

Chapter 11 – Business Organizations

Introduction

- When choosing an organizational form, entrepreneurs should consider:
 - Ease of creation
 - Owners' liability
 - Tax considerations
 - Ability to raise capital

Sole Proprietorships and Franchises

- Sole Proprietorships
 - The owner is the business
 - Advantages
 - Proprietor owns the entire business and has a right to receive all profits
 - Easier and less costly to start; allows flexibility
 - Disadvantages
 - The owner is personally liable for all losses or liabilities incurred by the business enterprise.
 - Lacks continuity on the death of proprietor
- Franchises
 - An arrangement in which the franchisor (owner of trademark, trade name or copyright) licenses franchisee to use the trademark, trade name, or copyright in the sale of goods or services.
 - Types of franchises
 - Distributorship
 - Chain-style business operation
 - Manufacturing or processing-plant arrangement
 - Laws governing franchises
 - Governed by contract law
 - Federal regulation of franchising
 - State regulation of franchising
 - The franchise contract
 - Payment for the franchise – initial fee or lump-sum price for the license
 - Business premises – lease or purchase
 - Location of the franchise – franchisor typically determines territory to be served
 - Quality control by the franchisor
 - Termination of the franchise
 - The Franchise Agreement may grant franchisee the opportunity to “cure” an ordinary breach within a period of time to prevent termination.
 - Wrongful termination
 - Generally the terms of a franchise contract favor the franchisor.
 - Importance of good faith and fair dealing
 - Courts usually try to balance the rights of both parties. If franchisor arbitrarily or unfairly terminates a franchise, the franchisee will be provided with a remedy for wrongful termination.

- If franchisor's decision to terminate was made in the normal course of the franchisor's business operations, and reasonable notice of termination was given to the franchisee, most courts will not consider the termination wrongful.

Partnerships

- **General Partnerships**
 - Arises from agreement, express or implied, between two or more persons to carry on a business together for profit
 - Sharing of profits and losses
 - Joint ownership
 - Equal right in management
 - Advantages and disadvantages
 - Firm does not pay federal taxes
 - Profits are "passed through" to partners
 - Joint and several liability – a third party has the option of suing all of the partners together or one or more separately
 - Fiduciary duties
 - Dissociation of a partnership – occurs when partner ceases to be associated with partnership; normally entitles partner to be bought out
- **Limited Partnerships**
 - Agreement of two or more persons to carry on a business for profit with at least one general partner and one limited partner.
 - Limits the liability of the limited partners to their investment.
 - Limited partners cannot participate in management.
 - An LP is a creature of state statute so filing a certificate with the Secretary of State is required.
- **Limited Liability Partnerships**
 - Hybrid form of business that allows for 'pass-through' for tax purposes, but limits personal liability from malpractice of other partners.
 - LLP formation – formed under state law
 - Liability – allows professionals to avoid personal liability for the malpractice of partners

Limited Liability Companies

- **LLC Formation** – must be formed and operated in compliance with state law
- **Advantages of the LLC** – profits pass through and taxes are paid individually.
- **The LLC Operating Agreement**
 - Management
 - How profits will be divided
 - Transfer of membership interests
 - Whether LLC will be dissolved on death or departure of member
- **Management of an LLC**

- Either member-managed, or manager-managed.
- Managers and members owe fiduciary duties to the LLC and each other.
- Dissociation and Dissolution of an LLC
 - Member has the power, but not the right, to dissociate from the LLC at any time.
 - Trigger Events: voluntary withdrawal, expulsion by other members or court order, bankruptcy, incompetence, or death.

Corporations

- A legal entity formed in compliance with statutory requirements that is distinct from its shareholder-owners.
- Model Business Corporation Act (MBCA)
- Revised Model Business Corporation Act (RMBCA)
- Nature and Classification
 - The limited liability of shareholders
 - Key advantage
 - Corporate earnings and taxation
 - Dividends and profits
 - Corporate profits can be subject to double taxation
 - S corporation
 - Criminal acts and tort liability
 - A corporation is liable for the torts committed by its agents or officers within the course and scope of their employment.
 - Domestic, foreign, and alien corporations
 - **Domestic Corporation** does business in its state of incorporation.
 - **Foreign Corporation** from X state doing business in Z state.
 - **Alien Corporation**: formed in another country doing business in United States.
 - Close corporations
 - One whose shares are held by members of a family or by relatively few people
- Formation and Financing
 - Articles of incorporation
- Corporate Powers
 - Express and implied powers
- Piercing the Corporate Veil
 - Courts pierce the veil when the corporate privilege is abused for personal benefit or the business is treated carelessly that it is indistinguishable from the controlling shareholder.

Directors, Officers, and Shareholders

- Directors
 - Election of directors
 - Compensation of directors
 - Board of directors' meetings
 - Rights of directors
- Corporate Officers and Executives
 - Hired by the board of directors

- Duties and Liabilities of Directors and Officers
 - Duty of care
 - The business judgment rule
 - Duty of loyalty
 - Conflicts of interest

- Shareholders
 - Shareholders' powers
 - Shareholders' meetings
 - Proxies
 - Shareholder proposals
 - Shareholder voting
 - Cumulative voting
 - Other voting techniques

- Rights of shareholders
 - Preemptive rights
 - Dividends
 - Retained earnings
 - Net profits
 - Surplus
 - Inspection rights
 - Transfer of shares
 - The shareholder's derivative suit

Major Business Forms Compared

- Businesspersons consider several factors when deciding which form of business organization to choose:
 - Ease of creation
 - Liability of the owners
 - Tax consideration
 - Ability to raise capital