

Question 7 – February 2020 – Selected Answer 1

(A) Amy, Bettie, and Cassie created a general partnership. General partnerships, under Texas law, courts will look at a number of factors in determining whether a partnership actually exists including the capital that the investors put and the amount of control each investor has, whether the investors have rights to share in the profits of the entity. A partnership is created when two or more people engage in operating a business for profit. Under these facts, without filing to perfect any specific form of partnership the general default is that the three girls formed a General Partnership. Here, pursuant to the partnership agreement, Amy, Betty, and Cassie, have all invested capital into the partnership satisfying the element of capital contributions. They have agreed to share the profits equally until their investments are recouped, and they also have each have significant control over the company as expressed in the agreement by the terms indicating that they will each operate the entity. Additionally, in General Partnerships, the partners share in the liabilities of the partnership jointly and severally. So, any claims brought against the general partnership each partner will be jointly and severally liable to the partnership for its debts. It is clear on these facts that Amy, Betty, and Cassie, because they failed to file with the SoS and are operating ABC together, with shared control, and with each of their invested capital have created a general partnership.

(B) ABC, Cassie, Bettie, and Amy are jointly and severally liable to the motorist. Under agency law, the issue in the question is whether the General Partnership is vicariously liable for the obligation of its liability in any suit arising out of the employee's crash with the motorist. Under agency law as applied to partnerships, in tort, an employer and an employee create a master/servant relationship through which the partnership can become liable for the actions of its employee's in the ordinary course of business. The question turns first on whether the employee was an actual employee and not an independent contractor, but under these facts it is clear that the employee is an employee. Next, the issue turns on whether the tort occurred during the employee's regular course of business or whether the employee was on a detour and frolic. A detour and frolic occurs when an employee diverts from his regular course of business conduct and performs an act outside of the regular course of business. If that is the case, the agency relationship will not hold and vicarious liability will not pass. In this case, however, the employee was driving a ABC car on his way to deliver an order to a customer which is an act within the scope of the employee's business with ABC. Because the employee was acting in the scope of his business duties when the accident occurred, ABC will be vicariously liable for the liability. Additionally, as mentioned, partners in a general partnership are jointly and severally liable to the company for its debt obligations. While the employee will be responsible for his own liability in the accident, Amy, Betty, and Cassie will be

vicariously because they are liable joint and severally to the obligations of the partnership.

(C) ABC, Cassie, Amy, and Betty are all liable to the bank for the loan. As mentioned, each partner is jointly and severally liable for the obligations of partnership liabilities. This question hinges on the agency principals involving contract law that create vicarious liability and whether Amy had Actual or Apparent Authority when securing the loan from the bank. Actual authority can either be express or implied. Implied Authority happens when the 3rd party is lead to believe or reasonably bleieves that a agent is representing a principal in in the principal's capacity to contract. Express Actual authrotiy is given expressly. Here, Amy lead the Bank to believe she was loaning on behalf of the bank and the bak would reasonably believe that to be the case because she took the note out in ABC's name thus establishing te requisite agency/principal relationship needed to make ABC vicariously liable for the loan. Additonally, she comingled the loan proceeds with her personal bank account and used partnership funds to purchase a car for herself. This would also breach a duty of loyalty to the partnership. Accordingly, because this is a general partnership, each partner is also joint and severally liable for the debt obligation.

(D) Cassie is Liable to ABC for breaching her fiduciary duty of loyalty to the partnership. Each partner in a partnership has a duty of loyalty and a duty of care to the partnership. A duty of loyalty means that each partner must act prudently with partnership funds and generally not make business deals that conflict with the interests of the partnership. Here, Cassie usurped a partnership business opportunity when she sold the warehouse that she had contributed to the partnership as her capital contribution to a buyer for \$110,000. She did not tell the other partners about the deal and personally benefitted from partnership assets. Partnership assets are assets that belong to th partnership and each partner has to duty to use those assets in the best interest of the partnership. On these facts, Cassie is liable to ABC. It is worth noting that the court may create a constructive trust and purchase money resulting trust for the principal and profit that Cassie earned on the sale of the warehouse.

Question 7 – February 2020 – Selected Answer 2

A. Amy, Betty, and Cassie have formed a general partnership. At issue is the type of business structure the individuals formed while operating their business. Under the Texas Business Organizations Code, a general partnership is an agreement between two or more people to engage in doing business for profit. The general partners agree to share profits and losses, to share management decisions, contributions to the partnerships and liability. There is also pass trthrough taxation for the partnership. To form a general partnership you do not have to file any documents with the secretary

of state. Furthermore, a general partnership is usually governed by an agreement entered into by the parties as long as there are no provisions that are against public policy. Because the partners of a general partnership are agents of the partnership, they will be held jointly and severally liable for losses incurred by the general partnership and for the actions of the partnership unless their agreement dictates otherwise. Partners owe fiduciary duties of loyalty and care to each other not to engage in self-dealing or other practices that would be against the interest of the partnership.

Here, Amy, Betty and Cassie have agreed to form a general partnership because they did not file a document with the secretary of state. They also have an agreement that governs the relationship of the partnership and states that they will jointly own and operate ABC Pottery Co. Ltd. Their agreement further states they will share in profits equally. The provision stating that they will not be liable to third parties for any obligations is against public policy however since liability to third parties cannot be limited. That provision will likely be struck. Otherwise, their business has all the hallmarks of a general partnership. Therefore, this is a general partnership.

B. Amy, Betty, and Cassie are all jointly and severally liable to Motorist for the damages caused by ABC Pottery's employee. The general partners in a general partnership are held jointly and severally liable for the negligent conduct of their agents and employees that occur in running the partnership. As stated above, the general partners are agents of the partnership (the principal) and they are agents of each other, owing a fiduciary duty to each other. Since the employee was involved in the accident while he was in the course and scope of his employment and he was furthering the objectives of the partnership, the employer (ABC Pottery) will be held liable. The Motorist will have to recover from ABC Pottery first however, before recovering from the partners individually.

C. ABC, Amy, Betty, and Cassie will all be held liable on the loan because Betty acted with the apparent authority of ABC Pottery. A partner is not permitted to assume loans without the consent of other partners because this would be a breach of their fiduciary duty of loyalty (which prevents them from engaging in self-dealing activities) and the duty of care (which requires them to place the interest of the partnership before their own interest) owed to the other partners and to the general partnership. However, a partner who enters in a loan or agreement with a third party will bind the partnership to the agreement if the third party had reasonable basis to believe that the partner had actual or apparent authority to enter into the agreement. A partnership will be estopped from denying liability but will be able to recoup the loss from the individual partner who breached their fiduciary duty.

Here, Betty breach her fiduciary duty by entering into the loan agreement without the consent of the partnership. Furthermore, she breached her duty of loyalty to the partnership by putting the depositing the funds into her account which shows self dealing activity. She also breached her fiduciary duty of care by using the fund to purchase a vehicle. Although partners would be held liable if they had knowledge of the activity or an interest in the activity, Amy and Betty knew nothing about the loan or how the loan was used. Therefore, thought the partnership will be held liable as principal, it is likely that they will be able to take recoup the money that they are entitled to pay to the lender from the \$25,000 Betty deposited and the profits Betty is entitled to under the partnership agreement. The loan will be taken from ABC first, and then from the individual partners if the partnership does not have sufficient funds.

D. Cassie will be liable for any profits she made from the transaction with Purchase because she breached her fiduciary duty of loyalty to the company. As stated above, a partner owes certain fiduciary duties to the partners which include the duty of loyalty and care. The purpose of which is to place the interest of the partnership before the interest of the individual partners. Partners who engage in self-dealing activity, even if the activity in some way benefits the partnership, will still be held liable for breach of the duty of loyalty. Usurping a business opportunity is also a breach of their duty of care owed to the partnership. Furthermore, property dedicated to the partnership or conveyed to the partnership is considered to be partnership property.

Here, Cassie knowingly engaged in a separate business venture without informing the partnership. Although she may argue that the partnership still benefitted since they were able to sell the warehouse for \$50,000, the partnership could have made \$110,000 from the sale and therefore, because Cassie usurped the business opportunity she will be held liable for what the partnership could have made had the transaction gone through. Cassie cannot argue that she was in control of the warehouse and was able to make the decision to sell the warehouse because the agreement in the partnership agreement that they jointly own and operate ABC Pottery suggest that the partnership would have the final say with respects to such a sale. Therefore, Cassie will have to forfeit the money made from the sale or the money will be taken from her share of the profits as they come in order to recompense the partnership for their loss of opportunity which would be \$60,000.

Question 7 – February 2020 – Selected Answer 3

A. ABC Pottery is a General Partnership

Although ABC intended to form a limited partnership as indicated by the Ltd in their name, a limited partnership requires the filing of certain forms with the Texas Secretary of State. Putting Ltd after your name has no legal significance unless you are properly registered with the state. Because ABC did not file any articles of incorporation or articles of partnership with the TX Sec of State, ABC did not form a limited corp/limited partnership. They formed a general partnership. A general partnership will be presumed when there are no articles filed with the state, when partners agree to join together to form an entity for business and when they agree to share the profits and share in the responsibilities of running the entity. Here, the women clearly intended to form a type of entity or partnership by signing an agreement. The women agree to share profits and agree to run the company together, although one partner has been charged with the principal responsibility of running the business, this is largely clerical as all three are consulted on major decisions. Therefore, ABC formed a general partnership.

B. ABC, Amy, Betty, and Cassie are all liable to Motorist.

Under Texas law, in a general partnership, the partnership is liable for the torts of its partners and agents who are performing within the course of their job and for contracts entered by partners or agents who act with actual or apparent authority. All of the partners are individually and severally responsible for the torts of its partners. An agent acts with actual authority when they perform work they reasonably believe the principal wants them to perform because the principal explicitly told them to perform the work or implied they should do that work. An agent acting with actual authority binds the principal to their actions. An agent acts with apparent authority when the actions or words of the principal lead a third party to reasonably believe the agent has authority to act on behalf of the principal. An agent who acts with apparent authority binds their principal.

ABC is liable for the tort caused by the employee who collided with the motorist. The employee was acting within the scope of their employment by delivering flowers, therefore ABC is liable for the employee's tort.

Amy, Betty, and Cassie as partners are liable to the Motorist. All of the partners in a general partnership are liable for the torts of the other partners and of the partnership's employees. As explained above, although the women tried to form a limited liability entity, by failing to file with the state, they did not effectively form such an entity. The partnership agreement attempts to limit their liability to third parties; however, they cannot agree to limit their liability since under Texas law, they are liable to third parties. Therefore, all three partners are liable to the motorist. The motorist must deplete the resources of the partnership before going after the partners individually.

C. ABC, Amy, Betty, and Cassie are all liable on the loan.

As explained above, under Texas law, a general partnership is liable for the contracts entered into by its agents acting with actual or apparent authority, and all of the principles are individually responsible for the torts and contracts of the partnership. Therefore, all three partners are liable on the loan.

Betty obtained the loan from the Bank with apparent authority since she named ABC as the borrower. The Bank would rely on her using the ABC name on the loan as apparent authority from ABC to act on its behalf. Therefore ABC is liable on the loan.

Because Betty did not have apparent or actual authority, she is responsible to ABC and her partners for this breach of loyalty. All partners owe each other and the partnership the duty of loyalty--to not take the resources of the partnership for their own and to not abuse the partnership financially. Clearly Betty has done so here. The other partners can indemnify their share of the loan from her and take other legal action if necessary. Betty should repay the entire amount of the loan, or the partnership should dissolve and the remaining portion of the loan should be deducted from Betty's profits.

D. Cassie must reimburse the partnership for the profit

As explained above, when a partner breaches their duty of loyalty, the other partners can indemnify that partner for the loss. They can also require Cassie to pay the entire \$110k to the partnership. Cassie breached her duty of loyalty by taking a deal that should have gone to the partnership. She conveyed the property by deed over to the partnership and then misrepresented her interest in order to sell the property to a third party for a profit. This is a clear breach of her duty of loyalty. The partnership can require her to return all of the funds, hold the extra funds in a constructive trust, remove her from the partnership, or revoke the sale. Cassie should repay the profit to the partnership since the proceeds from the sale are necessary to repay the loan obtained by Betty.

At this point, the partnership is \$160k in debt and counting, depending on the case with the motorist. Since the partners will not be receive profits until their investments have been paid back, that is another \$50k. The partners will not liekly receive profits for a long time.