

## Case Study: New England Farms LLC

**Purpose:** In this case study, we hope to accomplish 3 things: 1) Examine how an LLC can be utilized to help facilitate the transfer of a farm with a specific background and set of goals; 2) Look specifically at some of the key clauses in an example LLC agreement and how they were used in implementing the goals of the case study farmers as well as to protect the interests of all the parties; 3) Discuss other approaches and clauses and other legal tools which could be useful to helping facilitate the transfer and protect the interests of the parties.

**Workshop Preparation:** Before the in-person session: Read the Narrative Description of Farm Scenario below. At the end of the narrative, there is a list of questions to consider as you next review the attached LLC Operating Agreement for New England Farms, LLC. **Specific clauses are highlighted in the LLC Agreement to make it easier to find the important sections, that were customized to address this particular case.**

**Case Study Session Instructions:** During the in-person discussion of the case study, we will use these questions as a basis for interactive discussion in both small breakout groups and the large group. The questions are arranged in two groups: one group of questions will be discussed in small breakout groups during the session, and the second group will be discussed by everyone joining us in the case study. If the breakout groups complete the first set of questions, they are welcome to address the second group of questions

### Narrative Description of Farm Scenario

**NOTE:** New England Farms is fictional farm created for educational purposes. The name was chosen to be generic and is not based on any actual farm or business which may share the name of New England Farms or any variation of such name.

New England Farms is a family farm which has been in the same family in the “State of New England” for well over 100 years. Until 2021, the farm was a sole proprietorship owned completely by “Owner One”. The family has changed what the farm produces more than once over the last 100 years. It has become highly diversified and generally been very successful. Over the last 20 years, the farm has grown significantly. In addition to the home farm, “Owner One”, has acquired a number of other farm real estate parcels, and taken on additional rental land to facilitate the growth. The farm has also grown in employee numbers, and Owner One has developed a management team of employees to help him run the business.

As Owner One has gotten older, currently over 70, he has come to realize that he needs to plan for the transfer of the farm to the next generation. Owner One has 4 children, but only one has stayed with the farm as an employee with no ownership stake. That child, “Successor One”, expressed that they would not want the burden of taking over the farm as sole owner. The farm has become too big and

complex. Successor One has young children and realizes that the demand on a single owner would mean insufficient time for family. The divorce of Successor One's parents had been caused in part by the demands of the farm decades ago.

Five years ago, Owner One started to look to some of his management team as potential successors and partners. Owner One began exploring with three other members of the management team the prospect becoming legal partners. However, it became clear that two of the employees were not a good fit to step up and become owners and function as part of a team of owners. Fortunately, one of the employees, "Successor Two" has proven capable to take on the responsibilities of an owner and a long-term commitment to the farm.

Like with many farms, Owner One put almost all of his finances into the farm, and little into other investments or saving towards retirement. This means that Owner One will need to cash out of farm assets in order to be able to afford to retire. Owner One also wants to leave something to each of his other 3 children. The development rights were sold on all of the farm real estate parcels to a local land trust years ago. That money was used entirely to fund expansion so there will be no opportunity to use development rights proceeds to fund retirement or provide for an inheritance to the non-farming children.

In the meanwhile, neither Successor One nor Successor Two have any equity or liquid assets that could be used to leverage buying out Owner One in one step. Additionally, Owner One continues to have fair amount of debt, mostly long-term debt on the more recently acquired real estate which still needs to be addressed.

After exploring their options with the help of Farm Business and Succession Advisors and their attorneys over the last 5 years, the following plan was developed: A new manager managed LLC, New England Farms LLC, would be formed at the beginning of 2021 to hold the production (intermediate and current) assets: equipment, supplies, inventory, and cash on hand. The LLC would also take over the debt on intermediate assets and annual operating loan the farm uses every year. Successor One and Successor Two would become members and managers of the new LLC. Owner One would gift, as "sweat equity" to each Successor a 14.4% ownership stake in the business for a total of 28.8% interest in the business. Further, Owner One plans to gift each member 4.8% of the LLC shares each year for the next two years. This will bring Successor One and Successor Two up to 24% of ownership share each, or 48% total. At that point, the expectation is that, when Owner One is ready to retire, the Successors will be in a position to finance the buyout of the Owner One either through outside financing or seller financing or a combination of both. This will help finance the Owner One's retirement. The plan was put into place at the beginning of 2021 through the new LLC Operating Agreement which we will be looking at today.

In the meanwhile, New England Farm LLC is leasing the real estate from Owner One. The home farm parcel will be kept in the family and passed along through Owner One's estate plan. If the initial succession phase is successful, the plan is for the Successors to buy the other farm parcels, either through New England Farms, LLC or perhaps another LLC set up specifically to hold the real estate. In the meanwhile, the lease is "bearing on heirs, successors, and assigns" and has a 7-year rolling lease term to protect the interests of the Successors as best as possible until they can secure the real estate through a purchase. Also, Owner One also has a life insurance policy, required by the lenders, which will cover most all of the remaining debt on the real estate.

**Questions for Small Group Discussion:** (Feel free to jump around, and it's not important to answer every question).

- 1) In general, does the operating agreement seem to reflect the needs and desires for the farm transfer as described in the narrative. If not, where are there gaps or contradictions or problem areas?
- 2) How does the agreement address Death, Divorce, Disaster, Disability and Disagreement? In which clauses did you find the answers? Is the death of each member treated the same way?
- 3) If a member wants to leave the business, how is the amount of the buyout determined? What is the process and timeframe for the buyout? How is "vesting" set up in this agreement? Why would they want a vesting period? What are the implications of the vesting period?
- 4) How many shares will each member initially have at the beginning of the LLC? How was the amount of each member shares determined? What is the value of those shares? How was the value of the shares determined? Where did you find that information? As the value the business changes, and the amount and values of each members shares change over time, where is that information recorded and tracked? Why is this particularly important?
- 5) How are the distributions of profit determined? Where do you find that information? How does it relate to the amount of shares that each members hold?
- 6) How are major decisions made? How much of the business' money can an individual member spend without approval from the other members? Where did you find that information?
- 7) Can new members join? If so, how? Can a member transfer their interest to anyone else like their children? Where is this described?
- 8) How are disputes settled?

**Large Group Questions:**

- 1) Are there things that you see that could have been set up differently, or different approaches that you believe could or should have been taken for better clarity or otherwise to better protect the interests of the business or the individual members?
- 2) Are there other legal tools besides the LLC Operating Agreement that will be useful and important in this situation to address any additional concerns? Which are already being implemented and which should they consider adding?
- 3) Once the Successors start buying the farm real estate parcels should those parcels be included in the New England Farms, LLC, or should they be place in a new LLC created specifically to hold the real estate?