

**Professor Viveka Rydell
Business Organization
Fall 2014 – Issue Outline
December 8, 2014**

MIDTERM EXAM
3 Hours

This examination covers Introduction to Forms of Business Entities through Duty of Care (Chapters 1-10).

This examination will test your knowledge of the materials that we covered in class. Please answer each question concisely. Please use headings, underline issues and rules, as this will help you organize your thoughts, spot and frame the legal issues, and present the rules and doctrines clearly. Try to answer all questions with complete sentences. Do not use abbreviations, other than those commonly used for each business organization (like LLP). Answer all questions presented. If you cannot answer a question completely, answer as best you can. Partial answers will be given partial credit. Please write clearly. **Good luck!**

PART I (50 POINTS)

In 2006, Arthur, Bob and Christina, childhood friends, got together during a week in Santa Rosa during Christmas. While catching up on what they have been doing since leaving Sonoma County, they started talking about their shared love of fast cars, and protecting the environment. They are excited about trying a new idea and talk about working together sometime. Arthur has a patent on Special Emission Control Reducers (SECRs), specific to the race car industry, and would like to continue to innovate. Bob is currently in sales in Texas and thinks he could sell SECRs, and Christina would like to take care of securing funding and day-to-day Operations. In 2008, during the Recession, Arthur and Bob are laid off and they move in with their parents in Sonoma. They contact Christina, and ask if she is still interested in their idea from 2 years ago. Christina is, and she moves back to Sonoma as well. She does, however, keep contract position with her current employer, the Racecar manufacturer FAST in Detroit. They

plan on hiring local talent. They also hope, in the future, to reach out to other areas to attract environmentally forward-thinking innovations and business.

Dan Danielsson (DD), Christina's uncle, is a business partner at Sonoma Raceway. When Christina approaches DD about the project, he agrees to let ABC lease some unused office space at the racetrack, where they could (1) show racers their invention, and (2) be close to manufacturing (which they want to start in an industrial park in Rohnert Park). DD will also invest \$100,000 in the new business, in exchange for quarter interest in the business. Christina pays the first two months' rent with her own check book. DD then offers the three friends to use DD's own personal lawyer for the initial planning of the business.

The three friends now come to you, a seasoned business lawyer, asking (1) whether they should retain DD's lawyer, (2) the various business organizations available to them, with the pros and cons of each, and (3) what if any particular provisions you think they should make sure to memorialize to get the business off on the right foot.

A few year later, with ABC Business up and running, DD, takes one of the cars out on his own (after a day of testing the SECRs on the Sonoma Racetrack) for a drive to the ocean (on the windy coastal roads). On the way there, he accidentally hits Eric, who was out bicycling. While Eric luckily survived, he had to stay for 2 months in the hospital, and his medical bills are huge. Please discuss what liability, if any, ABC Business is exposed to.

- Don't use DD Esq – potential conflicts
- Be explicit re scope of C's duty to ABC, and not to compete or leak A's ideas/ABC project to FAST Co.
- Business forms
 - sole proprietorship - no
 - general partnership
 - limited partnership
 - limited liability partnership
 - corporation (public or closely held)

- pros/cons – costs/formalities-exposure to liability; ability to get additional funding,
- Liability only if the drive to the coast was within the scope of employment; was drive for testing or personal enjoyment & without A, B + C's knowledge; was DD an employee, partner or "only" investor?
 - Agent/Principal
 - Duties partners owe each other

PART III (50 POINTS)

Answer the following questions:

1. True or False: Creditors of a sole proprietorship may seek payment of business debt from assets of the sole proprietorship. True
2. True or False: A sole proprietorship can have more than one employee. True
3. True or False: In an agency relationship, a principal acts on behalf of an agent. False
4. True or False: LLPs offer more expansive personal liability protections to partners than general partnerships. True
5. True or False: Sole proprietorships terminate upon the death of the proprietor. True
6. Define the term *limited liability*.

The term limited liability refers to limitations placed on business owners' personal responsibility for the debts and obligations of

their businesses. If a business organization provides owners limited liability, creditors cannot look to the business owners' personal assets to satisfy business debts and obligations.

7. What is meant by

8. List as many factors you can that are considered in deciding whether to "pierce the corporate veil."

- Absence or inaccuracy of corporate records;
- Concealment or misrepresentation of members;
- Failure to maintain arm's length relationships with related entities;
- Failure to observe corporate formalities in terms of behavior and documentation;
- Failure to pay dividends;
- Intermingling of assets of the corporation and of the shareholder;
- Manipulation of assets or liabilities to concentrate the assets or liabilities;
- Non-functioning corporate officers and/or directors;
- Significant undercapitalization of the business entity (capitalization requirements vary based on industry, location, and specific company circumstances);

- Siphoning of corporate funds by the dominant shareholder(s);
- Treatment by an individual of the assets of corporation as his/her own;
- Was the corporation being used as a *façade* for dominant shareholder(s) personal dealings; *alter ego* theory.

(not all of these factors need to be met in order for the court to pierce the corporate veil. Further, some courts might find that one factor is so compelling in a particular case that it will find the shareholders personally liable.)

9. What is the difference between a limited partnership and a limited liability partnership?

A limited partnership is managed by general partners, who are personally liable for all debts and obligations of the partnership. Limited partners are merely investors in a limited partnership's business and do not have the right to participate in management of the business. In contrast, limited liability partnerships (LLPs) offer all partners management rights and limit partners' vicarious liability for the negligence and malfeasance of their partners.

10. What is needed in order to form a partnership?

Two or more persons agreeing to enter into a business to make profit.

END OF EXAMINATION