ABA ANNUAL MEETING
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Drafting an LLC Agreement
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I. Introduction

1. Your panel includes speakers from three disciplines. **Jean Batman** of Legal Ventures Counsel Inc. specializes in corporate law and has chaired the ABA Business Law Section Small Business Committee and wrote the ABA Publishing Best Seller: Advising Small Businesses . **Terry Cuff** of **Loeb & Loeb** specializes in **tax law**. He is a nationally known expert in partnership and real estate taxation. I am with Holland & Knight and specialize in real estate law.

2. CV's for each of us are included in the printed material.

3. Our talk will be in **three parts**. **Jean** will sketch the framework of an LLC Operating Agreement. **Terry** will focus on the distribution waterfall and related tax issues. **I** will discuss the **relationship** between the developer and the investor with particular focus on the **levers of control** within the LLC Operating Agreement. You are welcome to **ask questions** as we proceed and we will leave time at the end for additional questions.

II. Roles of Equity Investor and Developer

1. **Slide: Knights and Dragons**

   a. Imagine that the Knights want to build a residential condo project.

   b. The Investor agreed to contribute **90%** of the equity. The Developer will contribute the balance and will build the Project.

   c. If they succeed, they share the profit.

   d. However, the dragons along the path can stop the project. The dragons are the **risks**, including for example **cost over runs**, **natural disasters**, like fire or flood, **soaring interest rates** or a **bad market**.

   e. Here is our **challenge:** How do the developer and the investor create a relationship with enough **flexibility** to allow the project to be completed but with enough **controls** to protect each player from **unanticipated risks**.

2. Equity Investor is **passive**. He wants to invest a **predicable amount of money** in a project and get a **predictable return**. As Terry said, he gets his return out first before the developer promote.
3. The Developer **controls** the project, subject to any **limitations** placed on him by the Investor. He wants to be paid a development fee along the way and a **big profit** if the project is successful.
4. If the project is **successful**, both the Developer and the Investor **make money**. If the project **fails**, one or both **takes a hit**.

III. The LLC Operating Agreement

1. The LLC Operating Agreement **establishes the rules**.
2. As the Manager of the LLC, the **Developer** makes all of the **decisions** unless he or she is limited by the Operating Agreement.
3. **How does the Investor protect himself?**

IV. 3 Levers of Control (SLIDE 2)

1. **Money**-how much is invested and who controls the checkbook?
2. **Operational Decisions**- when is Investor consent required?
3. **Dispute Resolution Mechanisms**-when the parties **disagree** or an **unanticipated problem** comes up, how is the problem resolved
4. Lets look at how **risk** is allocated using the **3 levers of control**

V. Money (SLIDE 3)

1. Money is reflected in the **Capital Call** and **Major Decisions** provisions of the Operating Agreement
2. **Budgets**
   a. Developer **creates** the budget and the Investor **approves** it.
   b. The **budget** will establish how much **money is required** and **when** it must be contributed.
   c. The Agreement will provide that the Developer must **live within the budget** unless the Investor agrees to a change.
   d. In the **real world**, things often cost more than predicted. What happens when there is a **cost overrun**?
3. **Cost Overruns**
   a. The **risk of cost overruns** is often allocated to the **party** who is in the best position **to avoid** the problem.
   b. **Construction** is within **Developer's control**. Usually, the Developer **guarantees project completion** within the budget and pays for construction cost overruns
   c. **Budget Flexibility** (Developer has a contingency in the budget for cost overruns or emergencies)
   d. What if the **cost overrun** occurs because of **a fire or a strike** or something else that the **Developer does not control**?

e. That is handled in several different ways. It is all a matter of risk allocation. More money can require **mutual consent** or the developer could have the power to issue **a capital call**.

f. What if there is a **legitimate capital call** and the Investor or Developer **does not pay**? - Either member can make a member loan with **high interest** or contribute capital and **dilute** the other Member.

VI. Operational Decisions Requiring Mutual consent (SLIDE 4)

1. ***Major Decisions***
2. **Fees** to Developer or affiliates (Developer want to hire his brother in law)
3. ***Sale*** *of Property*
4. **Construction or permanent loan**
5. ***Change in Budget*** *or* ***Development Plan*** (The Developer wants to build a hotel instead of a residential condo.)
6. **Major contracts**, like the general contract for construction
7. ***Housekeepin****g*- (Lots of ways a developer could change the economics of the deal by taking unanticipated actions under the LLC Agreement. For example:)
   a. Distributions except as set forth in LLC Agreement;
   b. amend LLC agreement; admit new members,
   c. commence litigation,
   d. consent to an LLC guaranty,
   e. consent to withdrawal of Manger or a Member,
   f. transfer membership interest,
   g. file bankruptcy

VII. Dispute Resolution (5th SLIDE)

(What happens if the **developer defaults** under the LLC Agreement? Remember, the Developer is typically the manager. Or what if the parties cannot agree?)

1. Buy Sell (Jean)
2. Removal of Developer (Terry)

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