

Question 6

Albert, an attorney, and Barry, a librarian, decided to incorporate a business to provide legal services for lawyers. Barry planned to perform legal research and draft legal memoranda. Albert intended to utilize Barry's work after reviewing it to make court appearances and argue motions on behalf of other attorneys. Albert and Barry employed Carla, an attorney, to prepare and file all of the documentation necessary to incorporate the business, Lawco, Inc. ("Lawco").

Carla properly drafted all required documentation to incorporate Lawco under the state's general corporation law. The documentation provided that: Lawco shares are divided equally between Albert and Barry; Lawco profits will be distributed equally to Albert and Barry as annual corporate dividends; Barry is president and Albert is secretary.

Albert and Barry opened their business in January, believing that Lawco was properly incorporated. In February, they purchased computer equipment in Lawco's name from ComputerWorks. The computer equipment was delivered to Lawco's office and used by Barry.

Carla, however, neglected to file the articles of incorporation until late April.

In May, Albert, without consulting anyone, contracted in Lawco's name to purchase office furniture for Lawco from Furniture Mart. On the same day, also without consulting anyone, Barry contracted in Lawco's name to purchase telephones for Lawco from Telco.

1. Is Lawco bound by the contracts with:
 - a. ComputerWorks? Discuss.
 - b. Furniture Mart? Discuss.
 - c. Telco? Discuss.

2. Has Albert committed any ethical violation? Discuss.

Answer question number 2 according to California and ABA authorities.

Answer A to Question 6

1A) Lawco's Contract with Computer Works

Status of the Corporation

The first defense Lawco might raise against enforcement of this contract is that while it was entered into by Lawco, Inc., no such entity existed at the time the contract was formed. They might argue that because no corporation existed, the corporation is not liable on the contract. There are three scenarios under which a corporation might be bound.

If the corporation is a de jure corporation, it has been validly created by observing the formalities of incorporation and receiving its articles of incorporation from the state. While the second and third contracts discussed below were entered into by a de jure corporation, this first one was not, as attorney Carla had neglected to file the articles of incorporation with the state until April, two months later.

A corporation is a de facto corporation where the formalities have been entered into, and the corporation had a good faith belief that it is a corporation, but the paperwork has not been processed and the state has not actually issued corporate status. A corporation can rely on its de facto status in such a situation to enforce a contract that it might not otherwise be able to enforce. Here, A and B both believed that Lawco had been properly formed, though it had not yet been so. If they wanted to enforce the contract, they would depend on their de facto status. If they are trying to avoid being bound by it the de facto characterization might be considered, but the doctrine of corporation by estoppel is probably more appropriate.

Corporation by estoppel results when a corporation holds itself out to the public as a corporation, acts as such, and enters into contracts under that banner, but is not actually a corporation at the time. Such an entity is estopped from claiming that it was not in fact a corporation when it entered into those contracts, as it benefited from claiming that it was.

Adoption of Pre-Incorp Contract

Even if none of the doctrines above are successful, ComputerWorks (CW) will argue that the contract was a pre-incorporation contract and that Lawco adopted it by accepting and using the computers that it delivered. It will argue that such actions demonstrate its intent to profit from the contract.

Quasi-Contract

If no contract is found, CW will argue that Lawco benefited from the use of its computers after holding itself out as ready to contract and that under the doctrine of quasi-contract, should not be unjustly enriched. Under such a theory, CW will receive the value conferred upon Lawco.

Sue A and B personally

If none of the above work, CW can sue whomever signed the contract (A, B, or both) and claim that it was a pre-incorporation contract which was not adopted by the corporation and hold them personally liable.

1B) Lawco's contract with Furniture Mart (FM)

As described above, Lawco was a validly formed corporation when it entered into a contract with FM for furniture. The issue is whether or not Albert, by himself, had authority to enter into such a contract, or whether B's consent was required. This issue is best analyzed under the law of agency.

Agency

If FM can establish that A was acting as an agent of Lawco when he entered into the contract, then Lawco will be bound. An agent can have actual or apparent authority.

Actual Authority

Actual authority can be either express or implied. Actual authority is express when the agent and principal have agreed that the agent will act on behalf of the principal in a certain capacity. Authority can be implied to the extent that an agent's express authority requires it to do certain other acts as a matter of course in order to perform its functions as an agent.

In this case, A entered into the contract with FM. Under the articles of incorporation, A is the secretary of Lawco. While there is no evidence of express authority for A to purchase for Lawco, a corporation is not an individual and so must act through agents by necessity. Lawco will argue that as a 50% shareholder, A needed to have approval of B in order to enter into a contract to purchase assets for the corporation and that he was not an agent. It is much more likely that B will possess actual authority than A will, and this argument will probably fail.

Apparent Authority

If the argument for actual authority fails, FM will argue that, instead, A had apparent authority to act for Lawco. Apparent authority is authority that results from 1) an agent's position or title with respect to the principal, 2) where the principal has held the agent out in the past as its agent and has not published the revocation of authority, or 3) the principal ratifies the agent's actions after the fact.

In this case, FM will argue that because of his position as secretary of the corporation, even if A did not have actual authority to contract, they relied on his apparent authority to do so as the secretary of the corporation. This will be a weak argument, as the secretary is not usually expected to enter into contracts for a corporation. Although the facts are silent as to what happened after the contracts were entered into, if Lawco accepted the benefits of the contract with

FM, they will also argue that Lawco ratified the contract entered into by A when they accepted the furniture and used it.

Lawco will argue that A's role in the corporation was a 50% shareholder and secretary. It will argue that there was no express agency agreement, nor did it ever act in a manner that might hold A out as its agent. Furthermore, A's shareholder status grants him no right to enter into contracts on behalf of the corporation as that is a job for the officers and directors. Finally, A's role as a secretary is to take notes at meetings, and perhaps oversee documents. It is not to make unilateral decisions for the corporation or spend money.

Unlike the situation of B below, FM will not have access to some of the more persuasive arguments of apparent authority. Unless there is some manifestation of express authority in the corporate records, absent a decision by the officers or vote of all shareholders, they will probably not be able to bind Lawco under A's contract, unless Lawco takes some action after the fact to ratify A's actions. They may, however, be able to go after A personally for any damages due to breach on a contract he signed as a purported agent.

1C) Lawco's Contract with Telco (TC)

As described above, Lawco was a de jure corporation when B entered into the contract with TC on its behalf. As above with A, the issue will be whether B qualifies as an agent who might bind Lawco as the principal. Unlike A, however, who was the secretary of Lawco, B was the president. The president arguably has actual or apparent authority to enter into contracts for the corporation where the secretary is less likely to have such.

The same principles will be applied as above, but in this case, the facts probably dictate a different outcome. The president of a corporation is arguably an agent thereof by [the] very nature of his position. FM will argue that for a necessary business expense of the corporation, like securing furniture, the president had actual or at least implied authority to secure them. They will argue that the corporation cannot act on its own and that its president is the obvious choice to enter into contracts on behalf of it. They will also argue that Lawco accepted the benefit of B's actions and that in doing so it ratified B's actions.

TC will have access to more persuasive arguments than FM had above due to B's apparent authority as president, and will have a much stronger case to enforce its contract against Lawco than FM did.

2) Albert's Ethical Violations

Albert's Duty Not to Aid in the Unauthorized Practice of Law

A has a duty not to help a nonlawyer practice law. The practice of law includes advising or counseling clients, as well as arguing before the court. In this case, the facts state that B's duties are to perform legal research and to draft legal memoranda. A intends to review this work and use it to make court appearances

and argue motions. While B's legal research is probably not prohibited, his drafting of legal memoranda may be. The fact that A intends to review this work and basically attach his name to it after verifying its contents makes it a close call. Law clerks are able to engage in such activity before graduating from law school and passing the bar as long as they are appropriately supervised. A will argue that B's work is almost identical to that of a law clerk and that with proper supervision there is no breach of his duty.

Albert's Duty Not to Go Into Business With a Nonlawyer

A has a duty not to incorporate with a nonlawyer when he plans to practice law. Lawyers are allowed to form partnerships with each other, but they cannot form partnerships or corporations with another type of professional or nonlawyer such as a CPA. Here, A will argue that the actuality of the relationship is exactly like a lawyer – experienced paralegal. He is mistaken, however, in that the liability of Lawco, the ownership interests, and the division of power between A and B are almost exactly equal. A should not allow himself to enter into a business transaction with a nonlawyer like B who may try to exert influence on his decisions in legal matters as a result of his partial ownership in the venture. The fact that B is the president and A is the secretary makes this arrangement particularly suspect. B arguably has a persuasive role in determining the direction of the venture due to his office. Furthermore, he is the face of the venture that is in its very name offering legal services, yet he is not himself a lawyer. A has violated this duty.

A's Duty Not to Share Profits with A Nonlawyer

A has a duty not to share profits with a nonlawyer in his practice of law. Lawyers may hire paralegals or research assistants for salary, but arrangements under which a nonlawyer is entitled to a preset ratio of the profits is forbidden. In this case, Lawco's articles provide that Lawco's profits are to be distributed equally to Albert and Barry as annual corporate dividends. The form the profit sharing takes is not nearly as important as the fact that it exists. A will not be able to hide behind the fact that the distribution scheme is couched in dividends rather than an outright sharing. A has violated this duty.

Answer B to Question 6

1A) Contract with ComputerWorks

In [order] for Lawco to be bound, (i) the corporation must be validly incorporated, (ii) the doctrines of de facto corporations or corporations by estoppel must apply or (iii) the contract must have been adopted by the corporation after incorporation.

Valid Incorporation

A corporation is formed when the incorporator validly complied with the requirements of the state's general incorporation law. This typically requires the filing of the articles of incorporation. Since the articles were not filed until April and the contract was entered into in February, Lawco was not validly incorporated at the time of the contract.

Generally, a corporation is not liable for contracts entered into before it was incorporated until it adopts the contract. It can adopt the contract through (i) express adoption, such as a writing, or (ii) implied adoption, which may be accomplished by accepting the benefits of the contract without protest.

De facto Corporation

ComputerWorks could argue that Lawco is still liable on the contract since it was a de facto corporation. A de facto corporation may be found where (i) there is a valid general corporation law, (ii) the incorporation made a colorable good faith attempt to comply with the statute, (iii) the incorporator was not aware that the attempt to comply with the statute was invalid and (iv) the corporation took some action indicating that it considered itself a corporation.

In this situation, Carla properly drafted all the required documentation to incorporate Lawco. The state does have a general corporation law. Albert and Barry entered into the contract with ComputerWorks believing that the corporation was valid. The corporation took an action typical of a corporation by purchasing computer equipment in the corporation's name and having the equipment delivered to the corporation's office and used by a corporate employee.

This question of de facto corporation will revolve around whether Carla's neglect in delaying the filing of the articles negates her "good faith, colorable" attempt to comply with the corporation statute. Since Carla is a lawyer and knew her job was to prepare and file all the documentation necessary to incorporate Lawco, it is likely that this is not a good faith, colorable attempt to comply with the statute, and there is no de facto corporation.

Corporation by Estoppel

ComputerWorks can argue that Lawco should be estopped from denying the corporation existed since it received a benefit under the contract and would be unjustly enriched if the contract were not enforced. ComputerWorks can argue that there was (presumably) a promise to pay. ComputerWorks can argue that Lawco received a benefit by accepting and using the computers. It would be unjustly enriched by retaining the computers without paying for them. ComputerWorks can argue that it was foreseeable that it would expect to be paid for the computers and it was reasonable that it should be paid for the computers.

Adoption of the Contract

Finally, ComputerWorks could argue that Lawco should be bound on the contract since it adopted the contract after formation. A corporation adopts a contract after formation when it impliedly accepts the benefits of the pre-incorporation contract after incorporation. Here, Lawco retained the computers and probably continued to use them after formation in April.

The result is that the court would likely find that Lawco adopted the contract, or if not, that it should be estopped from denying the contract.

1B) Contract with Furniture Mart

In order for Lawco to be bound, (i) the corporation must have been validly incorporated at the time of the contract and (ii) the action taken must validly bind the corporation.

First, since the articles were filed in April, and it is presumed that all other requirements of the statute have been complied with, Lawco was validly in existence at the time of its contract with Furniture Mart in May.

Express Authorization by Articles

Second, there is the issue whether Albert validly bound Lawco when he contracted in Lawco's name with Furniture Mart. Albert is the secretary of the corporation and is thus a senior officer. The articles of the corporation would likely delineate the powers of the officer, and so Albert may be authorized under the articles.

Implied Authorization under Agency Law

If not, Albert may also be authorized under general principles of agency law to bind the corporation. Generally, an agent may bind a principal if he has express authorization, implied authorization or apparent authorization to do so. There is no evidence that Albert received express authorization to enter into the contract.

Albert would have implied authorization if (i) it was customary for someone in his position to bind the corporation, (ii) he reasonably believed, based on past behavior and actions, that he had the power to do so, or (iii) it was necessary for the performance of his duties that he be able to bind the corporation. It is also necessary that Albert acted within the scope of the authorization.

Since it is probably necessary for Albert's position as secretary that he be able to bind the corporation on such routine contracts as buying office furniture, he probably had implied authority.

He may also have had apparent authority if (i) the corporation "cloaked" him with the apparent position of being able to enter into the contract and (ii) Furniture Mart relied on this position.

In conclusion, even though he did not consult anyone, it is likely that the contract is valid since Albert had implied and apparent authority to enter into the contract. Since the contract is valid, Lawco is bound on the contract.

1C) Contract with Telco

In order for Lawco to be bound, (i) the corporation must have been validly incorporated at the time of the contract and (ii) the action taken must validly bind the corporation.

First, since the articles were filed in April, and it is presumed that all other requirements of the statute have been complied with, Lawco was validly in existence at the time of its contract with Telco in May.

Please see part (1)(B) for detailed discussion of agency law. Below is the application of the discussed legal principles to this situation:

Express Authorization by Articles

As President, it is likely that Barry was expressly authorized by the articles to enter into routine contracts, such as the purchase of telephones, for the corporation.

Implied Authorization under Agency Law

If not, Albert may have validly entered into the contract by express, implied or apparent authority. The facts give no indication of express authority. However, it is probably necessary for the president of a corporation to enter into contracts for routine items, so he probably had implied authority. It is also perfectly reasonable for another corporation to believe that the president has the power to bind the company, so Barry definitely had apparent authority.

In conclusion, even though he did not consult anyone, Barry had apparent and implied authority to enter into the contract, and Lawco is thus bound by the contract.

2. Possible Ethical Violations by Albert

Unauthorized Practice of Law

An attorney may be disciplined for aiding a nonlawyer to practice law. The practice of law consists of making decisions which require the exercise of legal judgment by the lawyer. However, activities related to law, which do not involve the “practice of law,” may be performed by any nonlawyer. Also, under the ABA Rules and California law, a nonlawyer may practice law under certain very specific circumstances. For example, under ABA Rule, a nonlawyer may practice law under the direct supervision of a practicing lawyer who is licensed in that jurisdiction.

Albert is an attorney, and he knowingly decided to incorporate a business in which Barry, who is not an attorney, would perform legal research and draft legal memoranda. Not only did Albert know that Barry would be doing these things, he intended to use Barry’s work to make court appearances and argue motions. There is no mention of Albert supervising Barry or reviewing his work before using it. Therefore, Albert can be disciplined for assisting Barry in the unauthorized practice of law.

Partnering with Nonlawyers

A lawyer is permitted to partner with a nonlawyer in a business providing legal services. A lawyer may hire a nonlawyer to work in such a business as long as they are not practicing law in an unsupervised way.

Here, Albert, a lawyer, and Barry, a nonlawyer, incorporated to form a business together. The business was specifically to provide legal services. The shares of business would be divided equally between Albert and Barry. Therefore, Albert may be disciplined for partnering with Barry to perform legal services, in a corporation in which they have equal shares.

Splitting Fees with Nonlawyers

A lawyer is not permitted to split fees with nonlawyers, except in certain very specific circumstances, such as employee benefit plans. Albert could argue that he was not splitting fees with Barry, and that fees for his services would be paid to the corporation. However, profits are distributed equally to Albert and Barry as corporate dividends. Therefore, Albert would be disciplined for splitting fees with Barry since his argument that fees are not split is illusory.