

ESSAY QUESTION NO. 8

Answer this question in booklet No. 8

Bill, Amy and Sue are three friends who share a passion for computers. They decide to form a business that goes to customers' homes to help resolve their home computer problems. Under the business name "De-Buggers R-Us", they obtain a business license, business phone and fax lines, and an internet website for their business. As the customer calls start coming in, they share the work equally. They verbally agree to split the costs and revenues three ways, and while nothing is ever put in writing, they do in fact split everything three ways.

Business picks up, and they need to start storing business inventory somewhere more secure than the back seats of their cars. A fourth friend, Ted, agrees to let them store their inventory in a portion of his warehouse in exchange for a 10% share of the yearly profits in lieu of paying cash for rent. This is memorialized in a written lease.

The business operations proceed profitably and smoothly until Amy gets into personal financial difficulties as a result of her excessive online shopping. Joe, who operates a much larger business in direct competition with "De-Buggers R-Us", loans Amy money in exchange for an assignment of her complete interest in "De-Buggers R-Us". He tells her she can get the interest back once she repays him. Joe is thrilled to own an interest in this business since it was starting to cut into his own business' profits. With Amy's interest in hand, he believes he will be able to create enough turmoil to shut "De-Buggers R-Us" down.

1. What form of business is "De-Buggers R-Us"? Explain.
2. Immediately before Amy transferred her business interest to Joe, who were the owners of "De-Buggers R-Us"?
3. What can the other owners of "De-Buggers R-Us" do to remove Joe as an owner of "De-Buggers R-Us" but still keep their business alive?

GRADERS' GUIDE

***** QUESTION NO. 8 *****

SUBJECT: BUSINESS LAW

1. What form of business is “De-Buggers R-Us”? Explain. (30 points)

“De-Buggers R-Us” is a partnership at will. A partnership is formed as a matter of law by the act of two or more persons carrying on as co-owners a business for profit, whether or not they intend to form a partnership. AS 32.06.202(a). Thus, the fact that the agreement among the friends was not in writing did not prevent them from forming a partnership through their conduct. Since the friends did not form the business to achieve a specific task, or establish a limited time frame within which the business was to be completed, it is not a “partnership for a specific term” or a “partnership for a particular undertaking”. The filing of a business license does not create a business entity, but rather gives the filing business entity legal authority to operate in the state. No documents purporting to form a business were filed with the state, so there is no factual basis to assume that the friends formed a corporation, limited liability company, or a limited partnership, which are all creatures of statute, and require the formal filing of organizational documents. No formal documents need be filed with the state to form a partnership at will.

2. Immediately before Amy transferred her business interest to Joe, who were the owners of “De-Buggers R-Us”? (30 points)

Bill, Sue and Amy are clearly partners in the business since they formed the business, equally participating in the running of the business and receiving equal shares of the profits of the business. While AS 32.06.202(c)(3) establishes a presumption of a person being a partner if he or she receives a share of the partnership’s profits, that presumption does not apply if the profits are received for one of the reasons listed in AS 32.06.202(c)(3). None of the enumerated exceptions applies to Bill, Sue and Amy.

Ted also receives a share of the profits in exchange for providing the warehouse space. The facts do not suggest that Ted has any other involvement in the operation of the business other than in providing the leased space. In this case, one of the enumerated exceptions to the presumption of partnership arising from the sharing of profits applies- receipt of share of profits in payment of rent. Under AS 32.06.202(c)(3)(C), Ted would not be presumed to be a partner by virtue of his sharing in the profits, since he receives them solely as payment of rent. Therefore, he would not be considered a partner in “De-Buggers R-Us.”

3. What can the other owners of “De-Buggers R-Us” do to remove Joe as an owner of “De-Buggers R-Us” but still keep their business alive? (40 points)

Under AS 32.06.502, when Amy transferred her partnership interest to Joe, all Joe received was Amy’s right to receive Amy’s share of the profits and losses in the business and the right to receive Amy’s share of distributions of profits and capital whenever paid. Joe became a transferee of a partnership interest, and does not stand fully in the shoes of Amy as a partner. Pursuant to AS 32.06.503, as a transferee, Joe is not entitled to participate in the management or conduct of the partnership business, nor can he require that the other partners give him access to the partnership records.

The existing partners in De-Buggers R-Us would be able to buy-out Joe’s interest on the grounds that Amy’s interest has been dissociated in a manner that does not require the dissolution and winding up of the partnership. Generally, when a partner assigns his or her interest in a partnership, the transferor retains the rights and duties of being a partner other than the right to receive profits and distributions. AS 32.06.503(d). However, the transfer may qualify as an event that causes the transferring partner to be dissociated from the partnership. Amy’s transfer to Joe to cover her debt is an event that would cause her dissociation from the partnership. Under AS 32.06.601(6)(B), a partner is dissociated when the partner “executes an assignment for the benefit of creditors.” Amy’s dissociation however, is not an event that would require the dissolution and winding up of the partnership under AS32.06.801.

Therefore, under AS 32.06.701, the remaining partners can buy out the dissociated partner’s interest in the partnership by purchasing it at a buy-out price equal to the greater of the liquidation value or the value based on a sale of the entire business as a going concern. Joe would be entitled to receive this payment as the transferee of Amy’s partnership interest and the existing owners could carry on the business of the partnership.