## Question MEE 2 – July 2023 – Selected Answer 1

Overrall, Parent is not liable to VanCo as a partner of Sub. Parent is not bound by agreement btween Sub and VanCo signed by Parent's manager. Lastly, the fact that Parent and Sub are separate organizations should not be disregarded.

### Parent is not liable to VanCo as a partner of Subb

Parent is not liable to VanCo as a partner of Sub because there is no partnership between Parent and Sub. For parties to be laible as parters, there msut be a partnership. A partnership is present where two or more persons (they can be entities) associate to carry on a business as co owners for profit. The key analysis is the sharing of profits. Here, Parent owns all shares of Sub, but they both have separate businesses. PArent sells plastic to Sub, which Sub then makes into shoes. Parent does not work with Sub in the business of making shoes. Most importantly, Sub does not share profits with Parent. Although Parent eventually receives distributions from Sub, which Sub apparently stops doing without consulting Parent, this is not the same as sharing profit. Although there is a requirement that Sub consult with parent before ceasing distributions, the failure to provide more distributions is different than sharing profits (if that were the case, every entity and its shareholderss would be partners).
Another factor in analyzing whether a partnership is the sharing of control. Here, Parent does not have any direct say in the control over Sub. Although Parent elects the manager to Sub, this person is not he manager of Parent and makes decisions indepdently, as shown by the ceasing of sharing distributions. Although there are some precesses that are shred, for HR, accounting, and government relations, that is different than Parent having direct control over portions of Sub's operations. The key is that their controlling persons are different people.
Therefore there is no basis in claiming Parent is liable to VanCo as a partner of Sub.

### Parent is not bound by the agreement between Sub and VanCo

Parent is not bound by the agreement between Sub and VanCo signed by Parent's manager because Greta signed it in her capacity as "agent of sub." Greta signed the agreement as an agent of sub based on her actual authority. Actual authority is present where the agent reasoanbly beleives they have the power to take a certain action based on the words or conduct of the principle. In this case, Greta went to Sub's office where the manager of Sub asked her to sign the agreement. It would be reasonable for her to beleive that the Sub manager wanted the agreement to be signed by her in capacity as an agent of Sub because ther eis no reason why she would do it as the manger of Parent. Therefore there was actual authority.

She was also the agent of Sub at the time she signed the agreement. An agency relationship is formed where the agent agrees to act on behalf of the principal and at the control of the principal. And the principal msut consent to the agent as acting as such. Here, Greta agreed or consented to act on behalf of Sub to sign the agreement and subject to Sub's control by signing the agreement. Further, Sub consented for her to act as such based the Sub manager's request for her to take such action. There also was the required capacity. For the prinicpal to have capacity, it must have the capacity to contract. Here, Sub manager was apparently a compenetn person who ran Sub and had no incapacity to contract such as minority, therefore the principal had the capacityto contract. Further, the agent just must have miniminal capacity, which Greta appears to have by understanding the she was to sign as the agent of Sub.
As there was a valid agency relationship and Greta had actual authority to sign the agreement as an agent of Sub, she did exactly that by signing the agreement as agent of Sub. When an agent signs an agreement on behalf of a disclosed and identified principal, only the principal and the thirdparty are bound unless the agreement explressly says otherwise. Here, the prinipcal was disclosed as Sub and identied as such. Further, the contract did not state the agent would be bound in any capacity, it specifically said as agent of sub. Therefore, only sub and Vanco were bound
The key to the agreement lied in that Greta signed it as agent of Sub. A person isgenerally only liable in the capacity under which they sign a contract. Here, she sugned as agent of Sub, and was authorized to do such. She did not sign as agent of Parent and Parent is not automatically bound even though its manager signed a contract in a capacity other than as the manager of Parent.

**The fact that Parent and Sub are separate organizations shopuld not be disregarded**

Parent and Sub's separate corproate status' should not be disregareded through veil piercing. The default rule is that a LLC is only liable for its own debts and obligations, except where one of its members commits a tort in their own right. Therefore, Parent is not autmoatically liable as a member of Sub.
There are means to pierce the corporate veil and hold a member liable through veil piercing. Veil piericng occurs where there is an abuse of the coroproate form and just requires holding a member or manager liable. The first type is alter ego, under which the entity acts as the alter ego of its emember and fairness demands veil piercing. Here, although some corporate formalities were disregarded, such disregard is not engough for veil piercing alone. The two companies shared some personnel for HR, accounting, and gov relations. They also shared some tewsting processes for new plactics recycling. In both these areas, there was no clear division of sharing costs, thus leading to some disregard of the corporate formalities. But that alone is not enough, overall, the two companies operate two separate business models with

separate managers and genraelly maintain seprate funds (as shown by distributions flowing to Parent, rather than just have a shared bank account). Therefore, there is no such an abuse that afinress demands veil piercing
There is a nother form of veil pericing where one entity is undercapitilized at the time of formation to account for reaosnable liablitieis. No facts here suggest Sub was undercapitalized.
The last form of veil piercing is applicable where itis necessary to prevent fraud by the member or manager of the LLC and thus veil pericing is needed. First, Parent does not even control Sub because it is managed by a separate manager. Second, there is no facts that suggest any fraud is occuring.
Therefore, no veil piercing is approrpiate and and both entities should be treated as separate

## Question MEE 2 – July 2023 – Selected Answer 2

#1 --- Is Parent liable to VanCo as a partner of Sub?
Parent is not liable to VanCo as a partner of Sub. The issue is whether Parent can be considered a partner of Sub, an LLC, when it is the sole member and shares resources between Parent and Sub.
A partnership is created when two or more persons associate to carry on as co-owners a business for profit. Persons can include entitles, like LLCs. Sharing profits, not gross receipts, creates a presumption of a partnership. And when a partnership is created, all partners are jointly and severally liable for the obligations of the partnership. Courts will look at whether the persons intended to carry on a business for profit, and look at factors like whether each had rights in the business or venture, whether they designated their relationship as such, whether they shared property as joint tenants or tenants in common, and whether the activity required extensive activity. They'll also look at whether each had a right to participate in the business or who had control. Also whether they agreed on losses and costs may indicate a partnership was formed. Here, Parent LLC and Sub LLC are both manager-managed LLCs. Parent is the sole member of Sub LLC and selects sub's manager. That Sub LLC doesn't select its own manager suggests that this wasn't a partnership---Sub is just the subsidiary and under Parent's control. But on the other hand, they share personnel for human resources, accounting, and government relations. But parent's staff is separate, even though it does regularly work with Sub in designing and testing new processes. But here, a factor suggesting this wasn't a partnership was that there was no sharing profits. Sub just distributes its profits to Parent as the sole member of Sub, and there is no *sharing*, just a transferring. Also, they don't have an arrangement for sharing the *costs* of the services. But on the other hand, a local newspaper has characterized them as "partners promoting business sustainability." Mere labels are not indicative though. And that

they didn't share profits, didn't arrange or actually share costs suggests they weren't a partnership. And that they shared personnel is not sharing property or holding it together suggests it wasn't a partnership. Finally, collaboration did occur, but it wasn't to carry on a business *together* for profit. It was more of a relationship whereby parent sells plastic to sub and sub uses that to make upscale shoes. This is really more like a parent-subsidiary relationship whereby only one side is getting the benefit of the bargain (Parent). Thus, it's unlikely that Parent was not a partner because Parent and sub did not form a partnership. But reasonable minds may differ on this from the sharing personnel and collaboration, and views in the paper. But absent a finding that they associated to carry on a business for profit together, rather than maintaining separate businesses, they were not partners to where Parent is not liable to Vanco as a partner of Sub.

<u>#2---Is Parent bound by the agreement between Sub and Vanco signed by Parent's manager?</u>

Parent is not bound by the agreement between Sub and Vanco signed by Parent's manager. The issue is whether Greta's signature of the Vanco agreement bound Parent.

An LLC can be liable for the acts of those with direction, oversight, and management authority based on agency principles. Manager-managed LLCs like Parent confine management power and thus agency power to a limited group. IN Parent's context, it had a sole manager, Greta. The general rule is that the debts of one LLC are the debts of the LLC and a veil is erected around its members.

Greta could bind Parent as an agent on parent if Greta acted with actual authority or apparent authority, or Parent ratified the transaction completely with knowledge of all material facts. Actual authority exists when the agent-manager acts with authority she reasonably believes she possesses based on her communications with Parent, her principal, and such conduct is within the scope of the LLC's ordinary course of business. Actual authority can be express or implied. Apparent authority exists when the principal holds out the agent as her own, while exceeding her actual authority, and the agent acts in such a way that a third party reasonably believes the agent to be acting with such authority, the agent is acting within the ordinary course of the LLC business, and the third party lacks notice that the agent lacks such authority and is exceeding her actual authority.

Here, Greta signed an agreement for Sub between VanCo whereby Vanco would deliver shoes to Sub's customers that were made by Sub. Sub's manager requested that Greta, the manager of Parent, sign the agreement. Sub's manager was the only one who had authority to bind sub. Greta wasn't employed by Sub but signed the agreement and wrote "as agent of sub" below her signature. Greta obviously did not have actual authority by Parent to bind Parent to such a delivery agreement, as she

was not acting for Parent in the scenario, but for Sub. And Sub's manager did ask her to sign for the delivery agreement. But the main issue is whether she had apparent authority, when signing for sub, to bind her principal, Parent. Here, Parent did hold out Greta as its agent. But Two things suggests no apparent authority: first, greta signed this agreement "as agent of SUB," NOT parent. Also, she signed the agreement at Sub's office, not Parent's office. Finally, Parent sells plastic to Sub. It's in the business of selling plastic. Sub is in the business of making shoes. Parent isn't in the business of making shoes, so Greta couldn't have been acting within the ordinary course of Parent's business, plastic selling, when it signed a delivery agreement for a shoe maker. Any reasonable third party would not have believed that Greta would've been acting with such authority based on what Parent holds out Greta as, even though Parent has associations and affiliations with Sub, they have their own managers.

#3 --- Should the fact that Parent and Sub are separate organizations be disregarded so that Parent is liable for Sub's obligations to VanCo?

Parent should not be liable for Sub's obligations to VanCo. The issue is whether SubCo's veil of limited liability should be pierced such that its sole member, Parent, should be held liable for the obligations of Sub.

An LLC is like a corporation in that it has a legal fiction: the debts, obligations, and liabilities of the LLCs are those of the LLC and not its members. Members are not personally liable for the LLC's debts, unlike partners in a general partnership. But, like a corporation, an LLC's veil of limited liability for its members can be pieced if three elements are present: (1) there is control by a member in his or her member capacity, not manager capacity; (2) the member uses that control to abuse the veil of limited liability; and (3) piercing the veil of limited liability and holding the member accountable is necessary to prevent injustice.

Here, Sub's sole member is Parent. Parent, as the sole member, has the ability to select Sub's manager. Parent, who elects and is the only person to determine who manages the day to day of Sub, is able to control Sub in its capacity as a member (or the corporate equivalent of a shareholder), despite Parent not running the day to day as the manager with boots on the ground. Thus, Parent had control of Sub in its member capacity. It owned 100% of Sub.

Second, there must've been abuse of the veil. Courts differ in the parent-sub context on what counts as abuse, and the supreme court has held before that a parent must be making such bad decisions for the sub that require the sub to be suffering for the benefit of the parent, that is the parent benefits at the expense of the sub and its minority shareholders. *See e.g., Sinclair Oil (in the corporate context*). But here, there are no minority shareholders in Sub. But the alter ego doctrine may be applicable. Courts may pierce the veil in this context if corporate formalities are ignored, there is commingling of resources, books are not kept secret, and the LLC entity is paying the

controlling member first before it pays its obligations, etc. (*See e.g., On Top Roofing in the corporate context*). And courts will obviously pierce the veil if abuse is found such by fraud, illegality, or oppressive conduct.
Sub had been for a time making distributions of profits to Parent as the sole member of Sub. And Sub required that its manager consult with Parent's management group before discontinuing distributions to Parent. But Sub's manager discontinued these payment without consulting parent, which suggests there actually wasn't any abuse. Instead, Sub was acting independently, despite all the sharing of personnel resources and entwinement between the two (see above in #1). None of the facts suggest Sub continued to distribute and pay off Parent first, as controlled by Parent at the time of the VanCo agreement or afterward. Also, Greta didn't engage in fraud in entering into the agreement with Vanco on behalf of the manager for Sub who asked her to do so. And while there are similarities, there doesn't seem to be any abuse by Parent in its capacity as a member and the sole member. the manager who makes the distributions in Sub seemed to be acting independently.
Thus, there seems to be no abuse of the veil of the limited liability.
And courts are less likely to pierce the veil in contract cases, whereby parties had ability to investigate an LLC or corporation's financial position before entering into the agreement, though inadequate capitalization at inception isn't even implicated in these facts.
Thus, that Parent and Sub are separate organizations should not be disregarded and thus Parent should not be liable for Sub's obligations to VanCo.

## Question MEE 2 – July 2023 – Selected Answer 3

Essay 2

1) Parent as Vanco's Partner

The first issue is whether Parent's activities with Sub created a partnership such that it should be foudn liable as a party to the contract with Vanco. A partnership is a fiduciary relationship created by two or more persons carrying on as co-owners of a business for profit. Parties need not file documents with the state to form a partnership. An agreement to share profit gives rise to a presumption of partnership. Courts will also look at other evidence, such as whether the parties exercised mutual control over any venture in carrying on as co-owners, whether they were actively involved in efforts, and any agreement to share losses. Many courts recognize that an agreement not to share losses would be indicative of no partnership. The labeling by outsiders or the parties themselves of partnership status is not dispositive. If a court recognized a partnerhship, each partner would be joint & severally liable for the

obligations of the partnership. Partners in a partnership are agents, one partner in a partnership has power to bind the partnership for acts apparently carrying on in the ordinary course of partnership business.
Here, Parent and Sub would not be considered partners. Importantly, at the outset, there is no agreement between Parent and Sub LLC for sharing profits, each company is involved in a different cycle of the overall recycling business in buying and selling without any apparent profit share plan. The facts state that sub distributed its profits to parent is a one way profit share, which is typical in sub-LLC's, and does not show that Parent was sharing its profits with Sub as a mutual profit share. Thus, there would be no presumption of partnership. Likewise, the lack of sharing the cost of services related to technical staff that overlap or formal arrangement disfavors a finding of partnership. While there are other factors that may favor partnership, such as the parties overlapping staffs and requirement in Parent's requirement for consultation if sub decided to cancel distributions, the court is unlikely to find that as strong as the evidence against the partnership given any lack of profit share or loss share arrangements. The newspaper's characterization of the parties as "partners" would not be considered dispositive, and the court would instead likely focus on the lack of profit sharing and loss sharing agreements. Thus, because there is no partnership, Parent would not be liable for the obligation entered into by Sub with Vanco based on partnership liability.

2) Parent's Liablity for Contract Entered Into by Manager
The next issue is whether Parent is bound to the Sub and Vanco Agreement under a theory of apparent authority. Agency is a fiduciary relationship entered into where there are manifestations of mutual consent for an agent to act on a principal's behalf and subject to a principal's control. The degree of control exercised by an agent need not be significant As an agent, one can bind a principal in contract where there is actual or apparent authority. Actual authority is that which is directly manifested between the princinpal and the agent and based on the agent's reasonable belief in that authority. Apparent authority is based on manifestations between the principal and third party where the third party reasonably believes in the agent's authority.
An agent's liability on the contract depends on their level of disclsoure. If the principal is fully disclosed, meaning that the third party knows the name of principal and that agent is acting in agent capacity, the agent is not liable. If the principal is only partially disclosed, meaning that the third party does not know identity of principal but knows person is acting in agent capacity, or is fully undisclosed, then agent may be liable
Here, Greta would be considered an agent of Sub for the purposes of the Vanco contract because there was a manifestation of mutual consent when Sub's manager requested Greta sign the contract on Sub's behalf and subject to Sub's control. Even

though Greta is the manager of Parent, this does not preclude her from acting as an agent of Sub for purposes of signing this contract. Thus, she had actual authority to bind Sub to the contract as provided by this communication and did so when she signed the contract on their behalf. The agency relationship between Greta and Sub thus is a basis for sub to be liable on the contract, but would not be a basis for Greta, or Parent to be liable unless principal was undisclosed or partially disclosed. Here, Greta enteredf into the contract clearly specifying that she was acting as an agent of sub in the contract. And as identified above, when a party who is an agent identifies the capacity they are serving in and specifies the agent relationship in the contract and who they are a principal for - here Sub, there is no liability for the agent. Thus, there is no basis for Parent to be bound to the contract signed by Greta, even though she was a manager for Parent, because she was working as a fully disclosed agent for Sub on this contract.

3) Piercing the Corporate Veil of Sub to Hold Parent Liable.

The next issue is whether the court should pierce the corporate veil. In general, members of a LLC enjoy limited liability, meaning that they are not peresonally liable for the obligations of the LLC and can only lose up to the value of their investment. But, similar to the corporations context, courts recognize piercing the corporate veil in the LLC context as a manner in which members can be held personally liable. Piercing the corporate veil claims often involve an abuse of corporate (LLC) privileges in such a manner that justice would require individual liability. Courts may recognize claims when 1) the LLC is undercapitalized from the outset considering the potential liabilities of the company; 2) the LLC is a mere instrumentality of the members and there is excessive comingling of assets and no effort to keep the LLC assets separate; or 3) there is evidence that the LLC is designed as a fraud. Importantly, courts are less likely to find piercing claims in the LLC context for failure to follow formalities as they are in the corporate context because of the lack of formalities often involved and inherent in LLC context. In the context of a Parent and Sub LLC, the court would hold the parent liable if they found cause to pierce the corporate veil.
Here, it is unlikely that a court would pierce the corporate veil. FIrst, the court would note that there are no issues of inadequate capitalization of Sub. While there are overlapping members of the LLC's there is insufficient evidence that there is an eggregious amount of comingling such that equity wuold require the court to pierce the LLC veil. A court may find it probative that Parent was the only member of Sub, but this is not unsual in parent-subsidiary context of corporate structuring. The fact that the parties overlap with each other's staff and operting requirement requires consultation with Parent's group" for sub's decisions does not show evidence that there was a fraud in forming Sub or sub was a mere instrumentality of Parent, given

that each has distinct funtions in the recycling business. Thus, on balance, the court should not pierce the corporate veil to hold the members individually liable.