

Anatomy of an operating agreement

ESTATE STEWARDSHIP

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“Exactly what He wrote is exactly what He meant to be true for your life.” That truth shared by Priscilla Shirer made me stop in my tracks, followed by a deep desire to proclaim to all, “The

playbook is already written, and the author is the One you can trust.”

If you have a tendency towards being analytical, then you may analyze every spoken word, each written word, and all actions. The analyst may assign varied levels of credence depending on the origination – the knowledge and experience of the author, or the trustworthiness of the person or entity.

The same is true when considering actions taken in estate planning. When one may be in the throes of establishing a business, far from that person’s mind may be the consideration that if the foundation of that business is comprehensive, then estate planning is being affected.

The focus may mainly be on what many consider the “fun action items” related to a new business: refining the product or service, deciding whether there is a need for a bricks and mortar front or if a virtual office is sufficient, selecting the perfect business name, creating the logo, choosing a tag-line, developing the website, creating marketing pieces, identifying the team of professionals who will provide continuous support and counsel, applying for an EIN, opening a business bank account, and having protective contracts drafted that are applicable to the products or services the business will be offering to the public.

Embedded in the excitement of starting a new business is, or should be part of the process, creating the foundational document that sets forth, delineates, and controls the terms by which the business operates. If one is now in her fifties or older, she grew up hearing about corporations and partnerships and their respective by-laws and partnership agreements. The hybrid of the two entities are called Limited Liability Companies (LLCs).

The terms that guide the running of an LLC are memorialized in an operating agreement, which is a document that contains the governing rules related to the entity’s financial and operational decisions. In § 13.1-1023 of the Code of Virginia 13.1-1023 the parameters and use of an operating agreement are set forth. “The members of a limited liability company may enter into any operating agreement to regulate or establish

the affairs of the limited liability company, the conduct of its business and the relations of its members . . . An operating agreement may 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 the Commonwealth or the articles of organization.”

In addition to including what may be called traditional terms found in an operating agreement, such as: memorialization of formation, powers and duties of members, powers and duties of the manager, indemnification, insurance, capital accounts, allocations of profits and losses, distributions, and accounting and bank accounts, a person forming an LLC may want to consider addressing retaining control of one’s entity.

Articles addressing maintaining control of an entity that are part of comprehensive estate planning include: who may be the manager and successor managers if you - the founder of the entity become incapacitated, succession – transfer of financial/economic interests and/or voting rights, control of voting rights (a control interest), and the dissolution and winding up of your entity.

“Start a business. It will be fun, they said.” Yes, it is enjoyable; it is also a lot of hard work and requires a significant amount of foresight. Picture having dreamed about running your own business, and day one arrives – ribbon cutting included. The fruits of your sacrifice and labor are paying off, and there is a high demand for your products and/or services. You are able to help many and are making a difference in your community. Time passes, and the unexpected occurs. You are in an accident and become mentally incapacitated. Now what? Your family was dependent on the revenue stream provided by your entity, and you failed to address such an occurrence in any documentation.

What about the possibility that when you pass, you would like your beneficiaries or heirs to inherit your entity, yet you have not made any provisions in a controlling document, so your beneficiaries or heirs receive only financial interests and not controlling interests. In fact, you made no preparations for your entity to continue following your death.

In addition, picture your company doing so well, that not only has it grown so rapidly that the physical location that you once thought was expansive is failing any projected accommodations. In fact, you have been asked to offer your products/services in two locations with higher

density than your present location, causing you to consider the logistics and provisional means of attaining the ability to service such an economy of scale. You develop a roadmap and business plan for such an expansion.

You decide such growth will require a capital investment, and you are willing to exchange a percentage (or units) for the needed capital investment. The exchange occurs. Though the capital investment enables your entity to continue to grow, you got caught up in the excitement and daily “to-do list,” and failed to plan for the “what ifs.” That money, the capital infusion that was “all so important,” just acquired a different look, with possibly a lot of authority.

The “grantor” of the money has become mentally incapacitated, and his agent under his power of attorney is now in a position to vote his interests because you made him a member with both financial and voting interests, and did not preclude agency authority in a controlling document.

A scenario that may present an even more precarious picture is the death of the “grantor” of the capital contribution. In your controlling document you may have set forth terms that permitted a beneficiary or heir to inherit both financial and voting rights from an interest holder. Such planning that is not comprehensive could mean that a complete stranger now holds an interest in your entity – yes, this company that you built from a dream with your own talents, sacrifices, and investments. Perhaps, including a right of first refusal, giving you the right to purchase any and all interests upon the death of the “grantor” of the capital contribution, may have been a wise consideration.

The Code of Virginia establishes the authority for an operating agreement to be the governing document of an LLC. The Code of Virginia also has default language in the event there is no operating agreement in place.

TD Jakes stated, “There is entrepreneurship in your house. There are companies in your house. There are ministries in your house.” If you have been given a dream – pray about it, pursue it. Use your talents to help people, to enrich others, and to make our community a better place.

While building that entity, give due respect to protecting your efforts. Draft a comprehensive operating agreement that anticipates the “what if” scenarios, making it a playbook that you can trust.

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