Planning for a Business Divorce

Starting a new business, with a new partner can be exiting for both the clients and the lawyer. An operating agreement, however, has to plan for both success and failure. New ventures and new relationships can be particularly risky. You need to take particular care in drafting the operating agreement to protect minority interests, to provide a mechanism for resolving disputes and to provide an escape hatch that will allow the business to continue in the event the business or the relationship sours.

Drafting to Avoid Deadlock

Deadlock is an instance where members share equal voting or management rights and cannot agree. It can freeze the business in place and can even lead to a court ordered dissolution. If you can't structure the agreement to provide that one member or group of members will have majority control, the operating agreement should include some sort of tie-breaker. This can include a provision that the members agree to negotiate in good faith but if the issue cannot be resolved the parties will mediate the matter or refer the matter to a trusted third party for resolution.

Protecting the Minority Member

Annual meetings for LLCs are not required. However, when there is a minority member or the relationship is newly minted it is a good idea to include many of the formalities found in the corporate structure. Meeting times, places and notice; quorum requirements, etc. should all be set out with specificity.

There may also be certain decisions that should require unanimous consent. Dissolution, capital withdrawal, additional capital, and withdrawal of a member are all potential actions that might require unanimous consent.

Requiring the minimum distribution necessary to cover any tax liability for income allocations can also protect a minority member. These should be tailored to the appropriate tax bracket of each member.

Clearly delineating a member's rights to view all books and records of the Company is another important provision to protect a minority member's rights.

Member Withdrawal

Most buy-sell agreements identify death or disability as triggering events for the buy sell. Deadlock can be another potential triggering event under the operating agreement. If deadlock is the triggering event, it is less likely that the members will be able to agree upon a value for the departing member's interest and an appraisal method of valuation is an important addition in the event of deadlock. The continuing operation of any covenants not to compete entered into by the withdrawing members post break up must also be considered. What is and is not competitive with the Company will be a function of the scope of the purposes for which the LLC was formed.

See Also: *Anticipating the Business Breakup at the Outset of the Business Startup*. Eric A. Vendt, Whiteford, Taylor and Preston, LLP. ABA Annual Meeting 2013. ABA Business Law Section.