

QUESTION 4

Years ago, Art incorporated Retail, Inc. He paid \$100 for its stock and lent it \$50,000. He elected himself and two family members to the Board of Directors, which in turn elected him as President and approved a ten-year lease for a store. He managed the store and was paid 10% of Retail's gross revenues as compensation.

Subsequently, Barbara bought 20% of Retail's stock from Art.

Retail's board approved a contract to buy 30% of the inventory of XYZ Co., a company owned by Art.

Subsequently, Art began taking home some of Retail's inventory without paying for it.

Retail had net profits in some years and net losses in others. It paid dividends in some years, but not in others. In some years, Retail's board met three times a year; in others, it never met.

Recently, Retail ceased business. Its assets were limited to \$5,000 in cash. Among the claims against Retail was one by Supplier, who was owed \$10,000 for computer equipment. Another claim was Art's, for the \$50,000 that he had lent and had just become due. Supplier and Barbara, individually, filed lawsuits against Retail and Art.

1. On what legal theory, if any, can Supplier reasonably seek to recover against Art on its claim against Retail? Discuss.
2. Does Barbara have a cause of action against Art, either derivatively or personally? Discuss.
3. If Retail is forced into bankruptcy court, will Art be able to collect from Retail any portion of his \$50,000 loan? Discuss.

4) Please type the answer to Question 4 below.**Â****When finished with this question, click to advance to the next question.***(Essay)*

1. S v. A

In order for S to recover against A for R's debt, it can either show that S had actually lent the equipment to A though it should have reasonably known he was not acting as an agent of R.

Actual Authority

A person has actual authority to act on behalf of the corporation when they are empowered to do so by the articles of incorporation, which designate the positions and responsibilities of the corporation.

S will not be able to show that A did not have actual authority to borrow the \$10,000 of computer equipment from S. A placed himself and two family members on the Board of Directors, which in turn made A President of R. Even if \$10,000 is arguably an excessive amount and an unreasonable investment for one store, reasonableness is not the test, and A likely had near absolute authority as President and a Boardmember.

Apparent Authority

A person has apparent authority to act on behalf of the corporation when they hold themselves out as such.

Although A is a Boardmember and President of R, that does not permit him to "take home some of Retail's inventory without paying for it." The chain of custody for the computer electronics from S is not clear, but S may be able to show that A had presented the transaction as under the authority of R, but actually been taking all \$10,000 of the computer equipment home. If S is able to do so, it may

be able to recover against A for the debt in S' name.

Piercing the Corporate Veil

In order to prevent shell corporations from abusing limited liability, that limitation is not applicable when a corporation is essentially in the control of another entity.

A lent R \$50,000, appointed himself a Boardmember and President, and took home some of R's inventory without paying for it. R subsequently ceased business and A is now suing R for the \$50,000 loan. Moreover, R entered into a contract to purchase 30% of its inventory from another of A's companies. Based on these circumstances, S has a fairly strong case for arguing that their suit should pierce the corporate veil and make A liable for the debt.

2. B v. A

Derivative Action

Shareholders generally do not have the right to control a corporation's behavior beyond the purchase and sale of the stocks, but can initiate an action against the corporation when it is objectively deviates from its fiduciary obligation to shareholders.

In some years, R paid out dividends. In others, R sustained losses. The board would sometimes meet three times a year, and some years none at all. Although a derivative action for being insufficiently ambitious would fall on its face, an action using misconduct at R to show it betrayed its fiduciary obligation might be more successful. A, a clearly interested Boardmember who is also President, approved R's purchase from his other company. He has also been taking some of those items home without paying for them. He is also paid 10% of the company's revenues.

A court might find that R has violated its fiduciary obligation to its shareholders

and find in B's favor.

Piercing the Corporate Veil

See 1

3. A v. R

Only \$5,000 in cash assets remain at the time of the suit. If R

Question #1 Final Word Count = 556