4) Please type the answer to Question 4 below.

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When finished with this question, click to advance to the next question.
(Essay)

Entrepreneur (P)

When an individual seeks to establish a corporation, they are acting as an entreupreur or Prosepector. In doing business on behalf of the corporation while it is being formed, the prosepector will not be personally heald liable.

Creation of Retail, Inc

A corporation has the same legal standing as a person (aside from the P&I clause). It is it's own entity and creates a shield of liability. In order to incorporate, incorporation papers must be filed with the Secretary of State. Here, years ago, Art (A)incorporated Retail, Inc. The facts do not indicate that Art filed the papers with the Secretary of State. However, in the absence of facts to the contrary, it is assumed that this corporation was incorporated properly.

De Facto Corporation

Even if a corporation is not correctly incorporated, it may still be considered a corporation. If a corporation and it's board act like a corporation and have no knowledge that the incorporation failed, then the corporation becoems a de facto corporation. This means that the court will treat the corporation as if it has correctly incorporated. Here, even if Art failed to file the paperwork, Retail, Inc. will be treated as a corporation.

Board of Directors

A Corporation (C), must have a board of directors. There must be at least one member of the board. Here, A and two family members serve on the Board. Having family members on the board is generally discouraged, but that alone will not create a conflict of interst. Thus, the number of people and relationships on the board is proper.

Lease approval

There does not seem to be a conflict with the board approving the 10-year lease for the store.

Paid President

Board members may be paid by the C for services they render to the C as long as it is not grossly disporportionate enough to create a conflict. Further, this amount must agreed upon by the board of directors. Here, A is being paied 10% of R's gross revenues as compensation. This does not seem to be a large amount considering that R is a closely held corporation. Thus, there is no conflict here.

Dissolution of Corporation

When a C disolves, it must pay its debts. Here, R ceased business recently and has a number of outstanding debts. Generally, creditors rights to payment subordinate shareholders.

<u>Supplier's legal claimsagainst Art on its claim against Retail</u>

Piercing the Corporate Veil

Since a C provides a shield of liability to the board of directors, individuals are generally not liable for the corporations wrongdoings. However, the court may pierce the corporate veil in instances to hold the Board liable for certain actions. In tort actions, the veil will be pierced in the interest of fairness. A tortiously injured plaintiff would be disadvantaged if they could not bring a suit against those that injured her. On the other hand, the court is reluctant to pierce the veil for suits arising from contract claims. This is because anyone entering into a contract with the corporation should investigate the potential for breach prior to entering into the contract. Here, S wants to bring a claim against R. S was owed 10k for computer equipment. S entered into a contract with R to provide computer equipment and has yet to be paid.

Creditors claims subordinate Shareholders claims

When a C is disolved, the remaining assets must be liquidated in order to pay off debts. Here, R's assets were limited to 5,000 in cash. However, the debt owed to S is 10k. If there were shareholder claims for debt repayment, they would be subordinate to the creditors debt. Here, we only have a creditors debt and A's loan. Thus, the assets would go to S to partially repay the debt.

Holding A liable for the debt

Generally a director is not liable for the debts of the corporation. Further, since this claim is based in contract, the court is not likley to pierce the veil to hold A accoutnable personally for the debt. Thus, S will get the 5k in cash, but will not be able to hold A liable for the rest of the debt.

<u>B's Claims against A</u>

Shareholders Rights

Shareholders of a corporation are those that own stock in the corporation. Shareholders are generally not liable for the corporations wrongdoing. There must be a shareholders annual meeting. Shareholders are also charged with electing and removing Board members. Here, B is a shareholder and can bring suit against A. A elected himself and then two of his family members. Since the corporation was not a public corporation at this point, the election of the board will likely be found to be proper by a court.

<u>Derivatively</u>

A derivative suit is one brought by a shareholder on behalf of the corporation.

When a director breaches their duty of care and loyalty, a shareholder can bring a derivitive suit against them. Here, B can bring a derivative suit on behalf of R against A.

Duties of the Board

Directors and Officers owe a C a duty of care, loyalty, and fiduciary duties. They must always act with the best interest of the C in mind. Further, the board must meet once a year either . During the meeting there must be a quorum. Here, the board has violated various duties and have failed to meet at least once a year in some years. In some years, the board met three times a years, but in others they never met. It is true that not every director must attend the meeting in person, attending via telephone if generally okay. Thus, B as a sharholder can bring a derivitive suit on behalf of other shareholders because the board breached many duties owed to R.

Duty of Loyalty

Directors owe a duty of loyalty to the C. Here, as the president of R, A is a director and owes R a duty of loyalty. Under the duty of loyalty a director must not engage in conflicts of interest. One conflict of interest in Self-dealing. Self dealing is when the director directs the corporation to partake in business transactions that would personally benifit the board member or someone closely related to the board member. Here, R's board approved a contract to buy 30% of the inventory of XYZ Co., a company owned by A. A has a substantial interest in the transaction because he owns XYZ. The board should not have approved this transaction. Further, since the board consists of relatives of A, it is likely that the transaction would benifit the entire board. Thus, the entire board breach their duty of loyalty. B has a cause of action for breach of loyalty.

Fiduciary Duty

A director owes a fiduciary duty to the C to look out for it's best financial interests. Here, A began taking home some of R's inventory without paying for it.

R clearly breached his fiduciary duty to the corporation because he was looking out for his own interests instead of R's. It is unlikely that the rest of the board knew about this breach, but if they did, then they would be held liable as well. Thus, B has a cause of action against A for his breach of fiduciary duty.

Business Judgment Rule

The BJR provides protection to the board if the board acts in good faith. There is a presumption that the board is acting on behalf of the C with good faith. This rule provides protection to individual board members. Thus, the court may use it to protect A and the rest of the board. However, that is unlikley because the breaches here are quite egregarious.

Reporting

Under federal law, the board must report annually. Here, there is no indication that the board filed the paperwork annually. Thus, there may be a federal cause of action for not reporting.

<u>Personally</u>

Since this is not a publically traded C, B may be able to bring suit against A personally. However, since R is incorporated it is likely that Awill not be personally liable to B for anything aside from his breach of duties to the C.

<u>Art's claim to collect from Retail the 50k</u>

A lent R 50k at the beginning of R's inception. A will not be able to collect any portion of his loan from the assets because the debt by supplier is senior to his loan. There are no other assets for R to give A after it pays the 5k to S.

Question #1 Final Word Count = 1414