

## Question 2 – February 2019 – Selected Answer 1

### (A) Lawsuit

#### Company

The Company will be liable in the lawsuit. The company is a master that is liable for most torts of its employees/servants committed in the scope of their employment. Here, the corporation's purpose was to sell tacos, and Erika, who is a servant, committed a tort while en route to serve tacos using the company food truck, therefore the tort is within the scope of employment and the company is vicariously liable for Erika's actions.

#### Dawn

Dawn will not be liable in the lawsuit. By law, members of an LLC are not personally liable for the debts of the LLC unless they are the tortfeasor themselves, they personally guarantee a debt, or they use the corporate form as an alter ego for their personal use (under the piercing the corporate veil doctrine). Here, Dawn was not the tortfeasor, she did not personally guarantee any debt to Gayle, and there's no evidence that the corporate form was used improperly, so there is no basis under which to hold Dawn personally liable, and her personal assets are protected. Dawn is only liable to the extent that she invested money into the company, which will be subject to a judgment resulting from the lawsuit.

#### Erika

Erika will be liable in the lawsuit. Normally members of an LLC are not liable as described above, but here, Erika herself is the tortfeasor because she was the one driving the truck. Therefore Erika's personal assets will be liable for a judgment based on her tortious acts.

### (B) Rescission of the Craft Brewery purchase

The issue here is that the craft brewery purchase was an ultra vires act. Generally, a company may only act within the purpose stated in its certificate of formation. While that purpose can be as broad as "any lawful purpose," here the purpose was limited strictly to selling tacos. While this purpose implies a lot of other lawful purposes (for example, renting a building in which to sell tacos, buying equipment to make tacos, hiring lawyers to draft contracts with taco suppliers, etc), it cannot be interpreted so far as to justify buying a craft brewery. Unless Dawn can show that she intended to convert the brewery into a taco-making factory or something else related to selling tacos, this will fall outside of the company's purpose and will therefore be an "ultra vires" act.

The Company may still be bound by the act even though it is ultra vires. The certificate of formation stated that all members are considered agents of the Company and may act to bind it in carrying out Company business. The Company will successfully argue that buying a brewery is not Company business, and therefore Dawn had no actual authority to buy it. However, as a

member in a member managed Company, Dawn likely had apparent authority to bind the Company in contracts such as the one with Sam.

There are not enough facts to make this determination, as we do not know what knowledge Sam had of the Company and Dawn's status as a member, nor do we know if Dawn agreed to the purchase in her representative capacity or individually. If Sam knew of the Company and reasonably relied on Dawn's status as a member and/or her representative capacity in agreeing to the sale, apparent authority will be established, and then the Company will be bound by Dawn's act and will not be able to rescind the contract, although it may sue Dawn and access her personal assets to reimburse the Company for the costs of the sale and any costs or losses incurred in disposing of the brewery.

However, if Sam did not know of the Company at all and believed Dawn was making the purchase on her own, then the Company will not be bound, and this will be treated as a personal purchase of Dawn's. In that case, Erika would not need to pursue rescission. However, the Company can pursue both civil and criminal actions against Dawn for improper use of Company funds for a personal purpose. Dawn may defend that she was acting in good faith by trying to supplement the Company revenue, which could be used to fund taco-selling activities, which were not ultra vires and fell within the purpose and which were not a breach of her duties to only use funds for company purposes. Dawn will likely lose and will be required to repay the Company for the misappropriated funds.

### **Question 2 – February 2019 – Selected Answer 2**

(A) In Gayle's lawsuit, the Company and Erica are potentially liable, but Dawn is not.

The Company:

A company is liable for the torts committed by agents or employees of the company that are committed within the ordinary course of business and within the scope of the agency. A person is an agent if they have actual or implied authority. Members are agents for purposes of tort liability when carrying out the ordinary business of the company.

Here, Erika was the tortfeasor who struck the vehicle driven by Gayle. Erika is a member of the Company, and the tort was committed in the ordinary course of business because it occurred while Erika was driving the Company's food truck, while carrying out the Company's business purpose to sell Tacos. Therefore, the Company is liable for the tort committed by Erika.

Dawn:

Members of a limited liability generally have no liability for the obligations of the company, including any tort liability. However, a member may be liable for her own torts. Here, Dawn was not driving the truck that struck Gayle, and there is no indication that she was otherwise involved in the accident. Therefore, Dawn would not be personally liable for any tort recovery related to the lawsuit filed by Gayle.

Erica:

Although Members of a limited liability generally have no liability for the obligations of the company, a member can still be liable for her own torts. Here, Erica was the tortfeasor, so she has personal potential liability if a court finds she was at fault.

(B) Erika would likely not be able to force the rescission of the purchase of the craft brewery.

A limited liability company is liable on contracts executed by agents of the company. An agent is someone who has actual or implied authority to enter into the transaction. Generally, a member has authority to enter into transactions within the ordinary course of business.

Further, the Company's certificate of formation states that the Company is member managed, and the Agreement states that each member is an agent of the Company for purposes of carrying out the company's business, which Dawn would argue gives her actual authority to enter into the transaction.

However, here, Dawn used Company funds to purchase a craft brewery from Sam, a third Party. Erika would likely argue that Dawn did not have authority because the transaction was not within the company's stated business: to sell tacos. However, even if an agent does not have actual authority, she may still have apparent authority.

Whether Dawn had apparent authority to enter into the transaction depends on whether the third party could reasonably believe that she had authority to do so. Here, a third party could reasonably believe that Dawn had authority to enter into the transaction, because Dawn is a member, and food and beverages are related services. If Dawn has apparent authority, Erika would not be able to rescind the transaction.

However, if Dawn sign the agreement in her personal capacity and well as in her capacity as a member of the Company, she could also be personally liable on the obligation.

### **Question 2 – February 2019 – Selected Answer 3**

(A) In Gayle's lawsuit against Company, Dawn, and Erika, only Company and Erika are liable. The issue is whether Erika's alleged tort renders Company liable and/or the other member of Company, Dawn, liable.

a. Company

The Company is liable in Gayle's lawsuit. The general rule is that a limited liability company is liable for the torts of its agents that were made in the scope of their employment. The only exception is if that agent or employee was on a frolic. A frolic is when the employee leaves its duties to do something else outside the scope of their employment.

Here, Agreement provides that Erika is an agent for the purpose of carrying out Company's business. When Erika hit Gayle with the Company's food truck, she was on route to its first

dining location. None of the facts indicate that Erika was on a frolic and not within the scope of her job as agent to Company. Erika inadvertently drove past a stop sign and struck a vehicle driven by Gayle during the scope of her employment.

Thus, Company is liable in Gayle's lawsuit.

b. Dawn

Dawn is not liable in Gayle's lawsuit. A limited liability company is created to afford its members liability protection. The general rule is that the members are not liable for the liabilities of the limited liability company or the liabilities of other members. The only exception is that a member of a limited liability company is still liable for their own torts.

Here, Dawn had nothing to do with Erika's tortious conduct. While Erika and Company are liable, Company's liability protection as a limited liability company protects Dawn from liability. The fact that Company is member-managed rather than manager-managed does not change Dawn's liability.

Thus, Dawn is not liable in Gayle's lawsuit.

c. Erika

Erika is liable in Gayle's lawsuit. While a limited liability company's structure does protect its members from the liabilities of the limited liability company and the liabilities of the company's other members, it does not protect a member from his or her own tortious conduct even if that conduct occurred in the scope of their employment to the company.

Here, Erika inadvertently drove past a stop sign and struck a vehicle driven by Gayle, injuring Gayle and damaging the food truck. Erika will likely be found negligent in her operation of the food truck and liable to Gayle. Even though Erika was operating in the scope of her employment, she is still personally liable. The liability protection of the limited liability company does not protect a member, here Erika, from her own tortious conduct.

Thus, Erika is liable in Gayle's lawsuit.

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(B) Erika likely will not be able to force Company's rescission of the purchase of the craft brewery. The issue is whether Erika can rescind the purchase of the craft brewery from a third party because of ultra vires behavior when purchasing a craft brewery is within a similar type of industry as the food truck.

The general rule is that if a member of a limited liability company acts with actual or apparent authority to enter into a contract with a third party the contract cannot be rescinded unless the contract is for goods or services that are outside the reasonable scope of the company's

work. It is inequitable to hold a third party liable for one of the members violating an agreement between the members about the purpose of a limited liability company.

Here, Dawn had actual authority to carry out the Company's business. However, Dawn did not have actual authority to purchase a craft brewer on behalf of Company because the Company's sole business is to sell tacos. Instead, Dawn had apparent authority. Apparent authority exists when an agent or the principal holds itself out as having authority and the third party reasonably believes that the agent has that authority. Dawn represented to Sam, a third party, that she had actual authority to purchase on behalf of Company. Sam reasonably believed this because it is reasonable to believe that a company selling tacos out of a food truck might want to expand business to owning and operating a craft brewery. So, Dawn had apparent authority to enter into this contract with Sam. Further, it would be inequitable for Sam to be punished for Dawn's ultra vires behavior when he acted in good faith.

Thus, Erika likely will not be able to force Company's rescission of the purchase of the craft brewery.

However, Erika will have a cause of action against Dawn because of Dawn's ultra vires behavior. While a third party cannot be punished for a member violating something in the certificate of formation, a member can have a cause of action against another member for breach of contract for breaching the agreements laid out in the certificate of formation. Erika will likely be able to succeed in a breach of contract action against Dawn because the Agreement provides that the sole business of Company would be to sell tacos. The remedy for this ultra vires action would likely be Dawn repaying the Company the funds she used to purchase the craft brewery from Sam.

Therefore, Erika likely will not be able to force Company's rescission of the purchase of the craft brewery but she will likely be able to recover Company funds used to purchase the craft brewery from Dawn through a breach of contract action.