursuant to the terms of the agency contract, the fulfillment of the agency purpose, by the death or bankruptcy of either the principal or agent, or by the act of the principal and agent or either one of them.

Agency and Business Organizations

21. A sole proprietor may hire employees to serve as agents.
22. In a partnership, partners act as agents for the partnership and for each other.
23. In limited partnerships, the general partners act as agents for the partnership and the other partners.
24. Either members or managers are agents of limited liability companies.
25. Officers and directors act as agents of corporations.

The Paralegal's Role

A basic understanding of agency law will benefit paralegals who work in nearly every area of law. An understanding of agency law will help paralegals who need to understand contracts and litigation that clients may be involved in. Some specific tasks related to agency law that may be assigned to corporate paralegals include reviewing and drafting powers of attorney, employment agreements, and other contracts that may involve an agency relationship.

Resources

Important resources for paralegals who are working in areas related to agency law include agency treatises, especially the Restatement of

the Law—Agency 3d. There are also several online resources that can provide valuable information on agency law.

REVIEW QUESTIONS

1. What is the difference between a general agent and a special agent?

A general agent has the authority to transact all business of the principal, all business of a particular kind, all business at a particular place, or all acts connected with a particular employment or business. This authority is much broader than that of the special agent, who is authorized to do one or more specific acts in accordance with instructions from the principal.

2. Suppose you give your friend some cash and ask her to pick up a video for you at the video rental store. Has an agency relationship been created?

Yes

Discuss each of the elements of an agency relationship as they relate to this situation.

Consent: If you ask and your friend agrees, you have consent.

Capacity: Assuming you and your friend are both competent adults, you both have capacity to act.

Written Agreement: No written agreement is required.

Consideration: No consideration has been exchanged for this favor, nor is any required.

Proper purpose: There is nothing illegal or improper in the proposed transaction.

3. Can an agency relationship be created without a written agreement?

Yes

What if the agent is asked to sell a parcel of land for the principal?

Almost certainly, a written power of attorney would be required to sell a parcel of land pursuant to state statutes.

4. Can an agency relationship be created if the principal does not pay the agent to act on her behalf?

Yes, the agent can act gratuitously on behalf of the principal.

5. Suppose that before a horse race, the owner of one of the horses, the trainer, and a racehorse investor are all having a conversation. The trainer offers to sell the racehorse to the investor for \$10,000 (in the owner's presence, and without her objection). The investor agrees and gives the owner a \$500 check to show his good faith. He also makes a deal to sell one of his other investments to raise the additional \$9,500. When the horse in question wins the next race, the owner refuses to sell, stating that the trainer was not acting on her behalf and had no authority to sell the horse. Is the owner correct?

No

What type of authority, if any, does the trainer have?

The trainer had apparent authority to act on behalf of the owner when the trainer offered to sell the racehorse to the investor in the owner's presence and the owner did not object.

Does the investor have any right to purchase the horse?

Yes, especially since the investor took action that may have been to his detriment in relying on the trainer's apparent authority. The investor sold one of his investments and provided a \$500 check based on his belief.

6. What duties does an agent owe the principal?

An agent owes the principal the duty to perform and perform with reasonable care. The agent also owes a fiduciary duty to act with the utmost good faith and loyalty in the principal's interests, including the duty to notify and the duty of loyalty.

7. Under what circumstances may a principal be liable for torts committed by her agent?

The principal may be liable under the doctrine of *respondeat superior* if the agent committed the tort while acting in the scope of her employment. The principal may also be responsible if the agent's act was intended by the principal, or if the principal acted negligently or recklessly.

8. What is *respondeat superior*?

***Respondeat superior* is the doctrine that provides that an employer who retains control over the manner in which the agent performs her duties has vicarious liability and is responsible for the torts committed by that employee if the agent is an actual employee and the employee acted within the scope of the employer's business.**

9. Who are the agents for a general partnership?

The partners all act as agents of the partnership and agents for each other.

10. Who are the agents for a corporation?

The corporation's board of directors, officers, and the employees they hire may all act as agents of a corporation.

SUGGESTED ANSWER TO PRACTICAL PROBLEM

The practical problem in this chapter asks the students to prepare a power of attorney, granting a fictitious brother the authority to handle the student's affairs while the student is out of the country for six months. Students should prepare a general power of attorney based on the forms provided in the text or found online specifically for your state. You may want to provide a sample from your state if the requirements vary significantly from those in the text.

EXERCISE IN CRITICAL THINKING

The Exercise in Critical Thinking in each chapter asks students to think beyond the materials

they have learned and consider the reasons for certain corporate and business organization laws and established policies procedures, and to consider their possible flaws. These exercises may be good fuel for class discussion or themes for student essays. There will, of course, be no right or wrong answer to these questions.

The Exercise in Critical Thinking for this chapter asks students to consider the importance and significance of the power of attorney—a document that is often prepared quite routinely in corporate law offices.

Exercise:

Attorneys often prepare power-of-attorney documents as a matter of convenience for their clients. What are some considerations to be given by clients and their attorneys before granting a power of attorney to another individual?

What consideration must be given concerning the individual named as attorney in fact?

What consideration must be given concerning the scope of powers granted in the power of attorney?

SUGGESTIONS AND SAMPLE DOCUMENT FOR THE WORKPLACE SCENARIO

The Workplace Scenarios at the end of each chapter ask students to put themselves in the place of a paralegal who works for a small law firm specializing in corporate law. Students are asked to put to use what they have learned in the preceding material of the chapter by completing assignments of the type often given to corporate paralegals. Students will complete their assignments based on a set of facts given in the Workplace

Scenario and client data information given in Appendix B in the text. At times, students will need to create some of their own facts in order to complete their assignments. The purpose of these Workplace Scenarios is for students to become familiar with the type of assignments re-

ceived by paralegals, the proper documents and forms to be used in their home states, and the procedures for filing documents (when necessary).

The Workplace Scenario for Chapter 1 asks students to prepare a special power-of-attorney document for a new client by the name of Bradley Harris to be given to a friend of his,

Cynthia Ann Lund, so that she may take care of his business while he is in the hospital recovering from surgery. Sample documents for several of the Workplace Scenarios throughout the text may be found in the appendices to this Instructor's Manual. See Appendix A for a sample special power of attorney for this chapter.

CHAPTER 2

Sole Proprietorships

THEME

Chapter 2 introduces students to sole proprietorships, the formalities associated with doing business as a sole proprietorship, and the advantages and disadvantages of doing business as a sole proprietorship.

CHAPTER GOAL

The goal of this chapter is for students to become familiar with the following terms and topics concerning sole proprietorships:

- Sole proprietor and sole proprietorship
- The legal formalities that must be followed by sole proprietors
- Advantages and disadvantages of doing business as a sole proprietor
- The concept of assumed names and the procedures that must be followed before using an assumed name, trade name, or fictitious name
- The role of paralegals who work with sole proprietors
- Resources for further research regarding sole proprietorships

SUGGESTED APPROACH

Most students will be familiar with individuals who are sole proprietors. They may even be sole proprietors themselves. Discussions may involve the students' personal experiences in complying with the formalities associated with doing business as a sole proprietorship. Many of these will be state or local formalities. Helpful information may be obtained from the local office of the U.S. Small Business Administration.

LECTURE NOTES

Sole Proprietorship Defined

1. The sole proprietorship is an unincorporated business owned by one person.
2. The sole proprietorship is not considered a separate entity. Rather, it is an extension of the individual sole proprietor.
3. The sole proprietor is personally responsible for all debts and obligations of the sole proprietorship and is entitled to all of the profits of the business.
4. The sole proprietor may hire employees and agents, but retains the ultimate authority for all business decisions.
5. The sole proprietor is responsible for all business-related acts of his or her employees.

Sole Proprietorships in the United States

6. Sole proprietorships are the simplest and most common form of business in the United States.

Advantages of Doing Business as a Sole Proprietorship

7. Advantages of doing business as a sole proprietor include the full management authority possessed by the sole proprietor, the minimal formalities and reporting requirements imposed on sole proprietorships, the low cost of operating the sole proprietorship, and income tax benefits.

Disadvantages of Doing Business as a Sole Proprietorship

8. The most serious disadvantage of doing business as a sole proprietorship is the unlimited liability of the sole proprietor for all debts and obligations incurred by the business.
9. Other disadvantages to doing business as a sole proprietorship include a lack of business continuity, a lack of diversity in management, difficulty in transferring the sole proprietor's business, the sole proprietor's limited ability to attract high-

caliber employees, and the limited ability to raise capital.

Operation of the Sole Proprietorship

10. Because a sole proprietorship is not a separate and distinct entity, no formalities must be completed to form the business. Any individual who begins operating a business without taking the necessary steps to form another type of business entity is a sole proprietor.
11. Common sole proprietorship formalities include filing a certificate of assumed name, obtaining tax identification numbers and sales tax permits, obtaining licenses to conduct businesses, and registering intellectual property. When an individual or business organization transacts business under any name other than its own, it is said to be using an *assumed name*, *fictitious name*, or *trade name*.
12. Requirements for assumed names are found in state statutes. Generally, if the name is not already in use and it complies with state statutes, an application for assumed name may be filed with the secretary of state requesting permission to use the name in that state.
13. State statutes may also require that a notice of assumed name be published in a local newspaper prior to its use.
14. The purpose of state statutes regulating the use of assumed names is to protect the public and to provide the public with notice as to the persons with whom they are actually dealing.
15. Sole proprietors who hire employees must obtain federal employer identification numbers (EINs) by filing a Form SS-4 with the Internal Revenue Service.
16. States also require the use of tax identification numbers, which may be obtained by filing an application with the appropriate state authority.

17. Certain types of businesses must obtain licenses to comply with state statutes and local ordinances.

18. When the business of a sole proprietorship involves intellectual property, including inventions, the use of words or symbols that represent the business or its products, or creative material, it may be beneficial for the sole proprietor to register patents, trademarks, or copyrights.

The Paralegal's Role

19. Short of giving legal advice to the sole proprietor, paralegals can assist with all aspects of organizing a sole proprietorship. They are often involved with helping to prepare the required documents, such as the federal tax identification number application (Form SS-4), any required state tax identification number applications, and any applications for business licenses that may be required. Paralegals may also prepare, file, and publish (if necessary) any certificate of assumed or fictitious name that may be required. Paralegals who are familiar with requirements for filing applications for intellectual property may also assist in that area.

Resources

20. The Small Business Administration, state and local government offices, state statutes, the secretary of state offices, and the Internal Revenue Service are the resources most often used by paralegals who are working with sole proprietorships.

CASE BRIEFS

Thomas v. Colvin, 592 P.2d 982 (Okla. App. 1979)

Purpose: This case illustrates two ideas presented in Chapter 2: first, the idea that the sole proprietor is personally liable for his or her actions and those of agents acting on behalf of the sole proprietor; second, the idea that using an *assumed name* (or d/b/a, as it is referred to in this case) does not change the nature of the sole proprietorship or the entity adopting the name.

Cause of Action: Conversion

Facts: The plaintiff in this case purchased an automobile from the defendant, R. A. Coker, d/b/a Sherwood Motors, on a credit plan. The resulting security agreement and promissory note were assigned to B.F.T.C. Finance Corporation, of which defendant Coker was president. Subsequently, defendant Coker called defendant Bennie Colvin and hired him to repossess the car, even though plaintiff was not in default on the note. Plaintiff brought a conversion suit against defendants Colvin and R. A. Coker, d/b/a Sherwood Motors, for their wrongful repossession of the automobile.

The jury returned a verdict against defendant Coker, d/b/a Sherwood Motors, for \$1,625 in actual damages and \$17,500 in punitive damages. Defendant R. A. Coker, d/b/a Sherwood Motors, appealed.

Defendant Coker argued on appeal that the trial court erred because evidence failed to establish that Colvin was an agent of “R. A. Coker, d/b/a Sherwood Motors.” Coker claimed that he was not acting on behalf of Sherwood Motors when he hired Colvin and directed him to convert plaintiff’s car. Furthermore, defendant Coker argued that because he was sued as R. A. Coker, d/b/a Sherwood Motors, and not personally, he was not liable. The plaintiff argued that even though defendant Colvin may not have been the agent of “Sherwood Motors” in repossessing the car, Coker’s participation in the repossession, both as an individual and as an agent of B.F.T.C., made him personally liable.

Issue: Does an individual who does business as a sole proprietor under one or several names remain one person, personally liable for all of his or her obligations?

Holding: Yes, defendant is personally liable.

Reasoning: A “d/b/a” designation does not create a separate entity or limit the personal liability of the sole proprietor in any way. An individual who does business as a sole proprietor under one or several names remains one person and is personally liable for all of his or her obligations.

REVIEW QUESTIONS

1. What form of business ownership is the most prevalent in the United States?

The sole proprietorship is the most prevalent form of business ownership in the United States.

2. What form of business organization generates the most income?

The corporation is by far the biggest generator of income in the United States, earning more than sole proprietorships and partnerships combined.

3. Suppose that the Johnson Grocery Store is a sole proprietorship owned by Jill Johnson. If Jill’s store manager, Ben, in the ordinary course of business, orders too many tomatoes, can Jill Johnson refuse to pay for the order?

Jill Johnson cannot refuse the order.

Why or why not?

A sole proprietor is responsible for the acts of his or her agents and employees who are acting in the ordinary course of business.

4. Explain why an individual with limited financial resources might choose to incorporate rather than operate a sole proprietorship.

A sole proprietorship may require capital input greater than the individual sole proprietor is capable of raising. The corporate structure offers many more options for raising capital, such as the issuance of equity securities.

5. Jim is contemplating going into business for himself as a general contractor specializing in apartment complexes. For what reasons may Jim choose to operate as a sole proprietorship?

Jim may feel that he wants full management authority of his business, without having a partner or other investors to answer to. He may also be attracted to

the low cost of organizing and operating a sole proprietorship in contrast with other forms of business. Finally, he may want to avoid the double taxation that may be associated with corporations.

What factors may cause him to consider incorporating or forming a limited liability company?

Jim may be concerned with his exposure to personal liability for his business obligations. He may also find that he needs the capital of equity investors.

6. If Lucy decides to start a tailoring business from her home, what must she do before she begins advertising under the name of “Lucy’s Alterations”?

Lucy must check to be sure that the name “Lucy’s Alterations” is available for use, and she must check the requirements in her state for using an assumed name. She will probably be required to file a certificate of assumed name (or some similar document) with the secretary of state’s office. She may also be required to publish the certificate, or her intention to use the assumed name, in a local newspaper for a specified length of time.

7. Would a student who operates a lawn service, working afternoons and weekends to help pay tuition, be considered a sole proprietor?

Yes

Why or why not?

The student owns and operates an unincorporated business with no partners or investors.

SUGGESTED ANSWERS TO PRACTICAL PROBLEMS

The Practical Problem in this chapter asks the student to research the laws of the student’s home state to answer several questions about formalities that must be followed by sole

proprietorships. The answers to the problems will, of course, vary by state.

Resources for answering the Practical Problems include the following:

1. State statutes (See text, Exhibit 2-7.)
2. Office of the secretary of state or other appropriate state authority (See text, Appendix A.)
3. State tax authority (Links to state tax authorities may be found at the website of the Federation of Tax Administrators at <http://www.taxadmin.org>.)

EXERCISE IN CRITICAL THINKING

The Exercise in Critical Thinking for Chapter 2 asks students to consider the characteristics and traits that contribute to the success of a sole proprietor.

Exercise:

It is estimated that at least 30 percent of small businesses fail within the first year. Even with that high failure rate, some sole proprietors enjoy great success. What do you think are some of the common characteristics and traits possessed by successful sole proprietors?

SUGGESTIONS AND SAMPLE DOCUMENTS FOR THE WORKPLACE SCENARIO

The Workplace Scenario for Chapter 2 asks students to assist with the legal formalities for client Bradley Harris, who will be operating a computer repair business as a sole proprietorship. Students are asked to prepare an application for a certificate of assumed name, an application for a federal employer identification number, and an application for a state tax identification number. Sample documents for several of the Workplace Scenarios throughout the text may be found in the appendices to this Instructor’s Manual. For Chapter 2, the sample documents include the following:

- Appendix B, application for certificate of assumed name (with cover letter)
- Appendix C, application for federal employer identification number

Downloadable forms for several states are available on the CourseMate website that accompanies this text at <http://www.cengagebrain.com>, or from the website of the secretary of state.

Requirements for state tax identification numbers vary too much among the states to make a sample form useful.

Students will need to obtain the current information from the state tax authority in their home state to determine the proper procedures. Links to state tax authorities may be found at the website of the Federation of Tax Administrators at <http://www.taxadmin.org>.

Students can complete the Form SS-4 for this assignment by filling in the online form at <http://www.irs.gov> and printing the form without submitting it.

ADDITIONAL EXERCISE 1

Rather than completing the documents for the Workplace Scenario, students may be asked to imagine that they are sole proprietors and to complete the necessary formalities for their own fictitious sole proprietorship within their state.

CHAPTER 3

General Partnerships

THEME

Chapter 3 is an introduction to partnerships, focusing on the nature of the partnership, the relationship between partners, the advantages and disadvantages of doing business as a general partnership, and the partnership agreement.

CHAPTER GOAL

The goal of this chapter is for students to become familiar with the following terms and topics concerning general partnerships:

- *Partner and partnership*
- Elements of a partnership
- Rights and responsibilities of partners
- Advantages and disadvantages of doing business as a partnership compared to other forms of business organization
- Partnership organization and management and the importance of the partnership agreement
- Formalities for forming, operating, and dissolving a partnership
- The role of the paralegal who works with partnerships
- Resources to assist paralegals working with partnerships

SUGGESTED APPROACH

As of late 2011, most states have adopted the Uniform Partnership Act (1997), but several still follow the Uniform Partnership Act (1914). This chapter focuses on the Uniform Partnership Act of 1997 (UPA 1997), with references and comparisons to its predecessor, the Uniform Partnership Act of 1914 (UPA 1914). The UPA 1997 can be found on the website of the National Conference of Commissioners on Uniform State Laws at <http://www.nccusl.org>.

Partnership law and interpretation of that law vary from state to state. For that reason, it is

important to bring the law of your state into your discussions on partnership law. Students may be encouraged to research the positions of their home state on some of the pertinent topics discussed throughout the chapter. Links to the partnership acts for most states can be found on the CourseMate website that accompanies this text at <http://cengagebrain.com>.

The importance of the partnership agreement may be stressed by discussing its application to the various topics included in this chapter, as they are discussed.

LECTURE NOTES

An Introduction to General Partnerships

1. A *partnership* is an “association of two or more persons to carry on as co-owners of a business for profit.”
2. All partners of a *general partnership* are considered general partners. *Limited partnerships* consist of general partners and limited partners.
3. *General partners* have personal liability for the debts and obligations of the partnership.
4. The partnership may be viewed as both a separate entity and as an aggregate of its partners. States that have adopted the UPA 1997 treat the partnership as a separate entity for most purposes.
5. Statutes of most states provide that partnerships may file a special election to be treated as a limited liability partnership (LLP). Limited liability partnerships are discussed in Chapter 5.
6. There are fewer partnerships in the United States than either sole proprietorships or corporations, and their income per year is less than that of either sole proprietorships or corporations.

7. The UPA 1914 was originally approved in nearly every state in the country. Most states have now adopted the UPA 1997 with limited liability partnership provisions.
8. Partnerships are also governed by common law and the partnership agreement. As long as the provisions of the partnership agreement do not conflict with the law, the partnership agreement governs the partnership.

The Relationship between Partners and Others

9. Partners are considered agents of the partnership and other partners.
10. With few exceptions, each partner may act on behalf of the partnership and has actual authority to bind the partnership to contractual relationships with third parties.
11. An act of any one partner is binding on the partnership as long as the partner's act is apparently undertaken for the purpose of carrying on the ordinary course of the partnership business.
12. A partner's act may bind the partnership even if the partner is not acting in good faith.
13. Certain acts require unanimous consent of the partners. These acts may be specified by state statute or the partnership agreement.
14. Under the UPA 1914, the following acts require unanimous consent of the partners:
 - Acts undertaken with a third party who has knowledge that the act is not authorized
 - Acts not apparently undertaken for carrying on the business of the partnership
 - The assignment of partnership property in trust for creditors
 - Acts to dispose of the goodwill of the business
 - Acts that make it impossible to carry on the business of the partnership
- The confession of a judgment on behalf of the partnership
- The submission of a partnership claim or liability to arbitration or reference
- The admission of new partners to the partnership
15. The UPA 1997, which relies more on provisions in the partnership agreement than the UPA 1914, provides that the following actions must have the unanimous consent of partners:
 - Acts undertaken with a third party who has knowledge or has received notification that the act is not authorized
 - Acts not apparently undertaken for the purpose of carrying on the ordinary course of the partnership business
 - Amending the partnership agreement (unless otherwise specified in the partnership agreement)
 - Adopting limited liability partnership status (unless otherwise specified in the partnership agreement)
16. In states that follow the UPA 1997 in this regard, the partnership may file a statement of authority with the secretary of state or other appropriate state official to give public notice of the authority granted or denied certain partners. Persons transacting business with the partnership are not necessarily deemed to know of a limitation of authority because the limitation is contained in the filed statement.
17. A statement of denial may be filed to revoke authority granted in a previously filed statement of authority.
18. The full extent of the personal liability of partners may vary depending on state statute and the partnership agreement. Generally, partners have joint and several liability for all debts and obligations of the partnership, and creditors may look to the personal property of the individual partners to satisfy the partnership's obligations.

The Relationship among Partners and between Partners and the Partnership

19. When a partnership enters into an agreement with a third party, the agreement often includes provisions specifying the limitations of each partner to act on behalf of the partnership. Actions taken outside of that authority will not be binding on the partnership.
20. Under the UPA 1914, partnership property is held in a *tenancy in partnership*. When property is held in a tenancy in partnership, each partner has an equal right to possess specific partnership property for partnership purposes, but has no right to possess such property for any other purpose without consent of the other partners.
21. With regard to partnership property, the UPA 1997 treats the partnership as a separate entity. Partnership property is owned by the partnership. The individual partners own the right to receive income or profits from the partnership property. A partner's right to receive income or profits from the partnership property can be transferred. A partner's right in specific partnership property is generally not assignable.
22. State statutes and partnership agreements generally grant each partner the right to have a separate account that reflects their contributions, share of the gains, and share of the losses in the partnership assets.
23. Partners are granted by statute the right to an equal share of the partnership profits unless that right is amended by the partnership agreement. Partners are also responsible for a proportionate share of the partnership's losses.
24. Unless otherwise specified in the partnership agreement, partners have the right to be repaid contributions and to share equally in the surplus remaining after partnership liabilities are satisfied.
25. Partners have the right to reimbursement for certain money they spend on behalf of the partnership.
26. Unless otherwise specified in the partnership agreement, each partner has the right to share equally in the management and conduct of the partnership business. The partnership agreement may provide for a managing partner or committee to oversee the management of the partnership.
27. Partners are granted, by statute, access to the books and records of the partnership.
28. Partners are entitled to reasonable compensation for their services in winding up the affairs of the partnership.
29. State statutes and the partnership agreement may provide that each partner has a right to have his or her partnership interest purchased by the remaining partners after a permissible dissociation from the partnership.
30. State statutes and most partnership agreements generally provide that partners owe each other and the partnership the following duties:
 - The duty to contribute toward losses sustained by the partnership according to each partner's share in the profits, unless the partnership agreement provides otherwise
 - The duty to work for the partnership without pay, unless such remuneration is provided for in the partnership agreement
 - The duty to submit to a vote of the majority of the partners when differences arise among the partners
 - The duty to provide information to the other partners concerning the partnership
31. Partners owe a fiduciary duty to each other. The UPA 1997 specifically states that the fiduciary duty partners owe each other includes the duty of loyalty and the duty of care (as defined in the UPA 1997).

Advantages of Doing Business as a Partnership

32. Some of the possible advantages of doing business as a partnership compared to other types of business organization include the following:
- Partners have flexibility in managing the partnership, including the ability of all partners to participate in the management.
 - Partnerships are subject to fewer formalities and regulatory and reporting requirements than corporations, especially publicly held corporations.
 - The cost of organization of the partnership is relatively low compared to other types of business organizations. Generally, partnership documents are not required to be filed at the state level, so no filing fees are assessed.
 - The flow-through income taxation of the partnership is probably the biggest advantage the partnership offers over most other types of business organizations.
 - Compared with sole proprietorships, partnerships generally have diversified capital resources because more than one owner is involved.

Disadvantages of Doing Business as a Partnership

33. Some of the possible disadvantages of doing business as a partnership, rather than as another type of business organization, include the following:
- Partners are generally personally liable for the debts and obligations of the partnership.
 - Compared to corporations, partnerships have a very loosely structured management under state statutes. Unless the partnership agreement is worded very carefully, it can be difficult for the

partnership to take action in the event of disputes among the partners.

- Compared to corporations, which have stock that may be freely transferred, partnerships present a lack of business continuity and difficulty in transferring partnership interests.
- Compared to corporations that may raise capital by selling stock on the open market, partnerships have a limited ability to raise capital to run the partnership business.
- Compared to sole proprietors, partners may incur significant expenses in organizing their businesses due mainly to legal fees to draft partnership agreements.

Management and Control of a General Partnership

34. Unless otherwise specified in the partnership agreement, all partners have an equal right to manage the partnership business.
35. The partnership may be managed by a designated managing partner or by a management committee.
36. In the event of a dispute, decisions are made by a majority of the partners, unless some other method of resolving the dispute is agreed on.

The General Partnership Agreement

37. A partnership may be formed by an oral agreement as long as all the elements of a partnership are present. A written partnership agreement is generally recommended for all partnerships.
38. The partnership agreement is entered into by all partners.

Financial Structure of a General Partnership

39. The partnership capital consists of all assets of the partnership, including the contributions of the partners and the undistributed income earned by the partnership.

40. Unless otherwise provided for in the partnership agreement, partners share equally the profits and losses of the partnership. The partnership agreement may provide a different formula for sharing the profits and losses based on (1) the amount of the initial capital contributions, (2) additional capital contributions, or (3) services rendered on behalf of the partnership by the individual partners.

Dissociation, Dissolution, Winding Up, and Termination of the General Partnership

41. Under the UPA 1914, whenever one partner quits the partnership for any reason, the partnership is dissolved. Under the UPA 1997, one or more partners may be dissociated from a partnership without causing its dissolution.
42. A partner's dissociation can be caused by agreement, by statute, or wrongfully.
43. Partners who dissociate from the partnership contrary to provisions of the partnership agreement and/or state statute cause a wrongful dissociation and may be liable to the partnership and other partners for damages caused by the wrongful dissociation.
44. In most instances, when the dissociation is not wrongful, the dissociating partner has the right to have his or her interest in the partnership purchased for a buyout price set forth in the partnership agreement or by statute.
45. Under the UPA 1914, the following acts cause a partnership dissolution:
- Expiration of the term or completion of a particular undertaking specified in the partnership agreement
 - The express will of any partner when no definite term or particular undertaking is specified
 - The express will of all the partners who have not assigned their interests in the partnership
 - The expulsion of any partner from the business pursuant to the partnership agreement
- The express will of any partner at any time, if contrary to the agreement, but circumstances do not permit a dissolution under any other statutory provision
 - Any event that makes it unlawful for the business of the partnership to be carried on
 - The death of a partner
 - The bankruptcy of any partner or the partnership
 - The order of a court
46. Only the following events cause a partnership to dissolve under the UPA 1997:
- Notice given by a partner to the partnership of that partner's express will to withdraw (in a partnership at will)
 - In a partnership for a definite term or particular undertaking, when (1) a 90-day period expires after a partner's dissociation by death or otherwise or through wrongful dissociation, unless a majority of the remaining partners agree to continue the partnership; (2) the express will of all of the partners to wind up the partnership business; (3) the expiration of the term or the completion of the undertaking
 - An event set forth in the partnership agreement resulting in the winding up of the partnership business
 - An event that makes it unlawful for the partnership business to be continued
 - A judicial determination to dissolve the partnership
47. Upon dissolution of the partnership, the partnership relation terminates and the winding-up process begins.
48. Guidelines for distributing the assets of the partnership on dissolution are usually set forth in the partnership agreement. These guidelines must not violate the statutes of the partnership's state of domicile with regard to partnership distributions.

49. The debts and obligations of the partnership owing to third parties must be paid in full before distributions may be made to the partners in respect of profits.
50. The partners must contribute to the assets of a dissolving partnership to the extent necessary to meet the financial obligations of the partnership.
51. In states that follow the UPA 1914, all nonpartner creditors must be paid before partner-creditors may be paid.
52. In states that follow the UPA 1997, the assets of the partnership must first be applied to discharge the partnership obligations to creditors, including partners who are creditors.
53. If any, but not all, of the partners are insolvent or unable to pay their share of the partnership's liabilities, that partner's share must be paid by the remaining partners.
54. Any partner who is required to pay in excess of his or her fair share to settle the affairs of the partnership has the right to enforce contribution of other partners pursuant to statute and the partnership agreement.

Other Types of Partnerships

55. *Joint ventures* are very similar, but not identical, to partnerships. Joint ventures are usually formed for a single transaction or an isolated enterprise, rather than for an ongoing concern.

The Paralegal's Role

56. Paralegals who assist attorneys representing partnerships often assist by researching state partnership law and drafting the partnership agreement. They may also assist with filing documents such as a statement of authority and with adopting an assumed name on behalf of the partnership.
57. The resources most often used by paralegals when assisting with partnership matters include state statutes, legal form books, and information available from the secre-

tary of state's office and the offices of other appropriate state agencies.

CASE BRIEFS

Cleland v. Thirion, 268 A.D. 842 (704 N.Y.S. 2d 316)

Purpose: This case is an example of how a court may view the elements of a partnership discussed in the text when determining whether a partnership does, in fact, exist.

Cause of Action: Breach of agreement

Facts: In this case, heard in 2000, the plaintiff Jennifer Cleland ("Cleland") brought suit against her former lover, Christian Thirion ("Thirion"). Cleland and Thirion lived together at Cleland's residence for approximately three years. When they moved in together, Thirion was already established as an artisan glassblower, doing business under the trade name of "Glassart," and he had recently purchased a building that he intended to convert into a studio and personal living quarters. Cleland assisted Thirion with his business in various ways when they lived together.

In 1994, after the parties had been together for about a year, they executed a one-page document intended to establish the parties' financial and personal relationship. Cleland initially brought this suit in 1997, seeking a declaration that the agreement constituted a partnership agreement for "ownership and operation" of the Glassart business; seeking damages for breach of the agreement and an accounting of the profits, losses, and assets of Glassart; and imposing a constructive trust upon the assets of Glassart. The New York Supreme Court found that the parties never entered into a partnership and that it was unenforceable due to the absence of any material terms. Cleland appealed.

Issue: Did the agreement between the parties form a partnership to own and operate the Glassart business?

Holding: The Court of Appeals upheld the lower court's decision in favor of the defendant, indicating that there was no partnership agreement between the parties.

Reasoning: In determining whether a partnership existed, the court considered the following elements of a partnership:

1. The intent of the parties (express or implied)
2. Joint control and management of the business
3. Sharing of the profits and losses
4. A combination of property, skill, or knowledge

The court found that there was no evidence that any of those factors existed. Some of the reasons given included the following:

- The studio property was owned solely by Thirion.
- The plaintiff's name was never placed on a certificate of doing business as partners indicating joint control and management of the business. This would indicate that a partnership was not the intent of the parties.
- No partnership tax returns were ever filed evidencing a sharing of profits and losses.
- Although the plaintiff contributed some financial support to the business, her support was characterized by both parties as a loan, further indicating there was no sharing of the profits and losses.
- Plaintiff contributed some services to the business, but then sought compensation in the form of wages, portraying herself as an employee rather than a partner.

REVIEW QUESTIONS

1. What five elements are necessary to form a partnership?
 1. **The partnership must have two or more partners.**
 2. **The partners must actively carry on the partnership business together.**
 3. **The partners must co-own the partnership business or property.**
 4. **The partnership must be formed to carry on a "business" (defined as "... every trade, occupation, or profession").**

5. The partnership must be formed with the intent of making a profit.

2. In what ways are partnerships similar to sole proprietorships?

Some of the ways in which partnerships are similar to sole proprietorships include the fact that both partners and sole proprietors have unlimited personal liability, partnerships are taxed in much the same manner as sole proprietorships, there are few organizational costs and formalities associated with both sole proprietorships and partnerships, and partnerships are sometimes considered to be an extension of the individual partners, not separate entities.

In what ways do they differ from sole proprietorships?

Unlike a sole proprietorship, it takes at least two individuals or entities to form a partnership. Also unlike sole proprietorships, partnerships are considered separate entities under certain circumstances.

3. Suppose that John, Megan, and Alex form a partnership to operate a restaurant in a state that follows the UPA 1997. John decides to buy hamburger buns from the Fresh Bread Bakery. He enters into a contract with the owner of the Fresh Bread Bakery, on behalf of the partnership, for the delivery of 500 hamburger buns each week, for the price of \$70 per week. If Megan and Alex disagree with this decision because they prefer another baker, is the partnership still liable for this contract?

Yes, John has apparent authority to bind the other partners in a relationship with a third party. The representatives of the Fresh Bread Bakery would be reasonable in assuming that John had authority to enter into the contract to bind the partnership.

Must the Fresh Bread Bakery be paid out of the partnership funds?

Yes

4. Suppose again that John, Megan, and Alex form a partnership, and John has contributed 50 percent of the capital, Megan has contributed 30 percent of the capital, and Alex has contributed 20 percent of the capital. Who has the right to manage the partnership under the UPA 1997, assuming the partnership agreement has no contrary provisions?

Assuming that there are no partnership agreement provisions to the contrary, John, Megan, and Alex all have an equal right to manage the partnership business.

How will decisions be made in the event of a disagreement?

Assuming that there are not partnership agreement provisions to the contrary, by the vote of a majority of the partners

5. In a state that follows the UPA 1914, how is partnership property owned? How is that different from property owned by a partnership in a state that follows the UPA 1997?

In states that follow the provisions of the UPA 1914 regarding property ownership, the partnership property is held in a tenancy in partnership, with each partner considered a co-owner of specific partnership property. Each partner has an equal right to possess the property for partnership purposes, but no right to possess for any other purposes without consent of the other partners. In states that follow the UPA 1997 with regard to partnership property, the property is owned by the partnership itself.

6. Kara, Tim, and Anna have formed a partnership to purchase and renovate old homes. Kara and Tim have contributed the bulk of the capital for the partnership, and Anna's main contribution has been her services. All partners agree that either Kara or Tim should have the authority to sign documents transferring real estate on behalf of the partnership and that Anna should not have that authority. If the partnership is

formed in a state that follows the UPA 1997, what steps must they take to give notice to those dealing with their partnership of their agreement with regard to the authority to transfer real estate?

In addition to entering into a partnership agreement stating their intentions, Kara, Tim, and Anna should file a statement of authority with the secretary of state or other appropriate state authority. The statement of authority will give public notice that Anna does not have authority to sign real estate transfer documents on behalf of the partnership.

7. Janet is a partner in a 10-partner partnership located in a state that follows the UPA 1997. If Janet decides to withdraw from the partnership before its duration lapses, what are the possible outcomes to the partnership and the remaining partners?

If Janet withdraws from an active partnership formed under the UPA 1997, Janet will become dissociated from the partnership. The partnership will not necessarily be dissolved, but Janet will lose her right to participate in the management and conduct of the partnership business. She will no longer be able to act on behalf of the partnership, except to assist with winding up the partnership (if necessary). In addition, Janet will no longer be liable for any debts and obligations of the partnership incurred after her dissociation.

Janet may have the right to have her interest in the partnership purchased by the remaining partners as provided in state statute or the partnership agreement.

What if the partnership is located in a state that follows the UPA 1914?

In states that follow the UPA 1914 in this regard, the partnership is dissolved whenever one partner withdraws. How-

ever, the remaining partners are free to form a new partnership without Janet.

8. Suppose that three retirees form a partnership to own and operate a horse ranch. They all plan to work at the ranch and board horses to supplement their retirement income. If the business does not go as planned, and the retirees earn no income from the ranch, do they still have a valid partnership?

Yes

Why or why not?

The partnership was formed with the intent to earn a profit. The fact that no profit was earned does not make it an invalid partnership.

9. Suppose that Ken, Bill, and Mary form a partnership to build and lease a strip mall. The partners agree that Ken will be responsible for securing the location on which to build the mall. Ken selects a site that turns out to have poor soil quality, and the project suffers several setbacks before they finally decide it is not feasible, and the partners decide to go their separate ways. If the partnership funds have all been exhausted, and the partnership still owes \$20,000 to an environmental engineering firm that Ken hired, who must pay?

Unless the partnership agreement indicates otherwise, all three partners are equally responsible for the debt of the partnership.

What if Ken and Mary have no substantial personal assets, but Bill has \$30,000 in the bank?

All three partners are still responsible for the debt, but as a practical matter, the creditors may choose to go after Bill for payment. Bill could try to collect from Ken and Mary at some future date if they acquire cash or assets.

10. Suppose that the three partners of a partnership have a falling out, and two of them stop

communicating, leaving the third partner to wind up and dissolve the partnership. The third partner claims she is entitled to compensation for her time spent winding up the partnership, but the other partners claim that, unless agreed to in a partnership agreement, partners are not entitled to compensation for their time spent on partnership business. Assuming that their partnership agreement is silent on the matter, who is right? Why?

Although partners typically have no right to compensation for their services rendered on behalf of the partnership, there is an exception for a partner who is left to wind up the partnership business. The partner who wound up the business of the partnership would be entitled to compensation for her time.

SUGGESTED ANSWERS TO PRACTICAL PROBLEMS

The Practical Problems in this chapter ask students to research the partnership laws of their home states to answer several questions concerning the partnership act that has been adopted. Questions 2 and 3 of the Practical Problems ask students to begin looking at the formalities that must be followed in their home states by partnerships. The answers to the problems will, of course, vary by state. Resources for answering the questions include: (1) state statutes (see text, Exhibit 3-10); links to the partnership acts for most states can also be found on the CourseMate website that accompanies this text at <http://www.cengagebrain.com>; and (2) websites of the offices of the secretary of state or other appropriate state authority (see text, Appendix A, and the CourseMate website that accompanies this text at <http://www.cengagebrain.com>).

EXERCISE IN CRITICAL THINKING

The Exercise in Critical Thinking for this chapter asks students to consider the management characteristics of a partnership and some potential pitfalls.