

### **Question 5 – February 2014 – Selected Answer 1**

1. ABC is liable in the Parent's lawsuit, but not Amy, Bart or Conner. In Texas, the members of an LLC are not liable for the obligations of the company, except in extraordinary circumstances where the courts can pierce the corporate veil. However, members can be held liable for their own obligation, including their own tortious actions. Texas law also provides for vicarious liability of a company for the tortious conduct of its employees in the scope of their employment. In the Parent's lawsuit, the facts indicate that the ABC product manager acted tortiously because he had been informed of the defect in the toy but did nothing to remedy the defect or pull the toy from the market. Through vicarious liability, ABC can be held liable for that manager's negligence because the manager was responsible for the product safety issues and did nothing when informed of the defect in the toy, so the manager's negligence was within the scope of his work. However, it does not appear that Amy, Bart or Conner committed a tort. Indeed, they did not even know of the defect. Also, there are no facts to indicate that there is any sort of veil-piercing claim here. Thus, ABC is liable in the parent's lawsuit, but not Amy, Bart or Conner because they are protected by the limited liability benefit of the LLC and they did not engage in any tortious conduct individually.

2. ABC is liable in First Bank's lawsuit, but not Amy, Bart or Conner. The first issue is whether Amy had the authority to bind ABC to the loan agreement. In Texas, an agent can bind a principal if they have actual authority or apparent. Actual authority is given by an express or implied granting of authority and apparent authority is granted by the principal engaging in conduct that could make a third party believe that the agent has authority. Here, Amy appears to have been given actual authority to bind the company to the Loan Agreement because she was given the role of "Managing Member." Even though the LLC agreement does not expressly give her authority to sign the company up for debts, it is foreseeable that the company will have to take on debt to conduct business and she is the managing member. Regardless, her title of managing member, given her by ABC is enough to make third parties believe that she has authority to sign debt documents. Under either actual or apparent authority theories, or both, courts will almost certainly find that Amy effectively bound ABC to the loan agreement.

The second issue is whether, by signing the loan application, Amy was a co-signer or surety on the loan. In Texas, if an agent signs a document with (1) the title "as agent of [principal]" or equivalent title that puts the counterparty on notice that the agent signs only in their capacity as agent and (2) signs with actual authority, their signature does not make them liable on the contract. In this case by Amy "as Managing Member, ABC Products LLC" is enough to have put First Bank on notice that Amy was signing in her capacity as manager of ABC, not in her personal capacity.

As discussed in 1, because this is a validly formed LLC, the members are not liable for the contracts of the company with third parties solely because of their capacity as owners. Thus, ABC will be liable under the loan agreement, but none of the members will be personally liable.

### **Question 5 – February 2014 – Selected Answer 2**

1. In Texas, a limited liability corporation (LLC) is used to shield individuals from personal liability from the negligence committed by others. This is subject to certain limitations. First and foremost, a party is always liable for his or her own actions. Second, a corporation will be held vicariously liable for the negligent actions of employees acting within the scope of their employment under traditional agency principals. Third, while an LLC can be used to shield individuals from being held personally liable for the negligence committed by others, if the individual is in a supervisory position, he or she can be held liable for any and all negligent supervision of the employees under his or her supervision. A last note is that under traditional agency principals any knowledge of an employee is deemed to be known by the corporation.

Applying the law to this set of facts, a youngster was seriously injured by a product an ABC manager knew to be defective but did not inform Amy, Bart, or Connor, act to remedy, or pull the toy from the market. Under the principals above, even though not named in the suit the manager can be held liable (liable for your own torts) as can ABC (a corporation will be held vicariously liable for the negligent actions of employees acting within the scope of their employment).

Bart and Connor will not be held liable. Under the facts this is a "manager-managed" LLC, not a "member-managed" LLC. Thus, because Bart and Connor are not employed or manage and because LLCs shield individuals personally from the negligence committed by others, there is no theory on which to find Bart or Connor liable. As to Amy, the only theory on which Amy can be held liable is a negligent supervision theory (she is in the same position as Bart and Connor as to other fields).

Here there is a legitimate agreement where the corporation is in effect indemnifying her as to negligent actions, which will be upheld. However, the gross negligence and intentional misconduct provisions will not apply. So the question is whether Amy was either grossly negligent or intentional here, and the answer is no. The information shows not even enough evidence to assert negligence against Amy. The record shows the employee failed to disclose the defect and that Amy did not know or have reason to know of the defect. Further, while the knowledge of an employee is imputed to a corporation, it is not imputed to a manager. As such, Amy cannot be held liable.

In sum, the parents can hold ABC and the product manager liable, but not Amy, Bart, or Connor.

2. Incorporating all the rules above, an agent is personally liable for contracts entered into on behalf of his or her principal in two situations, the principal is undisclosed or the principal is only partially disclosed. If the principal is disclosed, an agent can properly bind his or her principal and will not be personally liable when he or she is authorized or impliedly authorized to do so or when the principal gives a third party reason to believe that there is apparent authority for a part to bind the principal. Here, Amy is named in a LLC agreement as the Managing Member (actual authority), the agreement indicates none of the members will be held liable to third parties for any debt, obligation or liability of ABC, whether in contract, tort, or otherwise, and on the loan Amy signed on behalf of ABC and unambiguously noted she was signing as a "Managing Member, ABC Products LLC." As such, since there was actual authority coupled with an unambiguous and disclosed principal, Amy will not be held liable, and First Bank will lose.

Bart and Connor will also not be held liable. They were not signatories and by the ruled noted above, cannot be held personally liable for others debts, obligations or liabilities.

ABC WILL be held liable for defaulting on the First Bank Loan. Amy, as an agent of ABC, properly bound ABC under the actual authority given to her as the manager of ABC. Amy could bind ABC, Amy did bind ABC, so First Bank can sue ABC. As a side note, it is important to note that there is no reason to believe that the corporate veil can be pierced (alter ego, undercapitalized, lack of corporate formalities) or that Amy breached any fiduciary duties owed to the company. As such and in sum, only ABC will be held liable to First Bank Loan.

### **Question 5 – February 2014 – Selected Answer 3**

1. ABC: ABC may be held liable in Parents' lawsuit. Because a limited liability company seeks to protect its officers, directors and shareholders, rather than its own interests, it may be held liable on the tortious conduct of its employees. The facts state that the ABC product manager knew of the defect in the toy, but took no action to remedy the defect or pull the toys from the shelves. As product manager for ABC, he was an employee of ABC and thus under the control of ABC. On these facts, the product manager was certainly negligent in his duties under a vicarious liability theory, ABC will be held liable for the tortious conduct by its product manager. However, because this is products liability, the company will be held liable regardless of its or its employees' negligence.

Amy: Will probably not be held liable in Parents' lawsuit. In a tort action against a limited liability company, the only defendants who may be held liable are the company itself and the tortfeasor. The tortfeasor may claim that he was acting as agent for Amy, as she was the managing member, and was thus responsible for overseeing employees on a daily basis. However, because this is a products liability suit, the standard is strict liability and Parents do not need to prove that Amy or the product manager were negligent. ABC will be the only party held liable for the defective product.

Bart and Connor: Will not be held liable in Parents' lawsuit. Bart and Connor are shielded from personal liability because they are officers in their limited liability company. The only way in which they may be held personally liable is if their conduct is so egregious and malicious as to cause courts to pierce the corporate veil and hold them liable. As this is a close corporation, Bart and Connor are shareholders in the corporation and thus may be held liable under the PCV theory. However, the facts indicate that Bart and Connor neither knew or had reason to know of the defect.

2. ABC: ABC may be held liable in First Bank's lawsuit. A limited liability company may always be held liable for the tortious or contractual conduct of its employees. Here, Amy is ABC's Managing Member. She signed the loan for ABC as Amy, "Managing Member, ABC Products LLC." Amy entered into a contract with First Bank for \$100,000 as an agent of ABC. The signature on the loan indicates that Amy had actual authority as an agent for ABC (principal-agency relationship). An agent has actual authority for a principal when they hold themselves out as an agent for the principal, and the agent has been given direct authorization to conduct business on behalf of the principal. Here, the written LLC agreement states that Amy would act as ABC's Managing Member and be paid a salary for doing so. Therefore, Amy was an employee of ABC and acting within the scope of her employment when she signed the loan. Additionally, the loan agreement only states ABC as the sole borrower. Therefore, as principal, ABC will be held liable for the loan with First Bank.

Amy: Amy may not be held liable to First Bank. An agent or employee, acting within the scope of employment and with actual authority, who enters into a contract on behalf of the company as the principal, will not be held personally liable on that contract. As for the reasons stated above, Amy is discharged of her liability when entering into a contract with actual authority as agent for a principal and thus would not be held liable to First Bank. However, if she entered into the contract acting with gross negligence or intentional misconduct, she may be held personally liable.

Though the LLC agreement states that Amy cannot be held liable for such conduct, this is unenforceable. Officers of an LLC may be held personally liable if they act with gross negligence or their misconduct is intentional. In a close corporation such as ABC, courts may "pierce the corporate veil" if shareholders - here, this includes Amy, Bart and Connor - acted so badly and maliciously as to cause their own personal liability. However, there is no indication here to show that Amy acted in such an egregious way as to meet either of these standards. There is no indication in the facts that she used the First Bank loan for any of her own personal needs, nor did she embezzle or mismanage funds. Therefore, she cannot be held liable.

Bart and Connor: Bart and Connor may not be held liable to First Bank. Under the Texas Business Organizations Code, a limited liability company insulates officers and members from personal liability on contracts. Here, there is no indication that Bart and Connor were ever involved in the day-to-day management of ABC, nor were they acting as agents for ABC in contract formations with banks. Therefore, they cannot be held liable.