



AGENCY & PARTNERSHIP

*PROFESSOR DONALD J. KOCHAN
CHAPMAN UNIVERSITY SCHOOL OF LAW*

Final Exam Fall 2010

3 Hours

INSTRUCTIONS: The examination is a three-hour modified open book examination – each student may use his/her text, any assigned supplemental materials, any supplemental materials specifically provided by Professor Kochan (like the powerpoints), any notes or outlines which that student prepared, any group notes or outlines to which he/she made a *significant* contribution in preparation, and a general usage English and/or legal dictionary. No commercial outlines, treatises, or similar materials will be permitted for use during the examination. Other than ExamSoft and requisite hardware, no electronic materials or devices may be used during this exam. All notes and copies of the exam questions must be turned in at the conclusion of the exam, although only official answers on ExamSoft or in Bluebooks will be considered in the evaluation of your grade.

There are 3 essays.

Total points = 100 (Look at the point allocations and use your time wisely.)

In Essays 1 and 2, remember that you should identify the entire situation from every affected individual's standpoint before, during, and after any litigation may emerge as a result of the factual scenario. As explained in class, the entire question includes graded points, not simply the pinpoint issues presented at the end of the question.

There are ten (10) pages including the cover/instructions page.

ESSAY 1 (35 Points):

Preppy Private Day (“PPD”), a private middle school in Newport, has a high concern for the safety of its students and the security of its facilities. Head Master of PPD, Matt, engages Stan, a security consultant and specialist, “to review the security protocols at PPD, to act as the ongoing security representative of PPD on campus and to the outside world, and to institute promptly and effectively whatever measures and acquire whatever equipment or personnel as is necessary and prudent for the security of the school and its infrastructure and for the safety of the students.” Matt tells Stan that one of the major concerns is internet safety and access to inappropriate or dangerous content, especially as certain school bomb threats had been in the news the past few weeks in other counties.

As one of his first acts, Stan pays an outside firm called “SafeWeb” to test current website filtering devices in use at PPD and then install more sophisticated filters and blocking mechanisms if necessary to keep the students from accessing “unsecure, unsafe, lewd, or otherwise undesirable sites not suitable for children including any websites promoting violence or unlawful activity.” Stan has used SafeWeb in the past and they are known as the “best in the business” for internet filtration security measures.

The next Friday, Stan promptly receives SafeWeb’s first preliminary report on PPD’s internet security and it states in summary – “PPD’s filtration system has more holes than a block of Swiss cheese. It is a mess. The students, who all have unlimited access to the PPD computers, are at a ‘critical level’ with high safety risk that requires immediate attention. SafeWeb suggests that all student access be denied to the system until remedial measure can be taken. We await further instructions.” Stan reads the report before leaving work for a two week vacation but does not bring it to the attention of Matt or anyone else at PPD. While on vacation, however, Stan does mention the report to Bob, a major benefactor of PPD and who has a son in attendance at the school. Based on what he heard, Bob immediately removes his child from PPD and enrolls him at a competitor school and withdraws his substantial donative commitments promised to PPD.

The next week, also before Stan has returned from vacation and before PPD had been notified of SafeWeb’s recommendation, a student named Charlie – the disgruntled class clown who has it out for a few of his teachers – is searching the internet while in homeroom and on a school computer and Charlie finds a site with detailed instructions on how to build a low impact

bomb. This site would not have been accessible if the students had been denied access to the computer system and it would have been filtered and blocked if SafeWeb had instituted their remedial measures installing a new system. Charlie goes home, builds the bomb, and the next day blows up 2 of his “favorite” teachers’ cars in the school parking lot. An innocent bystander, student Jimmy, suffered third degree burns on his arms and legs because he was walking nearby when the bombs went off.

Matt immediately calls Stan asking “how could this have happened?” Stan says, “I had planned to have SafeWeb fix the internet security when I got back. I sure hope some kid didn’t learn how to do it from the web.” Stan immediately asks SafeWeb to search internet usage history on all PPD computers and they discover that Charlie had visited the bomb making website the day before and Charlie is arrested after the police act on that information and find the bomb making printouts and materials in his home.

Upon Stan’s orders, internet access is immediately suspended for students at PPD and SafeWeb sends its team out to thoroughly check the system, clean it, and install the top of the line filtering and blocking measures that prevent students from ever gaining access to such bomb making sites or other unsafe, unlawful, unsecure, lewd or violent websites. Lucky is the name of a technician that started checking the PPD system again before installing the security devices. All SafeWeb technicians sign confidentiality and nondisclosure agreements and are under strict orders to use client computers “only for purposes of diagnosing and curing security issues.” While working on the PPD computers, Lucky remembered that his friend Sally asked him to order a genuine Rolex watch for her. Sally told Lucky to use her Visa card and whatever wouldn’t fit because of her limit she would pay him for later. Lucky decides to wait until his lunch break before dealing with Sally’s request. At lunch, and before the safety software had been installed on the PPD computers, Lucky roams into the school library and uses his SafeWeb password to log on to a computer. He Googles “genuine rolex”, is taken to a site, and orders a watch for Sally using her credit card plus \$300 of his own money. After sending the order, a pop up appeared, Lucky clicked on it, and it ran an executable file that imported a virus on to PPD’s server which later that night copied data to the worm source and which erased major portions of PPD’s system including its grading archives. Lucky did not notice that the virus had been downloaded. Lucky goes back to work on the system and after work delivers the order confirmation form to Sally, asking for \$300. Sally says, “you stupid man, you ordered from a

fake Rolex site; it's a scam." Sally refuses to pay Lucky. Lucky tries to get a refund but the scam site is gone and no watch is ever delivered.

The next day, PPD notices the damage to its server, the copying and corruption of its files, and the lost data from the virus. After all of these events PPD has been criticized in the press, lost donors, enrollment has dropped, and PPD is sure to drop in the "best private schools" rankings.

- (1) PPD sues Stan, SafeWeb, and Lucky alleging several specific injuries and violations of duties. What are the multitude of agency-based claims and defenses of the parties? Be specific as between which parties for which bases for suit.
- (2) Stan sues SafeWeb and Lucky. What are the multitude of agency-based claims and defenses of the parties? Be specific as between which parties for which bases for suit.
- (3) Analyze both of these two alternative scenarios – Scenario (a) Jimmy and his family sues Stan. What is the basis for suing Stan and what are the agency-based claims and defenses of the parties? If Stan can be held liable, what's next for Stan? OR Scenario (b) Jimmy and his family sue PPD. What is the basis for suing PPD and what are the agency-based claims and defenses of the parties? If PPD can be held liable, what's next for PPD?
- (4) Lucky sues Sally for \$300. What are the agency-related claims and defenses of the parties?

EXAM CONTINUES ON NEXT PAGE

ESSAY 2 (35 points):

Five friends are sitting at a dinner one night and start to discuss starting a business selling a new product called “The Next Big Widget” (“NBW”) a not-yet-patented design by one of the friends, Ivan the Inventor. Ivan is a genius but is poor and has no business or legal experience. Among the other four friends are: Larry the patent Lawyer (who knows little about partnership law), Bob the MBA Business Guy, Cathy the Communications graduate, and Michael Money Bags who has never worked in his life but is sitting on a nice inheritance. After Ivan explains NBW, everyone believes in the project. Michael says, “NBW must be made – the people deserve it! If we all work together, I am sure we can bring it to market. I have some cash and everyone else here can help in their own way and we can all share in the profit. None of us can do this alone, but it is sure to work if Ivan shares NBW with us and the five of us join together. All in?” Everyone verbally and enthusiastically agrees, including Ivan, one at a time saying “I’m in!” After some further discussion, they jointly decide to call themselves the NBW Group. Larry commits to start the patent application; Bob agrees to draft a business plan, set up a joint bank account in the name NBW Group with each of the 5 having full rights to the account, and operate as the financial officer; and Cathy agrees to look for investors and draft an advertising campaign. At the end of dinner, Michael gives Bob a check payable to Bob for \$60,000, Bob writes a check to himself for \$10,000, and Larry and Cathy each write checks payable to Bob for \$10,000. Each person writes “for NBW Group” written in the memo line of their checks. They agree that Ivan will “pay with his brain.” Larry says, “Just so we’re clear, we’re all still just friends, right? This is for fun. It’s not like we’re creating a ‘partnership’ or anything.” Everyone laughs and agrees, saying “Well, of course we’ll stay friends.” Nonetheless, to preserve the friendship should things go wrong, they write out the following on a napkin and everyone signs:

“We five friends, hereinafter the NBW Group, will work together to design, patent, produce, and sell the Next Big Widget. Each of us commit to use our respective expertise in making the NBW Group a success and are equals in this project – it will rise or fall equally amongst us. Should we be lucky enough to profit, we will share the gains according to our respective contributions. If anyone is slacking off, we can expel them from the NBW Group by majority vote but in that event they will be bought out for \$1000. If anyone wants to exit the NBW Group they can do so but the NBW Group will continue with or without them and they will be entitled to \$2000 upon exit.”

The next day, Bob sets up a bank checking account in the name NBW Group and deposits all the checks from the prior night. Bob gives everyone a checkbook with checks that can be drawn on the NBW Group account and keeps one checkbook for himself. The day after that, Cathy has stationary and business cards made for everyone, with names only and no titles – she pays \$500 with an NBW Group check. The stationary and cards also had “NBW Partners” inscribed on them by her mistake (instead of “NBW Group”). But, Cathy thinks they look pretty and trying to save money does not have them reprinted. Cathy also hires a firm to start developing an advertising campaign for the NBW, paying them \$4500 in NBW funds.

Ivan needs to move out of his parents’ house if he is to work properly, so he buys the garage from his parents for \$5000, paid with a check drawn on NBW Group. The deed to the garage is recorded in Ivan’s name. Ivan then writes an NBW Group check to Contractor to convert the garage to his workshop (to build the NBW) and to build an extension apartment above the garage. He signs an agreement with the contractor, signing his own name, but with a description in the contract stating that Contractor was building the offices for NBW Group and with the \$5000 down payment on the \$30,000 project paid with an NBW Group check. Ivan does not keep receipts for any of these checks nor does he inform other members of the Group of the expenses.

Ivan also withdraws \$80,000 for supplies, which he then purchases and pays the suppliers in full. Ivan sends these receipts to Bob.

Larry does nothing to begin securing a patent even though Ivan provided him with all of the required technical materials to file the application the week after the dinner and agreement and even though he had told the others he was “working on it and has withdrawn \$2,000 from the NBW Group checking account “for legal expenses” which he used for attending a seminar on the Law of the Caribbean. Two months after the dinner, Egor (a stranger to all) filed an application for a patent for “THE Big Thing” (“TBT”) which is identical to NBW and thus precludes NBW from obtaining a patent.

Three months later, Contractor completes the renovations and expansion on the garage and gives Ivan a bill for \$25,000 for the work. Ivan writes him a check from the NBW Group account and moves into the apartment above the garage and begins using the workshop downstairs. The check bounces and Bob receives an overdraft notice.

Contractor asks Ivan for another check and Ivan says he has no money. (1) Contractor sues Michael. What are the claims and defenses of the parties? If Michael loses, what are his options?

Ivan learns of Egor's patent, informs the members of the Group, and the Group votes to expel Larry. (2) Larry sues the NBW Group and Michael, Cathy, Bob, and Ivan demanding a return of his \$10,000 or otherwise a "fair value" of his "partnership" interest. What are the claims and defenses of the parties?

Cathy wants out of the Group but gives no reason, simply saying in a letter to the Group that she is exercising "her right to exit". Upon receiving the letter, Ivan knows how he can get another patent, Bob wants to keep the Group together, and Michael is willing to provide new funding and find new, replacement "team" members to keep the NBW Group running. (3) If UPA or RUPA apply, what is the status of the Group after the letter?

Cathy demands her "share" as a "partner" upon exit. The Group says that she is entitled to nothing. (4) Cathy sues the NBW Group for her "share" and also sues Ivan and Bob for breaches of partnership duties which she claims are the only reason the Group has no money.

One year later, Michael, Bob, Ivan, and 2 new members (claiming to be operating under the same napkin agreement) successfully receive a patent for the new design, still calling it the NBW, and their patent is sold for a \$10 million profit. All 5 current members of the Group agree to disband, except Michael now believes it is a partnership and calls it "dissolution." (5) Under UPA, RUPA, and/or the napkin agreement, explain generally (in other words no need to offer calculations of amounts) what will happen and how will it be decided that the profits and value of the NBW Group are distributed?

EXAM CONTINUES ON NEXT PAGE

ESSAY 3 (30 points)

Agency Law and Partnership Law share many common themes and objectives. Included among these is an attempt to create discrete areas of law that use the legal form and rules attached thereto to satisfy associational preferences and to advance, foster, stimulate, and encourage certain such associations while regulating for the common good. **By using and explaining examples** from areas of agency and partnership law triggered by the statements below, the purpose of your answer here is to explain, in light of what you have learned about the formation and enforcement of agency and partnership law, how the paradigms, theories, doctrines, rules and jurisprudence involved in your studies of *Agency and Partnership* relate to the statements contained in this question – explaining where the law has been successful, where it has failed, and where it has struggled, using the remaining general statements as a guide for focusing your answer. The best answer will demonstrate through the use of examples why this question makes these specific statements and demonstrate through selected examples an understanding of why these statements are made rather than attempt to provide some comprehensive summary of the whole of agency and partnership law.

(1) Based in the concept of autonomy, the law of agency and partnership strives to ensure that each individual may choose – through actions or agreement – whether to become a principal, whether to become an agent, and whether to become a partner. Moreover, the law protects each individual's autonomy to exit these associations. By setting clear rules, individuals will know how they attain such labels and the operative rules once they have entered into such an association. Agency and partnership law thus provides a certain sense of security in the protection of applicable law. These areas of law also attempt to regulate or overcome certain risks associated with self-interest and natural tendencies (such as the problem of agency costs). Once one chooses to associate, her autonomy may be constrained while in the relationship and must operate within the established rules of the game. Finally, even if one chooses to exit these associations, there may be ongoing consequences for the initial decision to enter the relationship, suggesting caution before making that initial choice. By using examples, please explain what those statements mean and any nuances involved that may belie (cut away) at the truth of those statements.

(2) The legal rules in agency and partnership strive to establish stability in their respective regulation of such associations, along with a sense of certainty and clarity in legal rights, responsibilities and obligations. The law provides a set of rules for these associational forms to attempt accomplish these ends, while providing accountability within the relationship and to outsiders to the associational form. Agency and partnership law as such also serves the sometimes complementary and sometimes competing goals of autonomy, freedom of contract, continuity and efficiency of commerce, and the protections for third parties and society. By using examples, please explain what those statements mean and any nuances involved that may belie (or cut away) at the truth of those statements.

(3) The concept of choice to enter into an agency or partnership justifies the legal imposition of restraints on autonomy thereafter and the assumption of certain liabilities accompanying the free choice to enter into such relationships. Often, this means accepting liabilities to others in the relationship or to third parties that may not exist if one were not a principal, agent, or partner. By using examples, please explain what those statements mean and any nuances involved that may belie (or cut away) at the truth of those statements. Be sure to include a discussion of the concept of control and how it affects the law's treatment of principals and agents.

(4) In light of paragraphs (1)-(3) above, define default rules and mandatory rules how they are used in agency and partnership law to accomplish some of the identified objectives. Give examples. Be sure to discuss, among other things, how default rules and mandatory rules affect the freedom to contract.

(5) In light of paragraph (4) above, explain the meaning of the following statement: "the short-form contract contained in RUPA is more useful because partners are not required to incur costs to modify it. RUPA attempts to avoid burdening partners who fail to incur the modification costs with rules to which they would not have agreed," while generally providing protection for the investment in agreements such partners choose to make.

(6) In light of paragraphs (1)-(5) above, explain whether and how – by acts or omissions – one can define themselves in or out of such agency or partnership associations.

(7) How does dissolution and dissociation law particularly relate to the concepts discussed above in paragraphs (1)-(6)? In your answer, include an analysis of the following statement: “The problem with the UPA's use of the term *dissolution* is therefore much more fundamental than the absence of a clear definition of the concept. The UPA's definition and use of the concept of dissolution is a bad idea because it reflects an aggregate concept of partnerships that fails to recognize the stability of many partnerships. The UPA unnecessarily destabilizes many partnerships, particularly those that have continuation agreements, and actually undercuts the attempts of partners to contract for stability.”

-- END --