

Notes on Business Entities and Contracts in Small Claims Court

There are many reasons why people choose to create a corporation, partnership, or other business entity, and one of them is to limit risk of losing personal assets. In North Carolina, as in other states, there are several different kinds of business entities, and knowing what they are is a good place to start.

<i>Corporation</i>	GS Ch. 55	(Inc., Corp., Ltd., Co.)
<i>Professional corporation</i>	GS Ch. 55B	(P.A., P.C.)
<i>Non-profit corporation</i>	GS Ch. 55A	(Inc., Corp., Ltd., Co.)
<i>Limited liability company</i>	GS Ch. 57D	(LLC)

All of these entities are “artificial persons” under the law. There are specific legal requirements for their creation, and for their dissolution. All of these entities are required to register with the North Carolina Secretary of State’s Office, and to maintain a registered agent for the purpose of receiving service. This registration requirement makes it easy for anyone to verify the existence – and to check on the current status—of these businesses merely by visiting the Secretary of State’s website, at www.sosnc.gov. This website contains a great deal of general information of interest to small claims magistrates. In addition, the website is useful for determining information about a particular business entity, including the corporate name, identity and address of the registered agent, names of officers, and whether and on what date a business has been dissolved.

These business entities have the right to enter into legally binding contracts on their own behalf, as well as to sue and be sued. People who own part or all of these entities are not considered to be parties to such contracts and so they are not personally obligated under the law. In addition, individuals acting on behalf of these entities—whether as employees, officers, managers, or otherwise—are typically acting as agents and, consistent with general agency law, are not individually bound to contracts made on behalf of their corporate principal.

Because these entities are fictional people, all of their actions occur through agents. This is the source of frequent confusion on the part of consumers and of a variety of practical issues in small claims court. Common procedural issues related to corporate litigants have been addressed in another handout: *What in the World is an LLC? What You Need to Know about Businesses & Law*. This handout focuses on a different topic: what should a magistrate be thinking about in terms of substantive contract law one or both of the contracting parties is a corporation or LLC?

For the most part, the familiar principles of general agency law apply with equal force to contracts cases involving corporations. A corporation is bound to a contract entered into by an agent on its behalf, and the agent is not, assuming that:

- The agent had actual authority, whether express or implied, to act for the company; OR
- The agent had apparent authority to act for the company; OR
- The company either ratified, or is estopped to deny, the contract entered into by the agent.

Whether an individual has actual authority to contract on behalf of a corporation is of course dependent upon the facts of any given case. The law does not vest particular individuals with particular authority. Instead, a corporation itself determines, whether explicitly or implicitly, what persons are authorized to act for the business. Sometimes this is directly addressed in corporate bylaws, but quite often such authority is less formally granted. “Implied authority, in the corporate context, is actual authority that arises by implication from the nature of the position held or functions performed by the particular officer or agent, and it is therefore sometimes called inherent authority.” Robinson, NC Corporation Law §16.04[1] (2016).

A corporation may be bound by the acts of an agent having apparent authority, even if the agent had no actual authorization to contract. It is important to remember that agency—whether actual or apparent—may never be established based solely on the statements or actions of the agent. Some action on the part of the business itself is necessary to support such a finding. But it may be sufficient that the business vests an employee with a title and acquiesces in particular aspects of that employee’s job performance in a manner indicating to others that such authority exists. For example, the general manager of a restaurant may be reasonably assumed to have authority to place orders with a wholesale distributor for the purchase of grocery supplies.

After-the-fact ratification of a contract by an unauthorized agent is another means by which a corporation may be bound. A corporation that discovers the existence of a contract in such a case but takes no steps to disavow it or communicate to the third party the person’s lack of authority to act for the corporation may be found liable on the contract.

It is not unusual for corporate contracts to be incomplete or unclear in identifying the corporation as a principal, but such lack of clarity is not acceptable in a legal action. A lawsuit filed in the name of the agent in such a case is subject to dismissal unless the corporation itself is correctly named in the complaint and summons as the real party in interest. Similarly, an action incorrectly brought against an agent as defendant rather than the business itself is likely to be unsuccessful, since the agent has no liability under the contract.

Business entities required to register with the Secretary of State are required to meet certain requirements, including filing an annual report, and failure to comply with these rules may result in a corporation being *administratively dissolved*. Also, sometimes businesses voluntarily cease to exist, by means of a *voluntary dissolution*. In either event, the law allows these businesses to “wind up” their affairs, which sometimes requires them to sue their debtors for outstanding amounts. They may also be sued by their creditors while in a state of dissolution. The fact that a corporation has been dissolved is quite significant in one instance, however: the business is prohibited from entering into new contracts in such a case, and such contracts are void as a matter of law.