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LEGAL QUESTIONS TO CONSIDER WHEN FORMING A NEW BUSINESS ORGANIZED AS A GEORGIA LIMITED LIABILITY COMPANY

Once you have decided to start a new business and organize it as a Georgia limited liability company, there are a number of legal and organizational issues that should be considered. While legal issues are only a small part of the decision to form a new business or joint venture, they are nevertheless important. Careful planning can avoid misunderstanding, disappointment and tension with your fellow equity owners.

This memorandum sets out general topics to be considered. I have used a “bullet point” format to highlight issues and to minimize the discussion of technical legal points. Some of the issues identified may not be of great significance to you or you may not be sure how an issue is best addressed. Some issues are likely to be important and you may be very sure how you expect them to be addressed. In any case, the questions can assist the organizers of the LLC and their counsel to draft an operating agreement that reflects the parties’ understanding. This memorandum is best used as a client’s guide to issues.

1. Capital structure/economic rights
 - What percent of voting power will each member control?
 - How will profits and losses be shared?
 - How will the assets be distributed upon liquidation?
 - Does voting power correspond to economic rights?
 - When is cash and/or other property to be distributed?
 - Will members also receive a salary or other compensation?
 - Will a member increase his or her membership interest upon the satisfaction of certain performance-related goals?
 - Will an employee become a member if certain goals are met?
 - What are ownership rights to be called (shares, interests, membership interests, ownership interests)?

- Will you need additional capital and if so, when and from whom?
- Under what terms can the LLC issue equity or debt to members or third parties?
- Will members have a right to participate in future offerings?
- If a member is entitled to a preferred return, how is that to be calculated?
- How much of the LLC's capital is to be debt?
- May the LLC issue secured debt to a member?

2. Governance

- Will the LLC be “member managed” or “manager managed”? Members are owners of the LLC who have voting rights. Members of a member managed LLC have the power to manage the business and affairs of the LLC similar to general partners of a partnership. Managers of a manager managed LLC have the statutory power to manage the business and affairs of the LLC; managers are like directors of a corporation.
- If the LLC is member managed, how do the members act?
- If the LLC is manager managed, how are managers selected and how do they act?
- What types of fiduciary duties should members or managers be subject to?
- Is the LLC to have officers, and if so, what are their responsibilities and titles?
- If the LLC is manager managed, do the managers act by majority vote or on some other basis?
- If the vote of a majority of the managers is to be the act of the managers, are there special circumstances where more than a majority is necessary or where approval of the members is required? For example, who must approve a merger or the sale of all or substantially all of the assets of the LLC? Who must approve an amendment to the LLC operating agreement?
- What type of duties are the members of a member managed LLC and the managers of a manager managed LLC subject to? For example, are the members to be treated like partners, with fiduciary duties to each other, or like shareholders of a corporation, with no fiduciary duties to each other except in very limited circumstances?
- What happens when a member or manager undertakes an unauthorized act?
- Should the LLC be obligated to indemnify members and managers and if so, under what circumstances?
- Under what circumstances would a manager or member be liable to the members for monetary damages for breach of fiduciary duty?
- How are conflicts of interest to be handled?
- Will there be officers in addition to managers? If so, how are the officers to be selected?

3. Under what circumstances may a member sell or transfer an interest in the LLC?

- If the member receives from a non-member an offer to purchase some or all of the member's interest, must that member first offer the other members the right to acquire his or her interest on the same terms? (commonly called a right of first refusal)
- If a member is permitted to transfer an interest in the LLC, does the transferee have voting rights?

- Can a member give some or all of his or her interest in the LLC to another person? If so, under what conditions? For example, are gifts limited to family members or can anyone be the recipient of a gift?
 - Can the recipient of a gift vote?
 - May a member transfer his or her interest to an “affiliate” of the member? If so, what or who is an “affiliate” for this purpose?
 - What happens if a member becomes divorced?
4. When can the members or managers force the sale of the entire business?
- If a member receives an offer from a third party to buy the entire business, can that member force the other members to sell to the third party?
 - If a member ceases to be a member, can he or she force the unwinding or sale of the business?
5. What happens if the members and/or managers can’t get along?
- Does this trigger a buy-sell right?
 - Should the business be liquidated?
6. Buyout rights
- When, if ever, does a member have the right to force another member to sell his or her interest?
 - For example, after a period of time (2 to 5 years), does a member have the right to purchase another member’s interest at a price determined by (i) a formula set out in the operating agreement, (ii) an independent appraiser selected by the members or managers, (iii) some other method (book value)?
 - Consider whether it is appropriate to permit a member to set a price at which that member must sell his LLC interests to the other member(s) or buy out the LLC interests of such other member(s), as determined by such other member(s) after receipt of written notice from the initiating member.
7. What happens upon the death of a member?
- Is the LLC obligated to purchase the decedent’s interests?
 - Are the remaining members or the LLC entitled to purchase the decedent’s interests?
 - How is the decedent’s stake in the LLC to be valued? By a formula, by agreement, by appraisal, by book value?
8. If a member or manager ceases to be a member or manager, may that person compete with the LLC? May that person solicit customers or employees of the LLC?
- If a non-compete is to be used, carefully consider the geographic area covered, the duration of the non-compete, and the types of activities that constitute competition
 - Consider industry practice
 - Generally, the tighter the restrictions, i.e., the more unreasonable they are, the less likely they are to be enforced
9. Special issues for joint ventures

- Organizers of joint ventures that are conducted through a LLC should also consider carefully:
 - How is management power to be shared?
 - How is the business to be valued?
 - How are intellectual property rights to be shared?
 - How likely is a “culture clash”?
 - How are conflict of interest transactions to be handled?
 - Whether the benefits outweigh the costs in having at least two experienced managers who are independent of the members.
 - Who is responsible for the books and records and on what accounting basis are the financial statements to be prepared? When generally accepted accounting principles permit different methods of accounting for a transaction, are the parties in agreement as to which method is to be adopted?
 - What types of equity are appropriate? For example, is one class sufficient, or should there be multiple classes with varying levels of risk and voting control.
 - How are the business’s capital requirements to be met? How much equity, how much debt and from whom? Is the debt to be secured by specific assets of the LLC?
 - Will the LLC have the right to demand or draw down additional capital contributions of the members?
10. How will the LLC be taxed for Federal income tax purposes?
- The IRS generally permits multi-member LLCs to choose how they will be classified for Federal income tax purposes.
 - If you are forming a multi-member LLC, consider whether it is more advantageous for the LLC to be taxed as a partnership (pass through taxation) or as an association (entity level tax, like “C corporations”) or, in some cases, as an S corporation (also pass through taxation, but under a different set of rules generally not as flexible as those available for partnerships).
 - If you are organizing a single member LLC, you will be taxed as a sole proprietorship unless you make a special election to be taxed as an association (with entity level tax) or, with an additional election, as an S corporation (pass through taxation). Consider which tax method best benefits you.
11. Securities law issues
- If you are raising money from investors, the membership interests you are offering will be treated as securities. In order to raise the funds, the securities must be either registered or exempt from registration. There are many kinds of exemptions from registration. See, for example, “AN OVERVIEW OF REGULATION D SAFE HARBOR EXEMPTIONS” by Carl L. Sollee available in the “Publications” section of www.solleelaw.com. If you are raising funds from investors, you will need to identify an available federal and state exemption from registration.
 - Investors may expect registration rights. A registration right provides the investor with the right to require the company or its successor to register the shares with

- the SEC, usually not before the company's initial public offering of securities. If registration rights are to be granted, try to limit them to "piggy back registration rights," avoid multiple "demand registration rights," put all registration rights in the operating agreement so everyone has the same terms, and permit a super majority of the holders thereof to limit or abolish the registration rights.
- If you are forming a business with a few others, each of whom will work as a principal of the business, securities law issues probably will have little impact. They are, however, in the background. If you are raising capital from angel investors or venture capital firms, securities law issues will be a real but generally very manageable issue. If you are raising money from "non-accredited investors" (those without a good bit of money or income), securities law will impose many roadblocks and challenges.