

ESSAY QUESTION NO. 4

Answer the question in booklet No. 4

Dale and two friends decide to supplement their incomes during college by buying two snow blowers and several shovels, which they use to clear snow for businesses and homeowners. The season ends profitably and they divide their earnings three ways. They decide to call themselves the “Three Grunts”, and post ads using that business name. The three friends continue their winter enterprise for 4 years, always sharing the costs and profits equally, but never with any written agreements.

After leaving college, Dale’s two friends move on to other careers. Dale, however, decides to stay committed to the “Three Grunts” business. He gains the concurrence of his two friends and properly forms a new business called “Three Grunts Limited Partnership”.

The friends agree to a limited partnership agreement which provides that all of the original Three Grunts business assets will be owned by the new limited partnership. In exchange, Dale’s two friends will each hold a 10% limited partner interest. The agreement also provides that Dale may add additional limited partners, using a portion of his 80% general partner interest as consideration for the new limited partner investments.

A year later, Dale invites Carl Grunt, an experienced snow plow driver, to join as a 5% limited partner. Carl is employed as General Manager for the business enterprise, with responsibility to hire and manage the contract labor.

Dale desires to grow the business and sees a request for proposals for snow removal at a large Alaska shopping mall. This is the biggest job ever tackled by Three Grunts, and to succeed they will need to buy bigger equipment. Dale presents the proposal to all of the partners at a partnership meeting. They all agree to contribute more capital if they get the job. Three Grunts Limited Partnership bids for and wins the job. Dale signs the final contract which states that the contract can be terminated without cause on 30 days’ notice.

As General Manager, Carl visits New Auto alone and buys a new truck to be outfitted with a snowplow. As he picks out the truck, he states, “My employees are going to love the cherry color.” The truck is bought in the name of “Three Grunts Limited Partnership,” and the purchase agreement is signed by Carl as “Carl Grunt, General Manager.” The purchase is financed by New Auto, relying only upon financial information of Three Grunts Limited Partnership.

Six months into performance of the Mall contract, the Mall owner lawfully terminates the contract. Three Grunts Limited Partnership stops making its truck payments.

New Auto sues Carl individually and the Three Grunts Limited Partnership in Alaska state court to collect the balance due on the truck loan.

1. Describe the nature of the business relationship among Dale and the two friends while they were in college.

2. Discuss the basis of New Auto's legal claims against Carl and Carl's likely defenses. (Do not discuss issues of apparent agency.)

GRADERS' GUIDE
***** QUESTION NO. 4 *****
BUSINESS LAW

[Background: In 1992, Alaska adopted the Uniform Limited Partnership Act. In 1997, the Alaska legislature revised some of the provisions of the uniform law and renamed the body of statutory law governing limited partnerships as the “Alaska Revised Limited Partnership Act.” Limited partnerships are creatures of statute. They only exist when the statutory requirements are fully satisfied for their establishment. In contrast, general partnerships can arise as a matter of law, when two or more individuals decide to pursue a business venture jointly and share in the profits and risks of that venture. The key differences between limited partnerships and general partnerships lie in their types of partners and the scope of responsibility and liability of those partners. In a general partnership, all partners are on an equal footing, share control of the business and are personally liable for its debts. In a limited partnership, there are two levels of partners: general and limited. The general partner has responsibility for running the business enterprise and bears personal liability for the partnership’s debts. The limited partner(s) have a substantially reduced scope of involvement in running the business enterprise, and in exchange for that limited involvement, their personal liability for the debts of the partnership is limited to the funds which they invest or are obligated to invest in the partnership.]

1. Describe the nature of the business relationship among Dale and the two friends while they were in college (30 Points)

AS 32.06.202 provides that “the association of two or more persons to carry on as co-owners a business for profit forms a partnership, whether or not the persons intend to form a partnership.” Dale and his two friends by their conduct formed a general partnership. They jointly owned the business, and equally shared in the costs and the profits. They are deemed by law to have formed a general partnership even if they had no intent to do so, and even though they never entered into any formal business arrangement.

2. Discuss the basis of New Auto’s legal claims against Carl and Carl’s likely defenses. (70 points)

New Auto would claim that Carl is liable for the remaining balance on the truck loan because he should be deemed to be a general partner as a matter of law. As a general partner in a limited partnership, Carl would bear the same liability for the obligations of the limited partnership as a partner bears for the liabilities of a general partnership. AS 32.11.180. All partners are jointly and severally liable for all obligations of a general partnership. AS 32.06.306.

New Auto would attempt to establish Carl's liability under two theories: Theory One- Carl lost protection as a limited partner by engaging in the control of the business. First, New Auto would argue that even though Carl was a limited partner and ordinarily would have no liability for the obligations of Three Grunts Limited Partnership, because Carl participated in the control of the business, he lost that protection. New Auto would assert that it fit within the class of third parties that were intended to be protected by AS 32.11.130(a) which states, "if the limited partner participates in the control of the business, the limited partner is liable only to persons who transact business with the limited partnership reasonably believing, based upon the limited partner's conduct, that the limited partner is a general partner."

New Auto would point to Carl's title as General Manager, and the fact that he alone came out and purchased the truck without any obvious approval or review by other partners. They will point to Carl's comment about "his employees" loving the cherry color of the truck as reasonably implying it was his business. Further, Carl's name "Grunt" was contained in the name of the limited partnership which would suggest he was a principal in the business. Finally, after discovery, New Auto would show that Carl was a joint decision maker in the decision to bid for the Mall job. The facts are unclear as to whether Dale would have proceeded to bid on the Mall work if Carl had objected.

In his defense, Carl would point out that New Auto did not seek Carl's financial information, which would have been justified and prudent had New Auto truly believed Carl was a general partner, and not simply an employee or limited partner. In addition, Carl would note that under AS 32.11.120(b), he cannot be found to be participating in "the control of the business" if his conduct was merely that of an employee of the limited partnership. As an employee of the business, he could have been authorized to select and sign for the purchase of the truck on behalf of the limited partnership. Finally, Carl's vote in favor of the Mall job should be characterized as "advising a general partner with respect to the business of the limited partnership" and thus statutorily excluded from being considered evidence of "participating in the control of the business." AS 32.11.120(b)(2).

Theory Two- Carl allowed his name to be used in the Limited Partnership name and thus is liable to New Auto. AS 32.11.120(d) provides that a limited partner who knowingly permits his name to be used in the name of the limited partnership is liable to creditors who extend credit to the limited partnership, so long as the creditors lack knowledge that the limited partner is not a general partner. New Auto would argue that Carl Grunt knowingly worked with a limited partnership that had his name in its title, and obtained credit on behalf of the limited partnership.

Carl's defense would be that the liability imposed by AS 32.11.120(d) does not apply if the circumstances described in AS 32.11.810(a)(2) exist. In this case, AS 32.11.810(a)(2) does apply. Carl is insulated from liability for use of his name if "the business of the limited partnership had been carried on under that name before the admission of that limited partner." Carl Grunt was not admitted as a limited partner to the Three Grunts Limited Partnership until a year after it had been in operation.