

## **ESSAY QUESTION NO. 4**

### **Answer this question in booklet No. 4**

Agnes and Carl married and bought a home in an Alaskan town 30 years ago, and still hold joint title to their home. They moved out of the home six years ago to live a more rural lifestyle but kept ownership of the home.

After moving out of town, Agnes and her new neighbor Bertha began baking cookies with wild berries for friends and family. Five years ago, Agnes and Bertha decided to go into business together selling their cookies, and adopted the name "Berry Best Cookies." Agnes and Bertha had no written agreements between them. Other than getting a business license in the business name, they filed no other paperwork with the state.

From the beginning, they mutually agreed on operational decisions. They verbally agreed to evenly split the expenses and the profits of the business, and did so each year. Agnes and Carl's old downtown home served as the business' retail outlet, and instead of the business paying rent for use of the home, the business paid Agnes and Carl 5% of the business' total annual profits. Carl had no other involvement in the business and had no intention of becoming more involved in the business.

Sadly, Agnes died of a heart attack three months ago. At the time of her death, the business had no debts. Through her will, Agnes left everything she owned to her husband Carl. Bertha seeks legal advice from you about her ability to continue operating Berry Best Cookies.

1. Identify the legal business relationship that existed between Bertha and Agnes and the facts that support your conclusion.
2. Did Carl have an ownership interest in the business prior to Agnes' death?
3. What legal steps must Bertha take after Agnes' death to be able to continue to operate a business named Berry Best Cookies?

## GRADERS' GUIDE

### \*\*\*QUESTION NO. 4\*\*\*

#### SUBJECT: BUSINESS LAW

**Question (1) Identify the legal business relationship that existed between Bertha and Agnes and the facts that support your conclusion. (35 points)**

This question requires a discussion of how a partnership is formed. With respect to business structures, other than a sole proprietorship, only a partnership can be formed without written agreement or filings made with the state. Thus the fact that no paperwork, other than the business license application, was filed with the state indicates that no corporation, limited liability corporation or limited partnership was formed. In fact, a partnership can be formed without the intent to do so by the persons involved, so long as the persons carry on as co-owners a business for profit, and they share the expenses and profits. AS 32.06.202 (a).

The facts support the conclusion that Agnes and Bertha created a for-profit business as partners in a partnership. They agreed to share operational decision-making and split the expenses and profits evenly. However, the presumption of the existence of a partnership that arises from the sharing of the business' profits has several statutory exceptions. The presumption of a partnership can be set aside if it is shown that the profit sharing was for the purpose of:

- A. debt payment
- B. employee wages or independent contractor payments
- C. rent
- D. payment to a third person associated with a deceased or retired partner
- E. loan payment
- F. sale of good will of a business

AS 32.06.202(c)(3).

Only exception C has some applicability to the relationship between Agnes and Bertha. Although Agnes received 5% of gross profits as a payment for rent for use of the home she co-owned with Carl, this was not the only share of profits she was entitled to receive. She also received another 50% of the remaining profits. Her receipt of these other profits is not covered by the exceptions above and the presumption that she is a partner with Bertha would prevail.

**Question (2) Did Carl have an ownership interest in the business prior to Agnes' death? (15 Points)**

Carl receives a portion of the business' profits, namely 5% of the total profits, for payment of rent for the home that Carl co-owns with Agnes. While sharing in partnership profits ordinarily creates a presumption that the person is a partner, that is not the case when the profit share is received solely as payment of rent. Unlike Agnes, the only share of profits that Carl receives is for rent. Therefore the exception to the presumption of partner status in AS 32.06.202(c)(3)(C) discussed above would apply and Carl would not be considered a partner in Berry Best Cookies. In addition, the fact that Carl is allowing property he owns to be used in support of the operations of a partnership business does not make him a partner. His acquiescence in the use of his property is not being recognized as a partnership contribution, since he is receiving the 5% gross profit payment from the partnership for its use.

**Question (3) What legal steps must Bertha take after Agnes' death to be able to continue to operate a business named Berry Best Cookies? (50 points)**

The obvious question Bertha faces is whether she can continue to operate the existing business without doing anything else. The facts indicate that there is no formal partnership agreement. All that exists is the limited, informal verbal agreement between the two partners. Therefore resolution of what will happen to the partnership business after Agnes' death will be resolved by statute, rather than the partnership agreement.

Because there must be at least two persons or parties to create and maintain a partnership, the partnership necessarily must end with Agnes death. Thus, the partnership Berry Best Cookies will end and Bertha will have to dissolve and wind up the partnership. Therefore, Bertha does not have the option of simply continuing the former partnership business.

Bertha must instead close out the former partnership business in order to start up a new business. The provisions of AS 32.06.801 - .807 will govern the dissolution and winding up of the partnership.

So what happens to Agnes' partnership interest on her death? Upon her death, Agnes is considered a dissociated partner and is no longer a partner. AS 32.06.601(7)(A). Her interest in the partnership is considered personal property and the value associated with that partnership interest will be inherited by Carl. AS 32.06.502. Carl's inheritance of the partnership interest does not make him a partner.

Rather he has the legal right to receive the value of that interest resulting from the dissolution and winding up of the partnership. AS 32.06.502. Therefore, when Bertha resumes selling cookies as part of a new business, she will not have to include Carl.

But as part of closing out the old partnership, Bertha must value the assets of the business and divide them with Carl. This is known as “winding up” the business. The process of winding up a partnership entails applying the assets of the partnership to discharge all creditor obligations. Any remaining surplus is to be divided between the two partnership shares, which in this case would be Bertha and the interest inherited by Carl. Should the assets be insufficient to cover the debts, both Bertha and Agnes’s estate would need to satisfy the remaining partnership debts by additional contributions. AS 32.06.807(e). In these facts, it appears that this will not be necessary.

Bertha can continue to operate Berry Best Cookies while she winds up the business. AS 32.06.802(a). The filing of a statement of dissolution with the recorder’s office (which statement contains the name of the partnership and the fact that it has been dissolved and is being wound up) is likely unnecessary since the facts suggest no partnership documents were ever filed with the state previously and the partnership has no creditors. AS 32.06.805. Unless Carl asks for judicial supervision of the winding up, Bertha and Carl can handle the winding up themselves. AS 32.06.803(a).

In order for Bertha to continue to operate a cookie business after she dissolved the partnership, she will need to form a new business. If she wants to continue to operate a business using the “Berry Best Cookies” name, Bertha could attempt to form a new partnership with Carl and maintain all of the same business terms. However, Bertha’s option of forming a new business with Carl appears unlikely since the facts state that he has no desire to be more engaged in the business. Bertha’s other option would be to obtain the right to use the business name and its associated customer goodwill in the course of conducting the winding up and division of partnership assets. If Bertha is able to negotiate with Carl for the rights to continue to use the name Berry Best Cookies, she could continue in business alone, in the form of a sole proprietorship, corporation, or limited liability corporation.

Therefore, Bertha’s ability to continue the business using the name Berry Best Cookies will require her to wind up the partnership business, start a new business, and negotiate with Carl for the right to continue using the same business name.