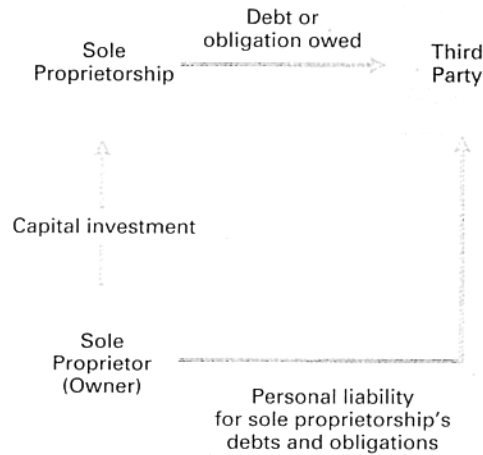


Exhibit 14.1 SOLE PROPRIETORSHIP

Assume that after several months, Nathan closes the business because it is unsuccessful. At the time it is closed, the business has no assets, owes the bank \$100,000, and owes other debts of \$25,000. Here, Nathan, the sole proprietor, is personally liable to pay the bank and all the debts of the sole proprietorship from his personal assets.

In the following case, the court had to decide the liability of a sole proprietor.

**CASE 14.1 Sole Proprietorship****Bank of America, N.A. v. Barr**

9 A.3d 816 (2010)
Supreme Judicial Court of Maine

“An individual doing business as a sole proprietor, even when business is done under a different name, remains personally liable for all of the obligations of the sole proprietorship.”

—Alexander, Judge

Facts

Constance Barr was the sole owner of The Stone Scone, a business operated as a sole proprietorship. Based on documents signed by Barr on behalf of The Stone Scone, Fleet Bank approved a \$100,000 unsecured small business line of credit for The Stone Scone. Fleet Bank sent a letter addressed to Barr and The Stone Scone, which stated, “Dear Constance H Barr: Congratulations! Your company has been approved for a \$100,000 Small Business Credit Express Line of Credit.” The bank sent

account statements addressed to both The Stone Scone and Barr. For four years, Fleet Bank provided funds to The Stone Scone. After that time, however, The Stone Scone did not make any further payments on the loan, leaving \$91,444 unpaid principal. Pursuant to the loan agreement, interest on the unpaid principal balance continued to accrue at a rate of 6.5 percent per year. Bank of America, N.A., which had acquired Fleet Bank, sued The Stone Scone and Barr to recover the unpaid principal and interest. Barr stipulated to a judgment against The Stone Scone, which she had converted to an limited liability company, but denied personal responsibility for the unpaid debt. The trial court found Barr personally liable for the debt. Barr appealed.

Issue

Is Barr, the sole owner of The Stone Scone, personally liable for the unpaid debt?

(continued)

Language of the Court

The trial record contains sufficient evidence that Barr is personally liable for the debt owed to Bank of America. The evidence demonstrates that, at the time Barr acted on The Stone Scone's behalf to procure the small business line of credit, she was the owner of The Stone Scone and the sole proprietor of that business. An individual doing business as a sole proprietor, even when business is done under a different name, remains personally liable for all of the obligations of the sole proprietorship. As the sole proprietor of The Stone Scone when that sole proprietorship entered into the agreement for a line of credit with Fleet Bank, Barr became personally liable for the debts incurred on that line of credit account.

Decision

The supreme judicial court affirmed the trial court's judgment that held Barr personally liable, as the sole proprietor of The Stone Scone, for the sole proprietorship's unpaid debt owed to Bank of America.

Case Questions

Critical Legal Thinking

What is a sole proprietorship? What are the main attributes of sole proprietorship?

Ethics

Did Barr act ethically in denying responsibility for The Stone Scone's debts?

Contemporary Business

Why are sole proprietors held personally liable for the debts of their businesses?

Taxation of a Sole Proprietorship

A sole proprietorship is not a separate legal entity, so it does not pay taxes at the business level. Instead, the earnings and losses from a sole proprietorship are reported on each sole proprietor's personal income tax return. A sole proprietor has to file tax returns and pay taxes to state and federal governments.

General Partnership

General partnership, or **ordinary partnership**, has been recognized since ancient times. The English common law of partnerships governed early U.S. partnerships. The individual states expanded the body of partnership law.

A general partnership, commonly referred as a partnership, is a voluntary association of two or more persons for carrying on a business as co-owners for profit. The formation of a general partnership creates certain rights and duties among partners and with third parties. These rights and duties are established in the partnership agreement and by law. **General partners**, or **partners**, are personally liable for the debts and obligations of the partnership (see **Exhibit 14.2**).

Formation of a General Partnership

A business must meet four criteria to qualify as a general partnership under the UPA [UPA Section 6(1)]. It must be (1) an association of two or more persons (2) carrying on a business (3) as co-owners (4) for profit. A general partnership is a voluntary association of two or more persons. All partners must agree to the participation of each co-partner. A person cannot be forced to be a partner or to accept another person as a partner. The UPA's definition of *person* who may be a general partner includes natural persons, partnerships (including limited partnerships), corporations, and other associations. A business—a trade, an occupation, or a profession—must be carried on. The organization or venture must have a profit motive in order to qualify as a partnership, even though the business does not actually have to make a profit.

general partnership
(ordinary partnership)
An association of two or more persons to carry on as co-owners of a business for profit [UPA Section 6(1)].

general partners (partners)
Persons liable for the debts and obligations of a general partnership.

Uniform Partnership Act (UPA)
A model act that codifies partnership law. Most states have adopted the UPA in whole or in part.

Law Case with Answer

Creative Resource Management, Inc. v. Soskin

Facts Nashville Pro Hockey, LLC, was a limited liability company organized under the laws of Tennessee. The LLC owned and operated the Nashville Nighthawks, a minor league professional hockey team. Nashville Pro Hockey, LLC, contracted with Creative Resource Management, Inc. (CRM), whereby CRM, for fees and other consideration, would provide employee leasing services to Nashville Pro Hockey, LLC. The contract was signed by Barry Soskin, the president of Nashville Pro Hockey, LLC. A paragraph in the contract provided: "By affixing my hand and seal to this agreement, I personally guarantee any and all payments payable as represented and outlined in this agreement." Nashville Pro Hockey, LLC, failed, owing CRM \$29,626. CRM sued Nashville Pro Hockey, LLC, and Barry Soskin to recover the unpaid compensation. Soskin defended, alleging that his signature on the contract was in his representative capacity only and not in his individual capacity as a guarantor. Did Soskin's signature on the contract constitute a personal guarantee for the payment of the debt of Nashville Pro Hockey, LLC, to CRM and thereby make Soskin personally liable to CRM for the debt?

Answer Yes, Soskin's signature on the contract constituted a personal guarantee for the payment of the debts of Nashville Pro Hockey, LLC, to CRM, thereby making Soskin personally liable to CRM for the debt. The contract contained personal guarantee language in the body of the contract. The words "I personally guarantee any and all payments payable as represented and outlined in this agreement" reflect indisputably a guarantee by Soskin. Soskin insists that he signed only as a representative of the limited liability company. CRM insists that his signature imposes personal liability upon him. The stark fact is that the words "I personally guarantee" are meaningless if applied to Nashville Pro Hockey, LLC, and not to Barry Soskin individually. Since the words "I personally guarantee" cannot refer to Nashville Pro Hockey, LLC, and retain any meaning at all in the context of this agreement, they must of necessity reflect the personal guarantee of Barry Soskin. Thus, Soskin was a guarantor, and he is personally liable to repay the money owed to CRM by Nashville Pro Hockey, LLC. *Creative Resource Management, Inc. v. Soskin*, Web 1998 Tenn.App. Lexis 788 (Court of Appeals of Tennessee)

Critical Legal Thinking Cases

15.1 Liability of a Franchisor McDonald's Corporation (McDonald's) is a franchisor that licenses franchisees to operate fast-food restaurants and to use McDonald's trademarks and service marks. One such franchise, which was located in Oak Forest, Illinois, was owned and operated by McDonald's Restaurants of Illinois, the franchisee.

Recognizing the threat of armed robbery at its franchises, especially in the time period immediately after closing, McDonald's established a corporate division to deal with security problems at franchises. McDonald's prepared a manual for restaurant security operations and required its franchisees to adhere to these procedures.

A McDonald's regional security manager visited the Oak Forest franchise to inform the manager of security procedures. He specifically mentioned these rules: (1) No one should throw garbage out the backdoor after dark, and (2) trash and grease were to be taken out the side glass door at least one hour prior to closing. During his inspection, the security manager noted that the locks had to be changed at the restaurant and an alarm system needed to be installed for the backdoor. McDonald's security manager never followed up to

determine whether these security measures had been taken.

One month later, a six-woman crew, all teenagers, was working to clean up and close the Oak Forest restaurant. Laura Martin, Therese Dudek, and Maureen Kincaid were members of that crew. A person later identified as Peter Logan appeared at the back of the restaurant with a gun. He ordered the crew to open the safe and get him the money and then ordered them into the refrigerator. In the course of moving the crew into the refrigerator, Logan shot and killed Martin and assaulted Dudek and Kincaid. Dudek and Kincaid suffered severe emotional distress from the assault.

Evidence showed that Logan had entered the restaurant through the backdoor. Trial testimony proved that the work crew used the backdoor exclusively, both before and after dark, and emptied garbage and grease through the backdoor all day and all night. In addition, there was evidence that the latch on the backdoor did not work properly. Evidence also showed that the crew had not been instructed about the use of the backdoor after dark, the crew had never received copies of the McDonald's security manual, and the

14.4 Tort Liability Thomas McGrath was a partner in the law firm Tarbenson, Thatcher, McGrath, Treadwell & Schoonmaker. One day, at approximately 4:30 P.M., McGrath went to a restaurant-cocktail establishment in Kirkland, Washington. From that time until about 11:00 P.M., he imbibed considerable alcohol while socializing and discussing personal and firm-related business. After 11:00 P.M., McGrath did not discuss firm business but continued to socialize and drink until approximately 1:45 A.M., when he and Fredrick Hayes, another bar patron, exchanged words. Shortly thereafter, the two encountered each other outside, and after another exchange, McGrath shot Hayes. Hayes sued McGrath and the law firm for damages. Who is liable? *Hayes v. Tarbenson, Thatcher, McGrath, Treadwell & Schoonmaker*, 50 Wash.App. 505, 749 P.2d 178, Web 1988 Wash.App. Lexis 27 (Court of Appeals of Washington)

14.5 Liability of General Partners Pat McGowan, Val Somers, and Brent Robertson were general partners of Vermont Place, a limited partnership formed for the purpose of constructing duplexes on an undeveloped tract of land in Fort Smith, Arkansas. The general partners appointed McGowan and his company, Advance Development Corporation, to develop the project, including contracting with materials people, mechanics, and other suppliers. None of the limited partners took part in the management or control of the partnership.

Eight months later, Somers and Robertson discovered that McGowan had not been paying the suppliers. They removed McGowan from the partnership and took over the project. The suppliers sued the partnership to recover the money owed them. The partnership assets were not sufficient to pay all their claims. Who is liable to the suppliers? *National Lumber Company v. Advance Development Corporation*, 293 Ark. 1, 732 S.W.2d 840, Web 1987 Ark. Lexis 2225 (Supreme Court of Arkansas)

14.6 Liability of Limited Partners Union Station Associates of New London (USANL) was a limited partnership formed under the laws of Connecticut. Allen M. Schultz, Anderson Nolter Associates, and the Lepton Trust were limited partners. The limited partners did not take part in the management of the partnership. The National Railroad Passenger Association (NRPA) entered into an agreement to lease part of a railroad facility from USANL. NRPA sued USANL for allegedly breaching the lease and also named the limited partners as defendants. Are the limited partners liable? *National Railroad Passenger Association v. Union Station Associates of New London*, 643 F.Supp. 192, Web 1986 U.S. Dist. Lexis 22190 (United States District Court for the District of Columbia)

14.7 Liability of Partners Raugust-Mathwig, Inc., a corporation, was the sole general partner of a limited partnership. Calvin Raugust was the major shareholder of this corporation. The three limited partners were Cal-Lee Trust, W.J. Mathwig, Inc., and W.J. Mathwig, Inc., and Associates. All three of the limited partners were valid corporate entities. Although the limited partnership agreement was never executed and a certificate of limited partnership was not filed with the state, the parties opened a bank account and began conducting business.

John Molander, an architect, entered into an agreement with the limited partnership to design a condominium complex and professional office building to be located in Spokane, Washington. The contract was signed on behalf of the limited partnership by its corporate general partner. Molander provided substantial architectural services to the partnership, but neither project was completed because of a lack of financing. Molander sued the limited partnership, its corporate general partner, the corporate limited partners, and Calvin Raugust individually to recover payments allegedly due him. Against whom can Molander recover? *Molander v. Raugust-Mathwig, Inc.*, 44 Wash.App. 53, 722 P.2d 103, Web 1986 Wash.App. Lexis 2992 (Court of Appeals of Washington)



Ethics Cases

14.8 Ethics When the Chrysler Credit Corporation (Chrysler Credit) extended credit to Metro Dodge, Inc. (Metro Dodge), Donald P. Peterson signed an agreement guaranteeing to pay the debt if Metro Dodge did not pay. When Metro Dodge failed to pay, Chrysler Credit sued Peterson on the guarantee and obtained a judgment of \$350,000 against him. After beginning collection efforts, Chrysler Credit learned through discovery that Peterson owned four limited partnership units in Cedar Riverside Properties,

a limited partnership. Chrysler Credit sued to obtain the money owed by Peterson from his interests in these other limited partnerships. *Chrysler Credit Corporation v. Peterson*, 342 N.W.2d 170, Web 1984 Minn.App. Lexis 2976 (Court of Appeals of Minnesota)

1. What is a personal guarantee?
2. Did Peterson act ethically in this case?
3. Can Chrysler Credit recover against Peterson's limited partnership interests?

hires Heather, a recent graduate of the University of Chicago and a brilliant software designer, as an employee. Heather's job is to design and develop software that will execute a computer command when the computer user thinks of the next command he or she wants to execute on the computer. Using Heather's research, Microhard.com, LLC, develops the Third Eye software program that does this. Microhard.com, LLC, sends Heather to the annual Comdex computer show in Las Vegas, Nevada, to unveil this revolutionary software. Heather goes to Las Vegas, and while there, she rents an automobile to get from the hotel to the computer show and to meet interested buyers at different locations in Las Vegas. While Heather is driving from her hotel to the site of the Comdex computer show, she negligently causes an accident in which she runs over Harold Singer, a pedestrian.

Singer, who suffers severe physical injuries, sues Microhard.com, LLC, Heather, Harold, Jasmine, Caesar, and Yuan to recover monetary damages for his injuries. Who is liable?

15.6 Liability of Members Isabel, Koshi, and Winchester each contribute \$50,000 capital to form a limited liability company called Fusion Restaurant, LLC, which operates an upscale restaurant that serves "fusion" cuisine, combining foods from cultures around the world. Fusion Restaurant, LLC, as a business, borrows \$1 million from Melon Bank for operating capital. Isabel, Koshi, and Winchester are so busy cooking, serving, and running the restaurant that they forget to hold members' meetings, keep minute books, or otherwise observe any usual company formalities for the entire first year of business. After this one year of hard work, Fusion Restaurant, LLC, suffers financial difficulties and defaults on the \$1 million bank loan from Melon Bank. Melon Bank sues Fusion Restaurant, LLC,

Isabel, Koshi, and Winchester to recover the unpaid bank loan. Who is liable?

15.7 Member-Managed LLC Jennifer, Martin, and Edsel form a limited liability company called Big Apple, LLC, to operate a bar in New York City. Jennifer, Martin, and Edsel are member-managers of the LLC. One of Jennifer's jobs as a member-manager is to drive the LLC's truck and pick up certain items of supply for the bar each Wednesday. On the way back to the bar one Wednesday after picking up the supplies for that week, Jennifer negligently runs over a pedestrian, Tilly Tourismo, on a street in Times Square. Tilly is severely injured and sues Big Apple, LLC, Jennifer, Martin, and Edsel to recover monetary damages for her injuries. Who is liable?

15.8 Duty of Loyalty Ally is a member and a manager of a manager-managed limited liability company called Movers & You, LLC, a moving company. The main business of Movers & You, LLC, is moving large corporations from old office space to new office space in other buildings. After Ally has been a member-manager of Movers & You, LLC, for several years, she decides to join her friend Lana and form another LLC, called Lana & Me, LLC. This new LLC provides moving services that move large corporations from old office space to new office space. Ally becomes a member-manager of Lana & Me, LLC, while retaining her member-manager position at Movers & You, LLC. Ally does not disclose her new position at Lana & Me, LLC, to the other members or managers of Movers & You, LLC. Several years later, the other members of Movers & You, LLC, discover Ally's other ownership and management position at Lana & Me, LLC. Movers & You, LLC, sues Ally to recover damages for her working for Lana & Me, LLC. Is Ally liable?



Ethics Cases

15.9 Ethics Christopher, Melony, Xie, and Ruth form iNet.com, LLC, a limited liability company. The four members are all Ph.D. scientists who have been working together in a backyard garage to develop a handheld wireless device that lets you receive and send e-mail, surf the Internet, use a word processing program that can print to any printer in the world, view cable television stations, and keep track of anyone you want anywhere in the world as well as zoom in on the person being tracked without that person knowing you are doing so. This new device, called Eros, costs only \$29 but makes the owners \$25

profit per unit sold. The owners agree that they will buy a manufacturing plant and start producing the unit in six months. Melony, who owns a one-quarter interest in iNet.com, LLC, decides she wants "more of the action" and soon, so she secretly sells the plans and drawings for the new Eros unit to a competitor for \$100 million. The competitor comes out with exactly the same device, called Zeus, in one month and beats iNet.com, LLC, to market. The LLC, which later finds out about Melony's action, suffers damages of \$100 million because of Melony's action. The LLC sues Melony to recover damages.

required warning about not using the backdoor after dark had not been posted at the restaurant.

Martin's parents and Dudek and Kincaid sued McDonald's to recover damages for negligence. Is McDonald's liable for negligence? *Martin v. McDonald's Corporation*, 572 N.E.2d 1073, Web 1991 Ill.App. Lexis 715 (Court of Appeals of Illinois)

15.2 Liability of Limited Partners In 2002, Damon Chargois and Cletus Ernster, both lawyers, formed a limited liability partnership known as Chargois & Ernster, L.L.P. (CELLP). CELLP prosecuted lawsuits against Dillard Department Stores, Inc. (Dillard's), alleging that Dillard's racially discriminated against customers. In June 2003, in an attempt to solicit business, CELLP developed a website that included a link using the "Dillard's" name and logo. Clicking on this link took visitors to dillardsalert.com, a separate website documenting acts of alleged racial profiling by the department store.

Dillard's sued CELLP in U.S. District Court for trademark infringement and cyberpiracy. On July 25, 2004, while the litigation continued, Chargois and Ernster dissolved their limited liability partnership, and CELLP's registration as a LLP expired. On November 2, 2004, the court entered a judgment ordering CELLP to pay Dillard's \$143,500 in damages. When the judgment was not satisfied, Dillard's sued Chargois and Ernster in their individual capacities, alleging that the partners were personally responsible for the judgment. Are Chargois and Ernster personally liable for the unpaid judgment obtained against their law firm? *Evanston Insurance Company v. Dillard Department Stores, Inc.*, Web 2010 U.S. App. Lexis ___ (United States Court of Appeals for the Fifth Circuit)

15.3 Liability of a Franchisee The Southland Corporation (Southland) owns the 7-Eleven trademark and licenses franchisees to operate convenience stores using this trademark. Each franchise is independently owned and operated. The franchise agreement stipulates that the franchisee is an independent contractor who is authorized to make all inventory, employment, and operational decisions for the franchise.

Timothy Cislav, 17 years old, died of respiratory failure. His parents filed a wrongful death action against the franchisee, a Costa Mesa, California, 7-Eleven franchise store, and Southland, alleging that Timothy's death resulted from his consumption of Djarum Specials (clove cigarettes) sold at the Costa Mesa, California, 7-Eleven franchise store. The Costa Mesa 7-Eleven was franchised to Charles Trujillo and Patricia Colwell-Trujillo. Southland defended, arguing that it was not liable for the alleged tortious conduct of its franchisee because the franchisee was an independent contractor. The plaintiffs alleged that the franchisee was Southland's

agent and therefore Southland was liable for its agent's alleged negligence of selling the clove cigarettes to their son. Is the Costa Mesa franchisee an agent of Southland, thus making Southland liable for the alleged tortious conduct of its franchisee? Does the doctrine of apparent agency apply in this case? Who wins? *Cislav v. Southland Corporation*, 4 Cal.App.4th 1284, 6 Cal.Rptr.2d 386, Web 1992 Cal.App. Lexis 375 (Court of Appeal of California)

15.4 Limited Liability Company Angela, Yoko, Cherise, and Serena want to start a new business that designs and manufactures toys for children. At a meeting in which the owners want to decide what type of legal form to use to operate the business, Cherise states:

We should use a limited liability company to operate our business because this form of business provides us, the owners, with a limited liability shield, which means that if the business gets sued and loses, we the owners are not personally liable to the injured party except up to our capital contribution in the business.

The others agree and form a limited liability company called Fuzzy Toys, LLC, to conduct the member-managed business. Each of the four owners contributes \$50,000 as her capital contribution to the LLC. Fuzzy Toys, LLC, purchases \$800,000 of liability insurance from Allied Insurance Company and starts business. Fuzzy Toys, LLC, designs and produces "Heidi," a new toy doll and female action figure. The new toy doll is an instant success, and Fuzzy Toys, LLC, produces and sells millions of these female action figures. After a few months, however, the LLC starts getting complaints that one of the parts of the female action figure is breaking off quite regularly, and some children are swallowing the part. The concerned member-managers of Fuzzy Toys, LLC, issue an immediate recall of the female action figure, but before all of the dolls are returned for a refund, Catherine, a 7-year-old child, swallows the toy's part and is severely injured. Catherine, through her mother, sues Fuzzy Toys, LLC, Allied Insurance Company, Angela, Yoko, Cherise, and Serena to recover damages for product liability. At the time of suit, Fuzzy Toys, LLC, has \$200,000 of assets. The jury awards Catherine \$10 million for her injuries. Who is liable to Catherine, and for how much? How much does Catherine recover?

15.5 Liability of Members Harold, Jasmine, Caesar, and Yuan form Microhard.com, LLC, a limited liability company, to sell computer hardware and software over the Internet. Microhard.com, LLC,

14.9 Ethics Robert K. Powers and Lee M. Solomon were among other limited partners of the Cosmopolitan Chinook Hotel (Cosmopolitan), a limited partnership. Cosmopolitan entered into a contract to lease and purchase neon signs from Dwinell's Central Neon (Dwinell's). The contract identified Cosmopolitan as a "partnership" and was signed on behalf of the partnership, "R. Powers, President." At the time the contract was entered into, Cosmopolitan had taken no steps to file its certificate of limited partnership with the state, as required by limited partnership law. The certificate was not filed with the state until several months after the contract was signed. When Cosmopolitan defaulted

on payments due under the contract, Dwinell's sued Cosmopolitan and its general and limited partners to recover damages. *Dwinell's Central Neon v. Cosmopolitan Chinook Hotel*, 21 Wash.App. 929, 587 P.2d 191, **Web** 1978 Wash.App. Lexis 2735 (Court of Appeals of Washington)

1. What is a defective formation of a limited partnership?
2. Did the limited partners act ethically in denying liability on the contract?
3. Are the limited partners liable?

Internet Exercises



1. Go to www.sba.gov/smallbusinessplanner/plan/getready/SERV_SBPLANNER_ISENTFORU.html and read the discussion about entrepreneurship. Would entrepreneurship work for you?

2. Go to www.powerhomebiz.com/vol144/starbucks.htm and read the article "Learning from Starbucks: 10 Lessons for Small Businesses."

3. Go to www.nytimes.com/1990/08/21/sports/steinbrenner-says-he-has-signed-resignation.html and

read about the former managing general partner of the New York Yankees professional baseball team.

4. Go to www.sfgate.com/cgi-bin/article.cgi?file=/chronicle/archive/2005/02/28/BUGJUBGR5D1.DTL&type=business and read the story of the founding of Yahoo, Inc. Go to <http://docs.yahoo.com/info/values/> and read what Yahoo values and does not value.