

### Instructions

This is the midterm examination for the Business Organizations course. It consists of one essay question, worth 50% of your grade on the examination, and ten short answer questions (collectively worth 50% of the examination grade).

#### **The Essay Question.**

Your answer should demonstrate your ability to analyze the facts in the question, to tell the difference between material and immaterial facts, and to discern the points of law and fact upon which the result turns. Your answer should show that you know and understand the pertinent principles and theories of law.

Your answer should evidence your ability to apply law to the given facts and to reason in a logical, lawyer-like manner from the premises you adopt to a sound conclusion. Do not merely show that you remember legal principles. Instead, try to demonstrate your proficiency in using and applying them. If the facts do not permit you to reach a specific conclusion, indicate what additional information you would need to form an opinion as to the outcome.

Your answer should be complete, but you should not volunteer information or discuss legal doctrines which are not pertinent to the solution of the problem. If your answer contains only a statement of your conclusions, you will receive little credit. State fully the reasons that support your conclusions and discuss all points thoroughly.

You should answer according to legal theories and principles of general application.

#### **The Short Answer Questions.**

You should answer each question directly and completely. Unless the question calls for a list, use paragraphs and complete sentences. You are advised to pay attention to the available time and budget the time you spend on each answer.

Good luck.

**Essay Question – One Hour  
50 Points**

Alice, Bob and Charles have consulted you. They have an idea for a company to provide rodeo clowns to rodeo events. The clowns would be out-of-work stunt actors and their job would be to run into the arena and try to distract angry bulls and broncos from stomping on fallen riders. Alice plans to handle marketing and accounting, Bob is to train the clowns, and Carl will finance the venture with \$100,000 he plans to borrow using his credit cards.

Alice is prepared to work full time and needs to have a steady salary. Bob thinks he can do the necessary training on an “as needed” basis and so plans to keep his current job and do the training on weekends. But he feels since he is the only one who knows anything about being a rodeo clown, he brings great value to the business and should get no less money than Alice. Carl's primary objective is to not lose money and wants to get at least 15% interest on the money he is investing because he will be paying interest to the credit card companies. The three expect to share control of whatever type of entity you recommend.

Alice has signed two booking contracts already to provide clowns at rodeos starting in two weeks. She made up a company name, "Clowns 'R Us", and put that name on the line at the top of the form identifying “Clowns ‘R Us” as the contracting party but at the signature line at the bottom she simply signed her name.

Now that they are starting operations, they want you to advise them as to ways in which they could organize themselves to achieve their objectives. They also want you to discuss any issues you see with what they've done so far.

They have done some research and are interested in being either a partnership of some sort, or a limited liability company, or a corporation.

How would you advise them as to how they might organize themselves and what issues do you see with what they have done so far?

**Short Answer Section – Two Hours  
5 Points Each**

**Please answer the following questions. You should use complete and grammatical sentences but you do not need to repeat the questions in the answer. For example, with respect to question one, you do not need to take the time to say “Cumulative voting is...” but can say, instead, “It is...” In answering each of the following, pay attention to your use of available time. The proctors will inform you as to the time available to complete this portion of the exam.**

1. What is cumulative voting and which shareholders does it benefit?
2. What is a "staggered" or "classified" board of directors and which shareholders benefit when a corporation has a staggered board?
3. In making a decision as to whether it is appropriate to pierce the corporate veil, what are five of the elements the court will look for?
4. What is "stated capital" and what is its importance to the payment of dividends by a corporation?
5. What are the advantages of capitalizing a corporation by borrowing the necessary money versus capitalizing the corporation by issuing and selling stock?
6. What are some of the most important elements to cover in a well-drafted operating agreement or set of corporate by-laws?

7. What should a person do to protect herself from personal liability if she is required to sign leases or other contracts on behalf of a limited liability entity that is not yet legally formed?

8. What are the common uses for voting trusts and shareholder agreements?

9. What tests are most commonly applied in the United States to determine whether a business association of two or more individuals constitutes a general partnership?

10. Why is the duty owed by shareholders to one another in close corporations different than the duty owed by shareholders to one another in publicly traded corporations?