

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 a 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, telling DD that she and her friends are trying to figure out how to start their business. DD then offers the three friends to use DD's own personal lawyer for 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 business organizations you think would be best for 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 years down the road, Christina calls you and asks for more advice. Turns out, DD took 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 tell Christina what liability, if any, ABC Business is exposed to.

PART II (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.
2. True or False: A sole proprietorship can have more than one employee.
3. True or False: In an agency relationship, a principal acts on behalf of an agent.
4. True or False: LLPs offer more expansive personal liability protections to partners than general partnerships.
5. True or False: Sole proprietorships terminate upon the death of the proprietor.
6. Define the term *limited liability*.
7. List as many factors you can that are considered in deciding whether to "pierce the corporate veil".
8. What is the difference between a limited partnership and a limited liability partnership?
9. What is needed in order to form a partnership?
10. *What is the business judgment rule?*

END OF EXAMINATION