PREVENTING PROBLEMS UP FRONT

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"An ounce of prevention is worth a pound of cure." - Attributed to De Legibus, circa 1240, as well as Benjamin Franklin.

Thus far in this seminar we have reviewed not only the key characteristics of the main types of Virginia business entities that presently are in use, but also how our carefully identifying and understanding the types of substantive issues that owners must resolve can help us to recommend to our clients one or another type of entity. Once our clients have chosen a particular type of entity, we turn to the issue of documenting the deal. Preparing the proper and complete documents is nearly a forensic exercise: as those of you who have handled business litigation already know, the art of effective attorney representation at the deal-making stage requires anticipating and addressing both issues that our clients disclose are important to them and issues that we reasonably can anticipate could become important to them as they add investors and operate their businesses.

I. SUBSTANTIVE ISSUES INCLUDE NOT ONLY THE "RELATIONSHIP" ISSUES DISCUSSED IN THE SECTIONS ABOVE, BUT ALSO SUCH ISSUES AS THE FOLLOWING:

A. Defining and/or Contracting Away Certain Fiduciary Duties:

In defining the word, "fiduciary," and the phrase, "fiduciary capacity," Black's Law Dictionary uses such descriptions as "a character analogous to that of a trustee, in respect to the trust and confidence involved in it and the scrupulous good faith and candor which it requires;" "a person having a duty, created by his undertaking, to act primarily for another's benefit in matters connected with such undertaking;" and "not… for his own benefit, but for the benefit of another person, as to whom he stands in a relation implying and necessitating great confidence and trust on the one part and a high degree of good faith on the other part" (emphasis added in each instance). In examining how Virginia law requires fiduciary duties, we see that the requirements are not uniform across different business entities:

Corporations

Fiduciary duties consist of the duties of care and loyalty. Va. Code §§ 13.1-690 and 13.1-691; *see, generally,* 18B Am. Jur. 2d, *Corporations* § 1689 (Supp. 2000).

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Although the Virginia Stock Corporation Act does not expressly state that directors owe a duty of care or loyalty to the corporation, the Act mandates compliance with general standards of conduct for directors and avoidance of conflicts of interests. Majority shareholders also have certain fiduciary duties. *See Willard v. Moneta Bldg. Supply*, 258 Va. 140, 515 S.E.2d 277 (1999) (thorough analysis of duties of directors and majority shareholders).

The standards provided in §13.1-690(A) require that a director discharge his duties in good faith and with care. Section 13.1-691, on the other hand, provides how a director may avoid a conflict of interest and abide by his or her fiduciary duty of loyalty. Other pertinent citations include *Feddeman & Co. v. Langan Assoc.*, 260 Va. 35, 530 S.E.2d 668 (2000) (providing a good example of how duties apply to specific facts); *Glass v. Glass*, 228 Va. 39, 321 S.E.2d 69 (1984) (holding that officers occupy a fiduciary relationship to the corporation and shareholders); *Adelman v. Conotti Corp*., 215 Va. 782, 213 S.E.2d 774 (1975) (analyzing and applying duties of officers and directors to corporation); *American General Insurance v. Equitable General*, 493 F. Supp. 721, 740-741 (E.D. Va. 1980) (holding, inter alia, that directors' duty to shareholders is as a class and not to individual shareholders); and *Stickley v. Stickley*, 43 Va. Cir. 123 (Rockingham Cnty. Cir. Ct. 1997) (holding, inter alia, that majority shareholders are in a fiduciary position to the corporation and minority shareholders); *but see Byelick v. Vivadelli*, 79 F. Supp. 2d 610, 623 (1999) (holding that where only one person was minority shareholder, directors had fiduciary duty to such shareholder). A good recent law review article exploring the duties of directors is *Misunderstanding Director Duties: The Strange Case of Virginia*, 56 Wash. & Lee L. Rev. 1127 (1999).

Limited Liability Companies

No Virginia statute expressly provides either for any "fiduciary duty" within the context of a limited liability company, or for any fiduciary duty toward other members. Va. Code Section 13.1-1024.1(A) defines only a manager's duty of care to the limited liability company: "A manager shall discharge his or its duties as a manager in accordance with the manager's good faith business judgment of the best interests of the limited liability company." Members who are not managers have no defined duty of care whatsoever. *See In re Garrison-Ashburn, L.C.*, 253 B.R. 700 (E.D. Va. 2000). Furthermore, Va. Code §13.1-1025 places limitations on the liability of managers and of members to the company and to other members, unless an operating agreement specifies to the contrary. Finally, by virtue of Va. Code §13.1-1023 (see below, at V-5), it is clear that anything not expressly prohibited by law or public policy is acceptable within the limited liability company framework.

General Partnerships

In the context of the general partnership, we all know that partners function as fiduciaries, and Va. Code §50-73.102 explicitly provides that partners have a fiduciary duty toward the partnership as well as toward other partners. However, said statute provides that the fiduciary duty is limited to the duties of loyalty and care in accounting to the partnership, in the use of its property, and in refraining from being adverse to or competing with the partnership. Outside these areas, partners have only an "obligation of good faith and fair dealing." Note that this is a standard much closer to the "good faith

business judgment" standard applicable to members and managers in limited liability companies. In *Harrell v. Crestar Bank*, 2000 Va. Cir. LEXIS 121, No. CH96-363, Norfolk Circ. Ct., May 5, 2000, the Court provided a good analysis of partners' fiduciary duties, including citing Judge Cardozo, who

> in *Meinhard v. Salmon*, 249 N.Y. 458, 464, 164 N.E. 545, 546 (1928) (citations omitted), detailed the fiduciary obligations of co-partners:
>
> > Many forms of conduct permissible in a workaday world for those acting at arm's length, are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals for the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior. As to this there has developed a tradition that is unbending and inveterate. Uncompromising rigidity has been the attitude of courts of equity when petitioned to undermine the rule of undivided loyalty by the "disintegrating erosion" of particular exceptions.... Only thus has the level of conduct for fiduciaries been kept at a level higher than that trodden by the crowd.

Limited Partnerships

Fiduciary duties of a general partner in the context of the limited partnership are identical to those of a partner in a general partnership, because Va. Code § 50-73.29(B) states that "[e]xcept as provided in this chapter or in the partnership agreement, a general partner of a limited partnership has the liabilities of a partner in a partnership without limited partners to the partnership and to the other partners." Also, Va. Code § 50-73.75 states that "[i]n any case not provided for in this chapter the provisions of the Uniform Partnership Act (§ 50-73.79 et seq.) shall govern." Therefore, Va. Code § 50-73.102 of the Uniform Partnership Act would apply equally to limited partnerships. *See Dulles Corner Properties II Ltd. Partnership v. Smith*, 246 Va. 153, 431 S.E.2d 309 (1993). The duty of a limited partner, furthermore, is presumed to exclude management, and thus a limited partner has no liability in connection with the partnership's actions. Va. Code § 50-73.24.

In summary, the law regarding fiduciary duties in partnerships and corporations has developed to such an extent that the scope, obligations and protections of such duties has become well known, although modifications and waivers are feasible within the permitted limits of the statutes. Whether fiduciary duties exist in a limited liability company, however, is far less clear. If it were established analogously to a partnership, for example, do the managers, or managing members, have fiduciary duties to anyone despite the lack of statutory provisions for them? If it were established analogously to a corporation, would the managers or managing members have fiduciary duties akin to those of directors, officers, or majority shareholders of a corporation?

Intellectually rewarding debates can result from these questions. The possibility of such debates, however, will generally be far from pleasing to a client. Rather than risk

such debates (translated also as "lawsuits"), the wiser course is to draft the applicable agreements, especially but not exclusively in the context of a limited liability company, to specify the nature and extent of those fiduciary or other duties that will exist, or of any limitations, modifications or extensions thereof, or, in the limited liability company context, at least, to specify that fiduciary duties will not exist. In this latter instance, providing for fair but less stringent duties would be a wiser course also. A few clauses regarding fiduciary duties that may be used in limited liability company operating agreements are included in the Appendix to this section, below at page V-9.

B. Mediation/Arbitration vs. Litigation:

Depending on the jurisdiction and venue where a dispute may be expected to be litigated if a dispute were to arise among business owners and/or operators, such persons, and their attorneys, often prefer to provide for alternative dispute resolution ("ADR") in the applicable governing documents of an entity. ADR can include anything that the parties or their counsel can imagine, from voluntary mediation to mandatory arbitration, with any combination of alternatives also being feasible.

ADR can often both achieve money savings, in terms of legal costs and "down time" of key personnel, and save time in accomplishing final dispositions or settlements of the disputes, thereby facilitating the business' surviving the dispute and moving forward. Attorneys sometimes debate the merits of various types of ADR. However, provisions for some type of ADR are often included in governing documents, including bylaws, partnership agreements and operating agreements.

A good, comprehensive provision for mediation and, if necessary, arbitration, is included in the Appendix to this Section, below, beginning at page V-10. It was developed by a major commercial ADR facilitator, and of course can and should be shortened or customized as appropriate. In addition to providing the whether, the what, and the how of any selected ADR, the parties may also want to require that any selected ADR methods shall be a condition to, or a binding and exclusive substitute for, court proceedings except as to enforcement.

C. Waiver of Remedies:

Addressing the issue of whether and how the parties to the entity document select one or more methods of alternative dispute resolution is of course only one aspect of the types of steering, restricting and/or prioritizing of remedies that are available to a party. Parties can, and routinely do, provide in their governing documents that any litigation must be brought in selected jurisdictions, courts, or venues, and that selected state laws shall apply to the determination of issues arising under or relating to the entity and the applicable document, to the extent permitted by law. Such provisions all can and should be included in bylaws or shareholder agreements, operating agreements and partnership agreements, as applicable.

Beyond such routine matters, however, the opportunity also exists, when crafting your entity documents, to provide for waivers of numerous remedies that clients who anticipate having control of the entity may want to eliminate. The rights to seek punitive damages and court-ordered receivership or dissolution are among the types of shareholder/member/partner rights that the drafter of an entity's governing documents may consider waiving or limiting. Note, though, that not all potential remedies necessarily are waivable.

In the context of corporations, the "operating" provisions normally appear in the bylaws, although shareholder agreements also can be used in this regard. Va. Code Section 13.1-624 permits the inclusion in corporate bylaws, generally, of "any provision for managing the business and regulating the affairs of the corporation that is not inconsistent with law or the articles of incorporation." Va. Code Section 13.1-671.1 allows the then-existing shareholders to vary the provisions of the Stock Corporation Act even beyond what the bylaws can do, presumably because the acceptance and any subsequent amendment will need to be approved by all the shareholders who then exist, or, under certain circumstances, if so stated in the original agreement, by all the shareholders who would be affected. Certain corporate waivers are required to appear in the articles of incorporation themselves, however, such as the waiver of pre-emptive rights of shareholders. Va. Code § 13.1-651. No express prohibition exists, however, on the inclusion in bylaws or a shareholder agreement of a waiver of the right to seek judicial dissolution, which right exists Va. Code § 13.1-747, or a waiver of the right to seek punitive damages. *See also Baylor v. Beverly Book*, 216 Va. 22, 216 S.E.2d 18 (1975).

With respect to limited liability companies, it seems to be only a slight exaggeration to state that the relationship among members can be customized in an operating agreement to the extent that virtually "anything goes." Va. Code Section 13.1-1023(A)(1) provides that an operating agreement may define

> the relations of [the] members…[and] contain any provisions regarding the affairs of a limited liability company and the conduct of its business to the extent that such provisions are not inconsistent with the laws of this Commonwealth or the articles of organization.

Thus the waivers of remedies discussed above in this section should be fully permissible with a limited liability company.

In the partnership context, Va. Code § 50-73.81 specifies that "relations among the partners and between the partners and the partnership are governed by the partnership agreement" except as limited in that section. The section then enumerates various restrictions on the right to modify or waive remedies, including, for example, prohibitions on the right to "unreasonably restrict the right of access to books and records;" on the right to "eliminate the obligation of good faith and fair dealing in subsection D of Section 50-73.102, but the partnership agreement may prescribe the standards by which the performance of the obligation is to be measured, if the standards are not manifestly

unreasonable;" and on the right to "vary the power [of a partner] to disassociate" as provided in Section 50-73.110(A). These limitations may also govern rules applicable to waivers or modifications of similar limited partnership issues, except to the extent that the Limited Partnership Act (Va. Code §§ 50-73.1 *et seq.*) contains specific provisions affecting such rights. *See, for example,* Va. Code §§ 50-73.37 and 50-73.38 for a discussion regarding the rights of partners in a limited partnership to withdraw. No prohibition exists, however, on the inclusion in a partnership agreement of a waiver of the right to seek judicial dissolution, which rights are addressed in Sections 50-73.117 and 73.50, or a waiver of the right to seek punitive damages.

D. Minority Owners as Third Party Beneficiaries:

What rights do or may minority owners in any business entity have to pursue litigation against co-owners or the entity itself, separate and apart from the rights provided by statute? A position may be conceived that minority owners have a right, under Va. Code § 55-22[2] or otherwise, to assert rights under corporate documents that do not expressly state therein that they are intended to benefit such owners and that exceed or supplement the rights that the owners have under the entity's governing documents or under applicable corporate, limited liability company or partnership statutes.

Such rights would seem to be very limited, at best, for the reasons set forth by the Virginia Supreme Court in analyzing the rights of persons to claim the status of third party beneficiaries in the leading case of *Copenhaver v. Rogers***,** 238 Va. 361, 367, 384 S.E.2d 593, 596 (1989):

> In order to proceed on the third-party beneficiary contract theory, the party claiming the benefit must show that the parties to a contract 'clearly and definitely intended' to confer a benefit upon him. *Allen v. Lindstrom,* 237 Va. 489, 500, 379 S.E.2d 450, 457 (1989); *Professional Realty Corp. v. Bender,* 216 Va. 737, 739, 222 S.E.2d 810, 812 (1976). Thus, Code § 55-22 has no application unless the party against whom liability is asserted has assumed an obligation for the benefit of a third party. *Valley [Landscape] Company v. Rolland,* 218 Va. 257, 259-60, 237 S.E.2d 120, 122 (1977); *Burton v. Chesapeake Box, Etc. Corp.,* 190 Va. 755, 763, 57 S.E.2d 904, 909 (1950). Put another way, a person who benefits only incidentally from a contract between others cannot sue thereon. *Valley Company,*

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[2] **§ 55-22. When person not a party, etc., may take or sue under instrument**

An immediate estate or interest in or the benefit of a condition respecting any estate may be taken by a person under an instrument, although he be not a party thereto; and if a covenant or promise be made for the benefit, in whole or in part, of a person with whom it is not made, or with whom it is made jointly with others, such person, whether named in the instrument or not, may maintain in his own name any action thereon which he might maintain in case it had been made with him only and the consideration had moved from him to the party making such covenant or promise. In such action the covenantor or promisor shall be permitted to make all defenses he may have, not only against the covenantee or promisee, but against such beneficiary as well.

> 218 Va. at 260, 237 S.E.2d at 122. The essence of a third-party beneficiary's claim is that others have agreed between themselves to bestow a benefit upon the third party but one of the parties to the agreement fails to uphold his portion of the bargain.

Third party rights of minority owners may exist, thus, but only if such owners are able to prove the existence of a clear and definite intent on the part of the parties to the documents. In the case of corporate governing documents, this would require proof of a specific intent, manifested in the document(s), to benefit such owners by name or by clear description of their status. A general duty to the entity is not the same as, and does not necessarily imply, a duty to its owners in their individual capacities.

Nonetheless, as difficult as it may be to establish such a claim, an attorney representing a controlling owner in preparing entity documents has the ability to include language in his or her documents that will protect the client from such claims, just as he or she can include language to clarify fiduciary obligations as discussed above. A sample provision, adapted from a contract, is provided in the Appendix to this Section, below, at page V-11.

II. DOCUMENTING THE DEAL

The pro-active and wise way to ensure that a client's business entity documents that you are asked to prepare do not become your litigation partners' next case – or, worse, the next claim to your malpractice carriers -- is to "trouble-shoot" the entity's documents as you prepare them. The concepts discussed above and below, both in this Section and in the presentations of my colleagues today, all bear consideration in an attorney's documenting of the deal that his or her client may bring in.

The requirements for formation and documentation of entities that appear in the Virginia Code also make a good starting point. *See, for example,* Va. Code §§ 13.1-619 and 624 (corporate articles of incorporation and bylaws); Va. Code §§ 13.1-1011 (limited liability company articles of organization); Va. Code §§ 50-73.11(certificate of limited partnership).

Over time you can, and probably will, develop your own lists of the issues that you believe are worth careful consideration in creating the appropriate deal documents for your clients' desired entities, which then will be supplemented by the development of your own "starter" documents. Your starter documents can and will include provisions that you prefer or suggest for both those issues that statutes mandate be addressed[3] and those issues that you prefer or recommend for your clients to address in a particularly manner.

[3] In the case of general partnerships and limited liability companies, of course, nothing is mandated by statute regarding the form of partnership or operating agreements.

Checklists of pertinent issues and considerations that you are welcome to adopt for your own use, or to incorporate into your existing lists, if you deem them worthwhile, appear in the Appendix to this Section, as listed:

1. Shareholder Agreements – see page V-12.
2. LLC Operating Agreements– see page V-15.
3. Limited Partnership Agreements– see page V-16.

Anyone preparing deal documents for other business entities, such as professional corporations, professional limited liability companies, nonstock corporations, general partnerships or registered limited liability partnerships, can apply the checklist herein that most closely approximates what you are working to document.

APPENDIX TO PART V

Fiduciary Provisions for Operating Agreements

3.5 Fiduciary Relationship. The Manager shall at all times act in a fiduciary capacity for the Company. The Members shall have no right to take actions, at any time, that are contrary to the best interests of the Company. The Manager shall not be liable, responsible or accountable to the Company or to the Members for damages or otherwise for any acts performed, or for any failure to act, taken in good faith; provided, however, that the Manager shall not be relieved of its respective fiduciary obligations to the Company for fraud, bad faith or gross negligence. [ENSURE that Manager does NOT have power to compete against Company, or if intended expressly .that Manager should have that right to compete, so state.]

OR

5.11 Liability of Managers. So long as the Managers act in good faith with respect to the conduct of the business and affairs of the Company, no Manager shall be liable or accountable to the Company or to any of the Members, in damages or otherwise, for any error of judgment, for any mistake of fact or of law, or for any other act or thing that he may do or refrain from doing in connection with the business and affairs of the Company, except for willful misconduct or gross negligence or breach of contractual obligations or agreements between the Managers and the Company. [ENSURE that Manager does NOT have power to compete against Company, or if intended expressly that Manager should have that right to compete, so state.]

AND

7.2 Conclusion of Affairs. In the event of the dissolution of the Company for any reason, the Manager shall proceed promptly to wind up the affairs of and liquidate the Company. Except as otherwise provided in this Agreement, the Members shall continue to share distributions and tax allocations during the period of liquidation in the same manner as before the dissolution. The Manager shall have reasonable discretion to determine the time, manner and terms of any sale or sales of Company property pursuant to such liquidation having due regard to the activity and the condition and relevant market and general financial and economic conditions and consistent with its fiduciary obligations to the Members.

Provision for Mediation, then Arbitration

The parties agree that any and all disputes, claims or controversies arising out of or relating to this agreement shall be submitted to [ADR COMPANY OF YOUR CHOICE], or other mutually acceptable ADR provider, for mediation, and if the matter is not resolved through mediation, then it shall be submitted to [ADR COMPANY OF YOUR CHOICE], or other mutually acceptable ADR provider, for final and binding arbitration. Either party may commence mediation by providing to [ADR COMPANY OF YOUR CHOICE] and the other party a written demand for mediation, setting forth the subject of the dispute and the relief requested. The parties will cooperate with [ADR COMPANY OF YOUR CHOICE] and with one another in selecting a mediator from [ADR COMPANY OF YOUR CHOICE]'s panel of neutrals, and in scheduling the mediation proceedings. The parties covenant that they will participate in the mediation in good faith, and that they will share equally in its costs. All offers, promises, conduct and statements, whether oral or written, made in the course of the mediation by any of the parties, their agents, employees, experts and attorneys, and by the mediator or any [ADR COMPANY OF YOUR CHOICE] employees, are confidential, privileged and inadmissible for any purpose, including impeachment, in any arbitration or other proceeding involving the parties, provided that evidence that is otherwise admissible or discoverable shall not be rendered inadmissible or non-discoverable as a result of its use in the mediation.

Either party may initiate arbitration with respect to the matters submitted to mediation by filing a written demand for arbitration at any time following the initial mediation session or 60 days after the date of filing the written request for mediation, whichever occurs first. The mediation may continue after the commencement of arbitration if the parties so desire. Unless otherwise agreed by the parties, the mediator shall be disqualified from serving as arbitrator in the case. The parties agree that all proceedings pursuant to this Section shall occur in _____, or other mutually acceptable location. The provisions of this Section may be enforced by any Court of competent jurisdiction, and the party seeking enforcement shall be entitled to an award of all costs, fees and expenses, including attorneys fees, to be paid by the party against whom enforcement is ordered.

The parties agree that any and all disputes, claims or controversies arising out of or relating to this agreement that are not resolved by their mutual agreement shall be submitted to final and binding arbitration before [ADR COMPANY OF YOUR CHOICE], or its successor entity. Either party may commence the arbitration process called for in this agreement by filing a written demand for arbitration with [ADR COMPANY OF YOUR CHOICE], with a copy to the other party. The arbitration will be conducted in accordance with the provisions of [ADR COMPANY OF YOUR CHOICE]'s _____ rules and procedures in effect at the time of filing of the demand for arbitration. The parties will cooperate with [ADR COMPANY OF YOUR CHOICE] and with one another in selecting an arbitrator from [ADR COMPANY OF YOUR CHOICE]'s panel of neutrals, and in scheduling the arbitration proceedings. The parties covenant that they will participate in the arbitration in good faith, and that they

will share equally in its costs. The provisions of this Paragraph may be enforced by any court of competent jurisdiction, and the party seeking enforcement shall be entitled to an award of all costs, fees and expenses, including attorneys fees, to be paid by the party against whom enforcement is ordered.

No Third Party Beneficiary

Except as expressly required by any applicable statute, this Agreement is intended solely for the benefit of the parties to it, and their respective successors and assigns, and no third party shall have any right or interest in this Agreement. No provision of this Agreement shall be deemed or construed to create any obligation on the part of any party hereto to any such third party, nor shall any third party have a right to enforce against any party hereto any right that a party may have under this Agreement.

Checklist for Corporate Shareholder Agreements

1. Number of shares the corporation is to be authorized to issue, how many are or will be issued, to whom and for what consideration/price? When is consideration to be paid? Want preferred shares? If so, what rights will their holders have?

2. How will purchase price be paid? Deferred in whole or part? Form of note and any security/pledge/escrow? (See Va. Code §8.9-304 regarding need for securities being held by secured party to perfect security interest.) If an escrow agent is to be used, designate, or state how (or who) to select?

3. Do clients want any confidentiality provisions (covering, for example, contact/customer lists, business processes, research processes and data, software, etc.)? Specify rights of access to information, if desired beyond Code minimums.

4. Stock rights for employees: When vested? Vest upon defined conditions to occur? Risk of forfeiture if other defined conditions occur (for example, if employment terminates at any time prior to a stated date or "for cause")? Does any such risk of forfeiture lapse?

5. Specify restrictions on transfer, such as outright prohibition or prohibition without consent of all other owners (e.g., in professional corporations or entities), or simpler right of first refusal, or combination? Permit certain gifts to family members or trusts?

6. Include required legend on stock certificates, and ensure that provisions of Agreement will bind any transferee.

7. Threshold management issues affecting control of corporation:

    a. Identify persons to be officers and/or directors, or who will choose, or for how long identified individuals (or their designees) must be selected?

    b. State any management issues that the client wants to lock in, if any (noting the difficulty of changing them later), such as: specific duties and responsibilities of officers and/or directors; limitations and/or authorizations regarding handling of specific management issues (such as leases, loans); and any salaries or other benefits for officers, directors and/or employees.

8. Issues of protecting minority or non-controlling owners:

    a. Require periodic financial statements or reports? Require CPA involvement (compiled, reviewed or audited)?
    b. Any affirmative covenants (such as maintenance of certain types or amounts of insurance)?

c. Notice of specified events of which notice is not otherwise required by statute (such as defaults under major contracts, or major litigation)?
d. Right to attend directors' meetings?
e. Any negative covenants (such as restrictions on compensation, dividends, issuance of additional stock (dilution/pre-emptive rights), debt, merger or sale of substantial portion of corporate assets, contractual commitments above X dollars, prohibition of self-dealing)?
f. Piggyback rights?
g. Avoid phantom income problem for minority shareholders? Mandate distribution of all earnings above certain minimum salaries?

9. Provisions for resolving deadlocks or disputes (and specify either or both): consider mandatory mediation and/or arbitration; possible buy-sell as remedy (Russian roulette); waiver or subordination of right to dissolution as a remedy.

10. Put (by non-managing members) or call (by managing members or company) options?

11. Does the client desire any covenant(s) not to compete? Or any employment provisions as part of the shareholder agreement?

12. Investment representations?

13. Securities provisions/disclaimers?

14. Specify triggers for redemption of shares, which are mandatory, and which are optional:

a. Death of shareholder;
b. Incapacity (set definition of incapacity);
c. Bankruptcy;
d. Termination of employment (for cause, not for cause, resignation);
e. Withdrawal.

15. Additional circumstances for, and terms of, stock redemption or cross-purchase upon disagreement or death/disability (define) of shareholder (cf. stock restrictions on transfer, above): Will purchase be required or optional? Does shareholder or estate have right to require repurchase, or does corporation or other shareholders have right of first refusal? How set price, other than upon a third party sale? Specify if any formula or periodic price setting are to be implemented.

16. If periodic or episodic valuation is to occur: how is appraiser to be selected? Three-appraiser method? "Baseball-style" method? Will/may minority discount be considered/used?

17. If insurance will or may be used to fund redemption, who will pay for or be charged for payment for policies? Will corporation be required to purchase? For how long? Proof of payment (especially if cross-purchase provision is used). If any insurance results in excess proceeds, what happens to them?

18. What will be the Option Period? If right of first refusal, written notice to corporation to be required, with copy of bona fide offer, setting forth all material terms and conditions of offer. Different option periods for termination, death, disability?

19. Attorneys' fees to party substantially prevailing.

Checklist for LLC Operating Agreements

1. Right and/or authority to file bankruptcy - who does/doesn't have?

2. Permit dissociation of a member (not a manager?) without dissolution?

3. Right of a manager to resign and impact thereof (analogy to general partner in a limited partnership)?

4. Attempt to counteract §365 of Bankruptcy Code regarding bankruptcy being a default and person no longer being a member? Make this a "buyout event?" Any personal services involved?

5. Any special allocations?

6. Special distribution or voting formulas or preferences?

7. Consider an overall bar on transfers that would constitute a deemed termination under the Internal Revenue Code, depending on tax intentions/protections.

8. Define/limit or deny fiduciary duties?

9. Alternative dispute resolution?

10. Consider key man insurance, especially if it is to be operating entity.

11. Consider class by class vesting of interests (as for employee compensation).

12. Want to specify corporate or partnership model for purpose of creating default rule for determining internal governance?

13. Consider provisions listed in Shareholder Agreement list, above, directly or by analogy to LLCs.

Checklist for Limited Partnership Agreements

1. Principal office and resident agent of limited partnership

2. Term and purpose(s)

3. Capital contributions and capital account calculations

4. Allocations of profits and losses and of cash flow (define)

5. Grants and limitations on rights, powers and of the general partner

6. Any limitations/restrictions on admission or on dissociation of additional partners

7. Grant/limitations/definitions on rights and obligations of limited partners (esp. management rights, if any, and expressly reserved approval powers, e.g., for a sale of major asset, merger or dissolution)

8. Provisions regarding transfer/assignment of partnership interests and any rights of first refusal

9. Put (by limited partner) or call (by general partner or partnership) options?

10. General partner compensation/fees and reimbursements

11. Dissolution events (see §50-73.117 for general partners and §50-73.49 for limited partners): specify, modify, and describe winding up and distribution processes

12. Accounting and reporting obligations of general partner, and audit right of limited partner?

13. Rights/restrictions regarding independent activities; transactions with affiliates

14. Indemnification/liability of general partner

15. General partner as power of attorney?

16. Securities laws restrictions

17. Disclaimer of securities registration

18. Alternative dispute resolution?

19. Consider provisions listed in Shareholder Agreement list, above, directly or by analogy to LLCs