

Illustrative Form of a Multi-Member Operating Agreement

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**OPERATING AGREEMENT
OF
NEWCO, LLC
A COLORADO LIMITED LIABILITY COMPANY**

_____, 2013

It should be noted that this Illustrative Form of a Multi-Member Operating Agreement contains potentially inconsistent and contradictory provisions that must be carefully considered before incorporating into a business transaction. These are included for demonstrative purposes, only.

OPERATING AGREEMENT¹

This Agreement is effective as of the ____ day of ____ 2013, by the Managers and the Members of NEWCO, LLC, a Colorado limited liability company whose signatures appear on the signature page hereto, and supercedes all other understandings with respect thereto.

ARTICLE 1)

DEFINITIONS

The following terms used in this Operating Agreement shall have the following meanings (unless otherwise expressly provided herein);

1.1 “Affiliate” shall mean any Person controlling, controlled by or under common control with a Person, including a Person controlled separately by a Member or collectively by the Members.

1.2 “Articles of Organization” shall mean the Articles of Organization of NEWCO, LLC as filed with the Secretary of State of Colorado as the same may be amended from time-to-time.

1.3 “Assignee” shall mean the owner of an Economic Interest who is not a Member.

1.4 “Bank” means a commercial bank or savings and loan association or other financial institution that is in the business of making loans to commercial enterprises that is not affiliated with a Member. When used in the preceding sentence, the term “not affiliated with” means that no Member or family member living in the home of such Member is an officer or director of the Bank, or (directly or indirectly) owns more than 1% of the outstanding equity interest in such Bank.

¹ It is important to note that, in drafting an operating agreement under the Colorado Limited Liability Company Act (C.R.S. § 7-80-101 *et seq.*), the Colorado legislators expressed their intention “to give the maximum effect to the principle of freedom of contract and to the enforceability of operating agreements.” C.R.S. § 7-80-108(4). Thus it is important for the draftsman to consider all relevant issues with the client, and then “scriven with precision.” See *Willie Gary LLC v. James & Jackson, LLC*, 2006 WL 75309, at *2 (Del.Ch.Ct. Jan. 10, 2006), affirmed *sub nom. James & Jackson, LLC v. Willie Gary LLC*, No. 59-2006 (Del. Sup. Ct. Mar. 21, 2006). There the issue was a dispute resolution clause which the court found was “unwieldy” but sufficiently clear to deny a motion to dismiss for arbitration of the claims. See, also, Kleinberger, “*Careful What You Wish For – Freedom of Contract and the Necessity of Careful Scrivening*” XXIV Pubogram 19 (October 2006), available at <http://ssrn.com/abstract=939009>. The examples of operating agreements being interpreted in courts and found wanting are too numerous to number.

1.5 “Business” shall mean the business of the Company as it may be set forth from time-to-time in any business plan, budget, operating plan, by resolution of the Managers, or by the Company’s operations. [further description?]²

1.6 “Capital Account” means, with respect to any Member or Assignee, the Capital Account maintained for such Person in accordance with the requirements of the Code including (without limitation) § 704(b) thereof and Regulations § 1.704-1(b) thereunder.³ In the event the Managers shall determine that it is prudent to modify the manner in which the Capital Accounts, or any debits or credits thereto (including, without limitation, debits or credits relating to liabilities which are secured by contributions or distributed property or which are assumed by the Company or its Members) are computed in order to comply with such Regulations, the Managers may make such modification. The Managers also shall (i) make any adjustments that are necessary or appropriate to maintain equality between the Capital Accounts of the Members and Assignees and the amount of Company capital reflected on the Company's balance sheet, as computed for book purposes, in accordance with Regulations § 1.704-1(b)(2)(iv)(g), and (ii) make any appropriate modifications in the event unanticipated events might otherwise cause this Operating Agreement not to comply with Regulations § 1.704-1(b), provided that, to the extent that any such adjustment is inconsistent with other provisions of this Operating Agreement and would have a material adverse effect on any Member, such adjustment shall require the consent of such Member.

1.7 “Capital Contribution” shall mean any contribution to the capital of the Company in cash or property by a Member or other holder of an Economic Interest whenever made. “Initial Capital Contribution” shall mean the initial contribution of any Member to the capital of

² The more precise the description of the Business is, the less concern that Members and Managers may have about inadvertently usurping opportunities of the entity (for which they would have to account for profits under C.R.S. § 7-80-404(1)(a) and may be a violation of a duty) or competition (prohibited in C.R.S. § 7-80-404(1)(c)). In addition, and perhaps more importantly, a more precise definition of Business gives more definition to the agency granted to the managers (§7-80-405(1)), or members in a member-managed LLC (§7-80-405(2)) to take actions in the ordinary course – actions out of the ordinary course require unanimous Member approval (§7-80-401(2) – or lesser approval as may be set forth in the operating agreement). *See, also*, the limitations suggested in Section 3.2, below.

³ There are several methods by which capital accounts may be maintained in accordance with the Treasury Regulation, including “tax basis,” “tax book rules” and “generally accepted accounting principles.” The Treasury Regulations also provide other methods, all of which are listed on IRS Form 1065, Schedule K-1. It is usually advisable, and sometimes essential, for an LLC to maintain capital accounts in accordance with the principles of Regulations § 1.7041(b)(2)(iv) (known as “Section 704(b) book capital accounts), whether or not the LLC also needs to maintain additional capital accounts under other principles. Under Regulations § 1.704-1(b)(2)(iv), each partner has one and only one capital account; capital accounts are kept for each partner, and not for each “unit” (or “share”). For purposes of the capital account rules, the division of LLC interests into “units” (or “shares”) is generally ignored by the IRS. Although the tax rules tend to have an enormous influence on capital account maintenance, capital accounts can be – and often are – fundamental to the economics of the deal. **Do not assume that everyone except the tax advisors can safely ignore capital accounts.**

the Company pursuant to this Operating Agreement. “Additional Capital Contribution” shall include all Capital Contributions to the Company not including any Person’s Initial Capital Contribution.

1.8 “Class A Member” and “Class B Member” are as defined in Section 1.22, below.

1.9 “Class A Units” and “Class B Units” are as defined in Section 1.35, below.

1.10 “Code” means the United States Internal Revenue Code as amended from time-to-time, and any successor legislation.

1.11 “Colorado Act” shall mean the Colorado Limited Liability Company Act at §§ 7-80-101, *et seq.*, as amended.

1.12 “Company” shall refer to NEWCO, LLC.

1.13 “Confidential Information”

(a) shall mean any and all information of or belonging to or developed by the Company (or Persons on behalf of the Company) that is of a confidential, proprietary, or secret nature, whether copyrighted, in paper format, digital format, blueprint, spreadsheet, photograph, or other format capable of conveying information which is or may be either applicable to or related in any way to:

- (i) the Business, operations, assets, financial condition, present or future, of the Company;
- (ii) the Company’s prospective or actual debt or equity partners, investors, or participants;
- (iii) the Company’s actual and prospective contractual partners;
- (iv) due diligence information that the Company has developed or received from others with respect to actual and prospective business combinations, acquisitions, dispositions, or other business transaction involving or that may involve the Company;
- (v) operational information regarding the products, processes or services that are being offered or that may be offered in the future as a part of the Business;
- (vi) computer programs, technical drawings, algorithms, ideas, schematics, trade secrets, processes, formulas, data, know-how, improvements, inventions (whether patentable or not), techniques, marketing plans, pricing information, forecasts and

strategies, and other information concerning the operational information described in the preceding paragraph or any aspect of the Business; and

(vii) all information of a like nature to the foregoing owned by any other Person and furnished to the Company by such other Person pursuant to an undertaking by the Company to maintain the same in confidence.

(b) shall not include information that a Person can reasonably demonstrate in writing is known to, or becomes generally available to, such Person or to the public without breach of any agreement imposing an obligation of confidentiality.

1.14 “Deficit Capital Account” means, with respect to any Member, the deficit balance, if any, in such Member’s Capital Account as of the end of the relevant fiscal year (or such other period at which time Capital Accounts are being determined), after giving effect to the following adjustments:

(a) increase such Capital Account by:

(i) any amount which such Member is obligated to restore pursuant to any provisions of this Agreement or is deemed obligated to restore under Regulations § 1.704-1(b)(2)(ii)(c), as well as any additions thereto pursuant to the next to last sentence of Regulations § 1.704-2(g)(1) or the next to last sentence of Regulations § 1.704-2(i)(5), after taking into account thereunder any changes during such year in Partnership Minimum Gain and in Member Nonrecourse Debt Minimum Gain;

(ii) the amount of deductions and losses attributable to any outstanding recourse liabilities owed by the Company to such Member and for which no other Member bears any economic risk of loss (within the meaning of Regulations § 1.752-2); and

(iii) the amount of deductions and losses attributable to such Member’s share of outstanding recourse liabilities owed by the Company to Persons other than Members and for which no Member bears any economic risk of loss (within the meaning of Regulations § 1.752-2).

(b) decrease such Capital Account by the items described in Regulations § 1.704-1(b)(2)(ii)(d)(4), (5) and (6).

This definition of Deficit Capital Account is intended to comply with the provisions of Treasury Regulations Sections 1.704-1(b)(2)(ii)(d) and 1.704-2, and will be interpreted consistently with those provisions.

1.15 “Distributable Cash” means all cash, revenues and funds received by the Company, less the sum of the following to the extent paid or set aside by the Company: (i) all

principal and interest payments on indebtedness of the Company and all other sums paid to lenders; (ii) all cash expenditures incurred incident to the normal operation of the Business; (iii) compensation, reimbursements, and guaranteed payments to be made to the Managers; and (iv) such reserves as the Manager reasonably deems necessary to the proper operation of the Business.

1.16 “Economic Interest” shall mean a Member’s or Assignee’s share (as a result of such person’s ownership of one or more of outstanding Units) of the Company’s Net Profits and Net Losses, capital, and distributions of the Company’s assets pursuant to this Operating Agreement and the Colorado Act, but shall not include any right to participate in the management or affairs of the Company, including, the right to vote on, consent to or otherwise participate in any decision of the Members or Manager unless the owner of the Economic Interest is a Member.

1.17 “Fair Market Value,” as to any property, means the price at which a willing seller would sell and a willing buyer would buy such property having full knowledge of the relevant facts, in an arm’s-length transaction without time constraints, and without being under any compulsion to buy or sell. If the property is a Unit or an Economic Interest in the Company or any other ownership interest in an entity, Fair Market Value of the entire entity shall be discounted to the percentage of ownership interest and then by an additional 25% for lack of liquidity and 20% for lack of marketability, as the Manager deems appropriate.

1.18 Gift. A gift, devise, bequest, or other transfer for no consideration, whether or not by operation of law, except in the case of a transfer of an Economic Interest in connection with a case under the United States Bankruptcy Code.

1.19 Gifting Owner. Any Assignee or Member who Gifts all or any part of its Economic Interest.

1.20 “Majority Interest” shall mean Members holding more than 50% of the Percentage Membership Interests⁴ entitled to Vote that are present at a meeting in person or by proxy at which a Quorum is present or, if separate Class votes are expressly required by the Managers with respect to any matter by this Agreement or the Colorado Act, Members holding more than 50% of the *aggregate Percentage Membership Interests* attributable to each such Class entitled to Vote separately on such matter.

1.21 “Manager” shall mean one or more Managers. Specifically, at the present time “Manager” shall be as set forth in Section 5.2(a). References to the Manager in the singular or as

⁴ This contemplates voting by Percentage Membership Interest. Alternatively, voting can be based on the number of Units which may not be consistent with Percentage Membership Interest. Alternative language would be “more than 50% of the aggregate number of Units entitled to Vote . . .”

him, her, it, itself, or other like references shall also, where the context so requires, be deemed to include the plural or the masculine or feminine reference, as the case may be. Managers need not be Members of the Company but must be natural individuals.

1.22 “Member” shall mean each of the parties who executes this Operating Agreement as a Member either at the effective date of this Operating Agreement or thereafter. Initially there will be two classes of Members.

The initial “Class A Members” are as set forth on Exhibit “A”.

There shall be no initial “Class B Member.”

To the extent a Manager has acquired a Membership Interest in the Company, such Manager will have all the rights of a Member with respect to such Membership Interest, and the term “Member” as used herein shall include a Manager to the extent such Manager has acquired such Membership Interest in the Company. If a Person is a Member immediately prior to the acquisition by such Person of an Economic Interest assigned to such Person by a Member or Assignee, such Person shall have all the rights of a Member with respect to such acquired Economic Interest. No Member may assign an Economic Interest (or any portion thereof) while retaining the right to Vote associated with such Economic Interest.

1.23 “Member Nonrecourse Debt Minimum Gain” has the meaning ascribed to the term “partner nonrecourse debt minimum gain” in Treasury Regulation Section 1.704-2(i)(2).

1.24 “Membership Interest” shall mean a Member’s entire interest in the Company including the Units such Member owns, the Economic Interest associated with such Units, the right to Vote associated with such Units, and such other rights and privileges that the Member may enjoy by being a Member. Class A Members will hold Class A Membership Interests; Class B Members will hold Class B Membership Interests. At the date of this Operating Agreement, there are no subsequent classes of Membership Interests.

(a) Class A Membership Interests will be entitled to Vote on all matters presented to the Company’s Members for approval. Class B Membership Interests will not be entitled to Vote on matters presented to the Company’s Members for approval except to the extent the consent of the Class B Members is specifically requested by the Managers. Subsequent classes of Membership Interests will be entitled to Vote to the extent provided in the resolutions of the Managers establishing such classes or otherwise, and may dilute the Vote of the other classes then outstanding. A Member’s right to participate in the Company as a Member (including the right to exercise the right to Vote on any matter presented to the

Members for consideration) shall be void to the extent the Vote exceeds the Member's Percentage Membership Interest.⁵

(b) The Economic Interests of Class A Membership Interests and Class B Membership Interests shall be equal to their Percentage Economic Interest. Subsequent classes of Membership Interests shall have an Economic Interest as provided in the resolutions of the Managers establishing such classes and may dilute the Economic Interest of the other classes then outstanding.⁶

⁵ There is an argument that a transfer by a Member of an Economic Interest to an Assignee which is not admitted as a Member leaves the assignor as a Member without an Economic Interest. This is intended to address this problem. Even without this statement, however, the LLC can maintain the position that a transfer by a Member of his or her entire Economic Interest in violation of the terms of the operating agreement should be treated as a resignation of the transferor as a Member under C.R.S. §7-80-602 or a withdrawal under §7-80-603.

⁶ There are circumstances where the parties may desire that the Class B Members (or other class) be in the nature of a "profits interest" – having no interest in the equity of the business at the time of issuance, but being allocated profits (and perhaps losses) as a result of subsequent operations. This avoids the "booking up" issues under I.R.C. § 704(c). The following are provisions that can be adapted to that end:

(i) Terms of Class B Membership Interests. Each Class B Membership Interest shall: (i) give the Member who is the owner thereof the right to receive distributions (liquidating or otherwise) in accordance with **Error! Reference source not found.** and as otherwise specified herein, (ii) give the Member who is the owner thereof no voting rights but such other rights with respect to such Class B Membership Interest as specified herein and (iii) be issued as provided in **Error! Reference source not found.**

(ii) Character of Class B Membership Interests. (A) The Class B Membership Interests are intended to constitute "profits interests" as that term (or any term of similar import) is used in Internal Revenue Service Revenue Procedure 93-27, 1993-2 C.B. 343 and Revenue Procedure 2001-43, 2001-2 C.B. 191, and any successor provisions of the Code, Treasury Regulations, IRS Revenue Procedures or Revenue Rulings, or other administrative notices or announcements, with the intended results that: (A) no compensation or other income shall be recognized by an owner of the Class B Membership Interests by reason of the issuance of such Class B Membership Interests; and (B) no compensation expense shall be deducted by the Company by reason of the issuance of such Class B Membership Interests. The Managers shall designate a threshold value applicable to each Class B Membership Interest to the extent necessary to cause such Class B Membership Interest to constitute a "profits interest" as provided in this Section, but not less than zero (such value, the "**Threshold Value**"). The Class B Membership Interests to be issued on the date of this Agreement (if any) have a Threshold Value of \$[____]. The Threshold Value for each additional Class B Membership Interest issued after the date of this Agreement shall equal the amount that would, in the reasonable determination of the Management Committee, be distributed with respect to existing Members with respect to their Economic Interests if, immediately prior to the issuance of such additional series the assets of the Company were sold for their fair market values and the proceeds (net of any liabilities of the Company) were distributed pursuant to **Error! Reference source not found.10.2.**

By executing this Agreement, each Member authorizes and directs the Company to elect to have the "safe harbor" described in the proposed Revenue Procedure set forth in Internal Revenue Service Notice 2005-43 (the "**IRS Notice**"), including any similar safe harbor in any finalized revenue procedure, revenue ruling or United States Treasury Regulation, apply to any Interest transferred to a service provider by the Company on or after the effective date of such final pronouncement in connection with services provided to the Company. For purposes of making such safe harbor election, the member designated as the "tax matters

(c) With the exception of the right to Vote, it is intended that Class A Membership Interests and Class B Membership Interests will be treated equally.

1.25 “Net Profits and Net Losses” shall mean for each taxable year of the Company an amount equal to the Company’s net taxable income or loss for such year as determined for federal income tax purposes (including separately stated items) in accordance with the accounting method and rules used by the Company and in accordance with Code § 703 with the following adjustments:

(a) Any items of income, gain, loss and deduction allocated to all holders of Economic Interests pursuant to Section 9.1(b)⁷ shall not be taken into account in computing Net Profits and Net Losses;

(b) Any income of the Company that is exempt from federal income tax and not otherwise taken into account in computing Net Profits and Net Losses (pursuant to this definition) shall be added to such taxable income or loss;

(c) Any expenditure of the Company described in Code § 705(a)(2)(B) and not otherwise taken into account in computing Net Profits and Net Losses (pursuant to this definition) shall be subtracted from such taxable income or loss;

(d) Gain or loss resulting from any disposition of any Company asset with respect to which gain or loss is recognized for federal income tax purposes shall be computed

partner” pursuant to **Error! Reference source not found.13.1(e)** is hereby designated as the “member who has responsibility for federal income tax reporting” by the Company and, accordingly, execution of such safe harbor election by the “tax matters member” constitutes execution of a “safe harbor election” in accordance with the IRS Notice or any similar provision of any final pronouncement. The Company and each Member hereby agree to comply with all requirements of any such safe harbor, including any requirement that a Member prepare and file all federal income tax returns reporting the income tax effects of each interest issued by the Company in connection with services in a manner consistent with the requirements of the IRS Notice or other final pronouncement. A Member’s obligations to comply with the requirements of this Q shall survive such Member’s ceasing to be a member of the Company and the termination, dissolution, liquidation and winding up of the Company.

In this example, there is no “booking up” of the profits interest (Class B Units) when granted, but each has a “Threshold Value” which must be exceeded to provide value to the holder. Special allocations of income can be made to the profits interest holder to build up the profits interest Capital Account, or all special allocations can remain at the Class A level. In either case, the ultimate business transaction must be determined by distributions. Where a Member has a zero Capital Account, all distributions will result in a Deficit Capital Account. Section 10.2(b) provides that no Member has an obligation to restore a Deficit Capital Account on liquidation. Section 9.2(b)(ii) provides for a qualified income offset allocation which does in fact require allocations on a year-by-year basis to restore Deficit Capital Accounts.

⁷ This section is entitled “*Guaranteed Payments and Regulatory Allocations.*”

with reference to the Fair Market Value of the asset disposed of, notwithstanding that the adjusted tax basis of such asset differs from its Fair Market Value;

1.26 “Notice” shall mean written notice, actually or deemed given pursuant to Section 13.7 or Section 13.8.

1.27 “Operating Agreement” shall mean this Operating Agreement as originally executed and as amended from time-to-time.

1.28 “Partnership Minimum Gain” has the meaning ascribed to such term in Treasury Regulation Section 1.704-2(b)(2) and as computed pursuant to Treasury Regulation Section 1.704-2(d).

1.29 “Percentage Economic Interest” shall mean the number of Units held by a Person divided by the total number of Units then outstanding, multiplied by 100.

1.30 “Percentage Membership Interest” shall mean the number of Units held by any Member divided by the total number of Units then outstanding held by all Members, multiplied by 100.⁸ If Voting is to be conducted by Class, “Percentage Membership Interest” shall mean the number of Units in any class held by a Member divided by the total number of Units in that Class held by all Members, multiplied by 100.

1.31 “Person” shall mean any individual or entity, and the heirs, executors, administrators, legal representatives, successors, and assigns of such “Person” where the context so permits.

1.32 “Quorum” shall mean the attendance, in person or by proxy, of holders of more than one-third of the Percentage Membership Interest

1.33 “Regulations” shall include proposed, temporary and final regulations promulgated under the Code in effect as of the date of filing the Articles of Organization and the corresponding sections of any regulations subsequently issued that amend or supersede such regulations.

1.34 “Restricted Period” shall be as defined in Section 11.1(a).

⁸ This only works if the Units are intended to be a measure of the Member’s Economic Interest in addition to the Member’s Voting Interest. Alternatively Percentage Economic Interest could be defined based on Capital Contributions or differently on a Class-by-Class basis (defining Percentage Economic Interest for Class B Units being an aggregate of 90% and for Class B Units being an aggregate of 10%). The intent must be to reflect the business arrangement desired by the parties.

1.35 “Selling Member” shall mean any Member or Assignee who sells, assigns, or otherwise transfers for consideration all or any portion of the Units owned by such Person.

1.36 “Three-Fourths Interest” shall mean Members holding more than 75% of the *aggregate Percentage Membership Interests*⁹ entitled to Vote on the matter being presented for consideration or, if separate Class votes are expressly required by the Managers with respect to any matter by this Agreement or the Colorado Act, Members holding more than 75% of the *aggregate Percentage Membership Interests* attributable to each such Class entitled to vote separately on such matter.

1.37 “Units” shall be the measure by which each holder’s Percentage Economic Interest and Percentage Membership Interest is determined, even though such ownership may be different from (more or less than) the holder’s proportionate Capital Account.¹⁰ The Company is not obligated to issue certificates to represent any Units. Only Units owned by Members entitled to Vote may Vote on any matter as to which this Operating Agreement requires or permits a Vote.¹¹ A transfer of Units will include a transfer of the Capital Account that is attributable to such Units as of the effective date of such transfer determined in accordance with Section 11.6(b), below, and such will be determined on a proportionate basis if fewer than all of the Units owned by any Member or Assignee are being transferred by such Member or Assignee.

(a) “Class A Units” shall mean Units held by a Class A Member in his or her capacity as a Class A Member and shall be entitled to Vote on matters presented to the Members for approval;

(b) “Class B Units” shall mean Units held by a Class B Member in his or her capacity as a Class B Member, and shall not be entitled to Vote unless the right to Vote is

⁹ As set forth in Section 1.20, above, this contemplates voting by Percentage Membership Interest. Alternatively, voting can be based on the number of Units which may not be consistent with Percentage Membership Interest. Alternative language would be “more than 75% of the aggregate number of Units entitled to Vote . . .”

¹⁰ This reflects the fact that the Voting rights and the Economic Rights (allocations and Capital Accounts) may differ from a straight “dollar-in, dollar-out” arrangement. The result must be to reflect the business deal among the parties.

¹¹ LLC interests are complex bundles of economic and governance rights - non-standardized interests that have the near-limitless flexibility of contract law. There is a widespread temptation in drafting LLC operating agreements to try to shoehorn these complex LLC interests into corporation-like “units,” which are the draftsman's shorthand for corporate stock. But that shorthand is very dangerous, sometimes truncating the rights of LLC interest holders or implying that more is given than can be given, as in the case of governance rights. In the world of “units,” there is substantial opportunity for LLC interest holders not to get the benefit of their bargain. Furthermore, the language of “units” has no recognition or force in state organizational laws or under federal income tax law. Units are only valuable as a representation of “percentage of the whole,” and this must be kept in mind when structuring an operating agreement around “units.”

expressly granted by the Managers in the resolutions by which a matter is submitted to the Members for consideration.

(c) Subsequent classes of Units may be created by the Managers as provided herein and shall be designated by letters or in any other way the Managers may deem appropriate. Such Units, when authorized, shall mean Units held by a Member in such class or classes in his or her capacity as a Member, and shall hold such Economic Interest, right to Vote, and other rights as may be specified by the managers in the resolutions establishing the class.

1.38 “Vote” includes not only casting a vote at a meeting but also the receipt of sufficient written consents (by facsimile, electronic mail, courier, or otherwise) to adopt a measure were it presented at a meeting.

ARTICLE 2)

FORMATION OF COMPANY

2.1 **Formation.** _____ organized a Colorado limited liability company on _____, 200__, by delivering articles of organization to the Colorado Secretary of State in accordance with and pursuant to the Colorado Act.

2.2 **Name.** The name of the Company is NEWCO, LLC.

2.3 **Principal Place of Business.** The principal place of Business of the Company within the State of Colorado is _____ Colorado 80___. The Company may locate its places of Business and registered office at any other place or places as the Managers may from time-to-time deem advisable.

2.4 **Term.** The term of the Company shall be perpetual, unless the Company is earlier dissolved in accordance with either the provisions of this Operating Agreement or the Colorado Act.

ARTICLE 3)

BUSINESS OF COMPANY

3.1 **Permitted Businesses.** The Company is authorized:

(a) To accomplish any lawful business whatsoever or which shall at any time appear conducive to or expedient for the protection or benefit of the Company, its Business, and its assets;

(b) To exercise all other powers necessary to or reasonably connected with the Company's Business which may be legally exercised by limited liability companies under the Colorado Act; and

(c) To engage in all activities necessary, customary, convenient, or incident to any of the foregoing.

3.2 Specific Undertakings. [should there be any specific requirements?]¹²

ARTICLE 4)

NAMES AND ADDRESSES OF MEMBERS

The names and addresses of the Members are as set forth in Exhibit A, as Exhibit A may be amended from time-to-time.

ARTICLE 5)

RIGHTS AND DUTIES OF MANAGERS

5.1 Management. The Business and affairs of the Company shall be managed by its Managers.¹³ The Managers acting as a board of managers shall have full and complete authority, power and discretion to manage and control the business, affairs and properties of the Company, to make all decisions regarding those matters and to perform any and all other acts or activities customary or incident to the management of the Company's business.¹⁴

¹² Generally, the more specific the purposes of the LLC are, the less likely there are to be unintended consequences – for example, provisions prohibiting competition (C.R.S. § 7-80-404(1)(c)) or providing for entity opportunities (C.R.S. § 7-80-404(1)(a) requires an accounting when a manager, or member of a member-managed LLC, appropriates an LLC opportunity). See, also, the definition of “Business” in Section 1.5, above.

¹³ Where the parties intend to operate the LLC as a Manager-managed LLC but without Manager, consider adding language more precisely defining the management roles:

“Although the Company is formed as a Manager-managed limited liability company, the Company does not intend to appoint Managers, and no person has or will have the authority of a Manager to transact business in the name of the Company except pursuant to this Agreement or resolution of the Members.”

¹⁴ A more detailed provision defining manager's discretion is as follows (If used, coordinate language with “*Limitation of Liability*” in §5.5(a), below):

Discretion of Manager; Limitation of Liability. The Manager shall be free to exercise his sole and absolute discretion in making any and all decisions relating to the conduct of the Company's Business or otherwise delegated to the Manager by any provision of this Agreement. The Manager shall not be liable (in respect of any decision) to

5.2 Number, Tenure and Qualifications.

(a) The Company shall initially have three Managers. The Managers are: _____, _____ and _____. The Managers shall be appointed, from time-to-time by the affirmative Vote of the Members holding at least a Majority Interest.

(b) Managers shall not be required to stand for election at any time. If any Manager resigns, is removed pursuant to Section 5.9, or otherwise ceases to function as a Manager, the Members of the Class entitled to Vote may, by the affirmative Vote of a Majority Interest, replace such Person.

(c) Each Manager shall hold office until his or her death, resignation or removal pursuant to Section 5.9.

(d) The Managers may hold meetings within or outside of the state of Colorado, in person or by telephone, internet, or other form of telecommunication. Meetings may be called by any Manager upon at least two days, but not more than 30 days, written notice.

(e) Any action that may be taken by Managers at a meeting may be taken without a meeting if such action is approved in writing by the number of Managers that would be required to approve such action at a duly held meeting.

5.3 Certain Powers of the Managers.

(a) Without limiting the generality of Section 5.1 (but subject to other limitations contained in this Operating Agreement), the Managers shall have power and authority on behalf of the Company and without a Vote of the Members being necessary to do and perform all acts as may be necessary or appropriate to the conduct of the Business. Unless a greater percentage is required, Managers may act by Vote of a majority of the Managers then in office.¹⁵

the Company, the Members, or any of their respective Affiliates or constituent owners for any resulting actual or alleged losses, damages, costs, or expenses suffered by them so long as:

- (a) The decision was made by the Manager in good faith for a purpose believed by him to be in, or not opposed to, the best interests of the Company;
- (b) The decision did not involve actual fraud or willful misconduct, gross negligence, reckless disregard of duty or a material breach of this Agreement; and
- (c) The decision was not part of any transaction from which the Manager (or any Affiliate) derives any improper personal benefit.

¹⁵ Even though these provisions give fairly broad powers to the Managers, the Managers are still subject to obligations of good faith and fair dealing. Arbitrary or capricious actions will probably not be upheld if challenged. *See Marshall v. Graubeger*, 796 P.2d 34, 37 (Colo. App. 1990) (a domestic relations case) holding that, although the husband had full discretion over certain of his ex-wife's assets, he "was required to operate within the bounds of prudent judgment, reasonableness, and equity." *See, also*, C.R.S. § 7-80-404(2)-(3).

(b) Managers may authorize the issuance of additional Units (including, without limitation, Class B Units) as contemplated in Section 8.3 of this Operating Agreement.

(c) Notwithstanding the provisions of the Colorado Act to the contrary, no Manager has the authority to act on behalf of the Company unless authorized to do so by a resolution of the Managers.¹⁶ Any Person dealing with the Company may rely (without duty of further inquiry) upon a certificate signed by all Managers as to:

(i) The identity of any Manager or owner of any Unit, and whether such owner is a Member;

(ii) The existence or non-existence of any fact or facts which constitute a condition precedent to acts on behalf of the Company by any Manager or which are in any other manner germane to the affairs of the Company; or

(iii) The Persons who are authorized to execute and deliver any instrument or document of the Company.

(d) The Managers (or the Members in the absence of any Manager) may (but are not required to) appoint officers for the Company. When appointing officers, the Managers may delegate to any one or more of the officers such of the Managers' authority under this Operating Agreement as the Managers (or the Members in the absence of any Manager) may determine to be appropriate.¹⁷ In the absence of any Manager or any officer, the Members shall act as the Managers until the Members appoint one or more Managers pursuant to this Agreement.¹⁸

¹⁶ Note that this provision is inconsistent with §7-80-405(1)(b) which provides that "Each manager is an agent of the limited liability company for the purposes of its business and an act of a manager . . . for apparently carrying on in the ordinary course of business . . . binds the . . . company unless the manager had no authority to act for the limited liability company and the person with whom the manager was dealing had notice that the manager lacked authority."

¹⁷ This is potentially a useful provision. Managers (in a manager-managed LLC) and Members (in a Member-managed LLC) are by statute agents of the LLC. §7-80-405(1)(b) [manager-managed] and 405(2) [member-managed]. Where officers are appointed in a Manager-managed LLC, the agency relationship can be established by the appointing resolution, and is not absolute. If there is no Manager in a Manager-managed LLC, there is no person with the full agency granted by the statute.

¹⁸ This provision provides that the Members will be the de facto Managers when there is no person (Manager or officer) with decision-making authority. This avoids the possibility that the LLC without any person with decision-making authority may be treated as a Member-managed LLC resulting in each Member having agency authority.

(e) The Managers shall, not less than annually, prepare a budget and operating plan which will set forth in appropriate detail the Company's anticipated activities, expenditures, and accomplishments during such period of time. The budget and operating plan will set forth specifically the amount, payee, and timing of all anticipated payments to Affiliates. The Managers shall amend the budget and operating plan when material changes occur and otherwise as they determine appropriate or necessary. The Managers shall provide a copy of the budget and operating plan and each amendment thereto or modification thereof to each Member.

(f) Any Manager may take the following actions on behalf of the Company without further authorization from the Managers or the Members:

(i) Deposit any funds received by the Company in the Company's bank accounts or accounts at other financial institutions;

(ii) Execute on behalf of the Company checks to satisfy regularly recurring obligations of the Company;

(iii) Delegate to employees responsibility for the day-to-day management and operation of the Company's affairs in accordance with authorization previously given by the Managers;

(iv) Open bank accounts or accounts at other financial institutions on behalf of the Company;

(v) Execute letters of intent or memoranda of understanding regarding general business terms of transactions to be considered by the Company provided that such letters or memoranda are non-binding on the Company (except with respect to confidentiality terms, return of due diligence information, and the requirement that each party bear its own expenses);

(vi) Purchase liability or other insurance with respect to the Company's assets and activities; and

(vii) Take any action specifically authorized by the Managers, or allocated to such Manager in any operating plan or budget adopted by the Managers.

(g) Any Manager **[may/may not]** appoint another person to act as proxy for the Manager in making decisions, casting votes or executing statements of consent in such person's capacity as Manager.¹⁹

¹⁹ The statute provides that a manager of a manager-managed LLC is an agent of the LLC (§ 7-80-405), but (unlike for members in § 7-80-706(2)) does not provide express authority for managers to appoint agents. Under § 3.15 of the Restatement (Third) of Agency:

(h) A Manager acting alone or with the other Managers may incur and/or cause the Company to expend, or cause the Company to be obligated for an amount (whether in a single transaction or through a series of related transactions) up to an aggregate of \$_____ for the purpose of carrying on the Business of the Company whether or not included in the budget and operating plan without the need for a vote of Members.

5.4 Limitations on Authority.²⁰ Notwithstanding any other provision of this Operating Agreement or Section 7-80-405 of the Colorado Act, no Manager shall cause or commit the Company to do any of the following (whether or not for the purposes of the Business of the Company) without the Vote of the Managers then in office and a Vote of Three-Fourths Interest:

- (a) sell all of its assets as part of a single transaction or plan, or
- (b) enter into a transaction with an Affiliate where the amount to be paid to or received from the Affiliate is greater than \$25,000 per year not contemplated herein or in any operating plan or budget adopted as contemplated in Section 5.3(e);²¹ or
- (c) mortgage, pledge, or grant a security interest (collectively, “pledge”) in any property of the Company not in the ordinary course of Business; or
- (d) lend money to or guaranty or become surety for the obligations of any Person, except in connection with a sale/leaseback transaction .

(1) A subagent is a person appointed by an agent to perform functions that the agent has consented to perform on behalf of the agent’s principal and for whose conduct the appointing agent is responsible to the principal. The relationships between a subagent and the appointing agent and between the subagent and the appointing agent’s principal are relationships of agency as stated in § 1.01 [of the Restatement].

(2) An agent may appoint a subagent only if the agent has actual or apparent authority to do so.

Thus a Manager may only appoint a proxy or other subagent if given express authority to do so in the operating agreement or by other LLC action, or if circumstances exist which indicate apparent authority. In any event, the Manager would be responsible for the actions of his/her subagent unless exonerated in the operating agreement or other LLC Act.

²⁰ Note that (as discussed above) limitations on the Manager’s authority are inconsistent with §7-80-405(1)(b) which provides that “Each manager is an agent of the limited liability company for the purposes of its business and an act of a manager . . . for apparently carrying on in the ordinary course of business . . . binds the . . . company unless the manager had no authority to act for the limited liability company and the person with whom the manager was dealing had notice that the manager lacked authority.”

²¹ This expressly permits transactions (such as compensation) that are described in the operating agreement.

5.5 Liability for Certain Acts.

(a) Each of the Managers shall perform his duties as Manager in good faith, in a manner he reasonably believes to be in the best interests of the Company, and with such care as an ordinarily prudent Person in a like position would use under similar circumstances.²² A Manager who so performs the duties as Manager shall not have any liability to the Company or the other Members by reason of being or having been a Manager of the Company. The Managers do not, in any way, guarantee the return of the Capital Contributions of any Member or Assignee, or a profit from the operations of the Company. The Managers shall not be liable to the Company or to any Member or Assignee for any loss or damage sustained by the Company or any Member or Assignee, unless the loss or damage shall have been the result of fraud, deceit, gross negligence or willful misconduct.

(b) If any Manager incurs a debt or obligation on behalf of the Company, or takes any action beyond such Person's authority as set forth in this Operating Agreement, such Manager shall be solely responsible for any and all resulting damages to the Company and to the other Members.

5.6 Duty to the Company.

(a) Persons serving as Managers and officers of the Company are expected to devote such time and effort to the Business as they determine to be appropriate or necessary in the circumstances. This provision is for the benefit of the Company and may only be enforced by the Company; the Members and Assignees have no right to enforce this provision on their own behalf.

(b) Except as otherwise agreed in writing between such Person and the Managers, no Person who is a Member (other than a Manager) shall be required to devote any time to the management of the Company, and such Person may have other business interests and may engage in other activities in addition to those relating to the Company.

5.7 Related Party Transactions.²³

²² This duty of Managers to act as an ordinarily prudent person in the best interests of the Company is derived from the business judgment rule concept for directors under the Colorado Business Corporation Act (§7-108-401(1)) and is inconsistent with elimination of fiduciary duties set forth below in Section 5.7(a). Section 5.7(a) contemplates that there are no duties between the Members/Managers other than the contractual duties of good faith and fair dealing (as required by statute). Section 5.7(a) basically contemplates that the Members can act in their own self interest (and can direct managers appointed by them to do so), with the belief that the self interest of the Members in the business will ultimately prove to be in the best interests of the Company, but the Company is not the measuring stick. Especially where the Members and the Managers are closely interrelated, it would be best not to have this potential conflict between the duties of the Managers and Members, and either the approach in Section 5.5(a) or Section 5.7 should be followed for both Managers and Members.

²³ The authorization of related party transactions needs to be considered carefully, especially in connection

(b) The Managers shall have the right and responsibility from time-to-time as necessary and appropriate to enter into transactions between the Company and related parties, including the Manager or any Member or any affiliate thereof, provided such transactions adequately compensate the related party for the services being provided or the assets being used or acquired without unreasonable charges to the Company for such services or assets. Among the related party transactions contemplated are the following (which list is not intended to be exclusive of other possible related party transactions):

(i) To the extent the Company uses office or other space leased by a related party, the Company will reimburse the related party for reasonable direct and indirect costs of the space attributable to the Company's usage;

(ii) To the extent the Company uses general or administrative services or equipment provided by a related party, the Company will reimburse the related party for reasonable direct and indirect costs of the usage of such general or administrative services, or such equipment;

(iii) To the extent the Company uses personnel employed by a related party to conduct the Business of the Company, the Company will reimburse the related party for reasonable direct and indirect costs for such personnel;

(iv) To the extent the Company provides personnel employed by it to provide services to or for the benefit of a related party, the Company will seek reimbursement from the related party for reasonable direct and indirect costs for such personnel; and

(v) To the extent the Company engages in other transactions with a related party, the Company will reimburse the related party for reasonable direct and indirect costs associated with such transactions.

(c) It is not the intent that the related party will substantially profit from related party transactions with the Company, and it is not the intent that the Company will disproportionately benefit from related party transactions. It is the intent that the Company will bear its share of costs for related party transactions.

(d) The Company may negotiate fixed rates for any or all related party transactions to avoid the necessity of calculating individual costs for each transaction, which may include hourly, daily, monthly (or other period) charges.

with affiliated entities where there may be office sharing, G&A expense sharing, and the like. Proper documentation will more likely preserve the limited liability and separateness of the different entities.

(e) When entering into related party transactions, the Managers will provide notice of such transactions (including the economic terms thereof) to the Members, although the failure to provide such notice does not invalidate any such transaction. Upon the request of any Member, the Manager will provide information to such Member about the calculation of the reimbursement or payments between the Company and the related party. Upon the request of any Member, the Manager will provide such Member a copy of any written agreement for such related party transactions.

5.8 Elimination of Fiduciary Duties.²⁴

(a) To the fullest extent permitted by the Colorado Act, no Member or Manager has fiduciary²⁵ duties²⁶ with respect to the Company or any other Member, Assignee, or

²⁴ An operating agreement is a contract, and as such incorporates an implied duty of good faith and fair dealing. *See, e.g.*, RESTATEMENT (SECOND) OF CONTRACTS § 205 (“every contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement.”). Under the Revised Uniform Limited Liability Company Act, § 110(c)(5), an operating agreement may not eliminate the obligation of good faith and fair dealing, set forth expressly in that Act in § 409(d), but the operating agreement may prescribe the standard by which the performance of the obligation of good faith and fair dealing will be measured. RULLC § 110(d)(5). Similarly, see C.R.S. § 7-80-108 and § 7-80-404. There is, however, significant distinction as to the meaning of “good faith.” For example, in *Stone v. Ritter*, 911 A.2d 362, 370 (Del. 2006), the Delaware Supreme Court determined that good faith is a “subsidiary element” of the duty of loyalty. The scope of what constitutes good faith or the absence of bad faith is recognized as being murky at best. In the *Disney* decision the Delaware Chancery court acknowledged that it likely is impossible to articulate a broad enough definition to capture the “universe of acts that would constitute bad faith.” *In Re The Walt Disney Company Derivative Litigation*, 907 A.2d 693, 755. *See also* The Committee on Corporate Laws, *Changes in the Revised Model Business Corporation Act --- Amendment Pertaining to the Liability of Directors*, 45 BUS. LAW. 695, 697 (1990). The phrase “acts or omissions not in good faith” is “easily susceptible to widely differing interpretations, especially retroactively” and was determined to be too imprecise a standard or duty to be barred from being waived in a corporation’s certificate of incorporation. Instead, the breadth of what might constitute non-waivable bad faith has been narrowed under the Model Business Corporation Act to include acts or omissions (i) with respect to which the director derives a financial benefit to which he or she is not entitled or (ii) that are either intentionally criminal or intentionally designed to harm the corporation. The *Disney* decision refers to the case law in this area as a “fog of . . . hazy jurisprudence,” but “[t]o act in good faith, a director must act at all times with an honesty of purpose and in the best interests and welfare of the corporation,” which includes not intentionally disregarding his or her duties as a fiduciary. Be aware that “good faith” may be a fiduciary obligation while “good faith and fair dealing” is a rule of contract.

²⁵ The application of fiduciary duties derives from 18th century English real property law where “it emerged as a means of moderating the tension between current and future interests in land.” Helfman, “*Origins of Fiduciary Duty*,” 41 Real Property, Probate and Trust Journal 651 (ABA) (Fall 2006). In *Bishop of Winchester v. Knight*, 24 Eng. Rep. 447 (Ch. 1717), the tenant leased property and then proceeded to mine copper instead of conducting the traditional farming operations. The Lord Chancellor said: “the tenant is a sort of a fiduciary to the lord, and it is a breach of the trust which the law reposes in the tenant, for him to take away the property of the lord.” The jury found for the bishop on the ground that it “could not find that the customary tenant without the license of the lord, might by custom dig and open new copper-mines . . . so that . . . neither the tenant without the license of the lord, nor the lord without the consent of the tenant, could dig in these copper-mines, being new mines.” Justice Cardozo described fiduciary duty as follows: “Joint adventurers, like copartners, owe to one another, while the enterprise continues, the duty of finest loyalty. Many forms of conduct permissible in a workaday world for those acting at

Manager under Section 7-80-404 of the Colorado Act or any other provision thereof other than²⁷ the contractual obligation of good faith and fair dealing.²⁸ To the extent that, under the Colorado

arm's length are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the marketplace. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior." *Meinhard v. Salmon*, 164 N.E. 545 (N.Y. 1928).

²⁶ One can question whether the use of the term "fiduciary" in this context is too great of a limitation. The phrase "no duties" may provide broader protection to the manager (if that is the goal). The Delaware Supreme Court has criticized a lower court which had found statutory default fiduciary duties in the Delaware LLC Act. The Supreme Court explained that the Chancery Court's holding on this issue was unnecessary to this case (where the operating agreement did impose a contractual fiduciary duty) and that the Chancery Court's discussion of default statutory duties "must be regarded as dictum without any precedential value." *Auriga Capital Corp. v. Gatz Properties LLC*, Del. Ch. C.A. 4390-CS, 44 Sec. Reg. & L. Rep. (BNA) 333 (Jan. 27, 2012), *affirmed sub nom. Gatz Properties, LLC v. Auriga Capital Corp.*, No. 148, 2012 (Del. 11/7/2012).

²⁷ The use of the phrase "other than the contractual obligation" leads to the impression that the contractual obligation is, itself, a fiduciary duty (since that is the term that "other than" modifies). A better statement might be: "To the fullest extent permitted by the Colorado Act, no Member or Manager has fiduciary duties with respect to the Company or any other Member, Assignee, or Manager. Members, Assignees, and Managers do owe each other the contractual obligation of good faith and fair dealing."

²⁸ See the conflict between this Section and Section 5.5(a) discussed above. § 7-80-108(1.5) provides that the fiduciary duties of a Manager (or member in a member-managed LLC) can be "restricted or eliminated by provisions in the operating agreement as long as any such provision is not manifestly unreasonable," but (under § 7-80-108(2)(d)) no provision can eliminate "the obligation of good faith and fair dealing" under Section 7-80-404(3). § 7-80-108(2)(d) goes on to say that the operating agreement "may prescribe the standards by which the performance of the obligation is to be measured, if such standards are not unreasonable." Section 7-80-404(3) provides that "each Member and each manager shall discharge the member's or manager's duties to the limited liability company and exercise any rights consistently with the contractual duty of good faith and fair dealing." In *Kelly v. Blum*, 2010 WL 629850 (Del. Ch. Feb. 24, 2010) at n. 95 [citing *Kuroda v. SPJS Hldgs., L.L.C.*, 971 A.2d 872, 887 (Del.Ch.2009) (citing *Dunlap v. State Farm Fire & Cas. Co.*, 878 A.2d 434, 442 (Del.2005)], the covenant of good faith and fair dealing is held to require parties to refrain from arbitrary or unreasonable conduct that prevents the other party from receiving the fruits of the contract. Needless to say, including such a limitation or elimination of fiduciary duties may raise concerns in the minds of investors; on the other hand, this may be appropriate in a joint venture organized as an LLC where the members are also managers and can protect their own affairs, but do not want to risk violation of stricter duties in the LLC context. This was added in SB 06-187 by the 2006 legislature.

It is important to consider the possible effect of public policy on any attempted waiver of fiduciary duties. Under the common law, waivers must be specific and knowingly granted. A general waiver of "all fiduciary duties" as attempted here may be unenforceable between a promoter and investors, while it may be enforceable between two sophisticated business partners using the LLC form to establish a joint venture. Section 5.7(b) is intended to provide some specificity to the general waiver found in Section 5.7(a). Any fiduciary waiver must be drafted clearly and unambiguously. See *Kahn v. Portnoy*, 2008 WL 5197164 (Del. Ch. Dec. 2008) and Ribstein, whose has stated: "uncorporation (i.e., LLC and limited partnership) fiduciary duty opt-outs are more broadly enforced than corporate contracts." See <http://busmovie.typepad.com/ideoblog/2009/03/freedom-of-contract-in-uncorporations-vs-corporations.html> and Ribstein, *The Uncorporation and Corporate Indeterminacy*, *U Illinois Law & Economics Research Paper No. LE08-012*, *University of Illinois Law Review, January 2009* avail. on the Social Science Research Network, id 1115876."

Act, the law of agency, or common law or any other law or at equity,²⁹ a Member, Assignee, Manager, or Officer of the Company has duties or obligations to the Company or to a Member, Assignee, Manager or other Person who is a party to this Agreement, that Member, Assignee, Manager or officer of the Company shall not be liable to the Company or to any such other Member, Assignee, Manager, or Person for its good faith reliance on this Agreement.

(b) Specifically, and without limitation of the generality of the waiver contained in Section 5.7(a), the Manager may compete with the business of the Company,³⁰ is not required to refrain from dealing with the Company in the conduct or winding up of the Company's business as or on behalf of a party having an interest adverse to the Company,³¹ and is not obligated to account to the Company and hold as trustee any property, profit, or benefit derived by the Manager in the conduct or winding up of the Company's business or derived from the use by the Manager of property of the Company, including (without limitation) an appropriation of an opportunity of the Company.³²

²⁹ Note that a reference only to the Colorado Act may be inadequate. The Colorado Act specifically incorporates the law of agency by stating that a manager (or a member of a member-managed LLC) is an agent of the Company. § 7-80-405.

³⁰ This provision may not be appropriate in all contexts. The statute provides that, unless the operating agreement provides otherwise, managers and (in a manager-managed LLC) and members (in a member-managed LLC) must "refrain from competing with the limited liability company in the conduct of the limited liability company business before the dissolution of the limited liability company." §7-80-404(1)(c).

In *M.C. Multi-Family Development, L.L.C. v. Crestdale Associates, Ltd.*, 193 P.3d 536 (Nev. 2008), the Nevada Supreme Court interpreted the following provision in the operating agreement of a residential real estate development LLC which permitted members to engage in competition:

This Operating Agreement shall not preclude or limit in any respect the right of any Member or Administrative Committee Member to engage in or invest in any business activity of any nature or description, including those which may be the same or similar to the Company's business and in direct competition therewith. Any such activity may be engaged in independently or with other Members or Administrative Committee Members. No Member shall have the right, by virtue of the Articles of Organization, this Operating Agreement or the relationship created hereby, to any interest in such other ventures or activities, or to the income or proceeds derived therefrom. The pursuit of such ventures, even if competitive with the business of the Company, shall not be deemed wrongful or improper and any Member or Administrative Committee Member shall have the right to participate in or to recommend to others any investment opportunity.

The court concluded that, while members were entitled to engage in competition with the LLC, they were not permitted to use the LLC's contractors license for the purpose of competition.

³¹ See §7-80-404(1)(b). This is probably not appropriate in most situations.

³² See §7-80-404(1)(a). This also is probably not appropriate in most situations.

5.9 Indemnity of the Managers, Officers, Employees and Other Agents.

(a) Subject to Section 5.5, the Company shall indemnify the Managers and make advances for expenses to the maximum extent permitted under the Colorado Act. The Company shall indemnify its officers, employees and other agents who are not Managers and make advances for expenses to the maximum extent permitted under the Colorado Act.³³

(b) (i) Notwithstanding any other provision of this Operating Agreement, no Manager, officer, employee, or agent shall be liable to any Member or Assignee or to the Company with respect to any act performed or neglected to be performed in good faith and in a manner which such Person believed to be necessary or appropriate in connection with the ordinary and proper conduct of the Business or the preservation of its property, and consistent with the provisions of this Operating Agreement.

(ii) The Company shall indemnify its Managers, officers, employees, or agents for and hold them harmless from any liability, whether civil or criminal, and any loss, damage, or expense, including reasonable attorneys' fees, incurred in connection with the ordinary and proper conduct of the Business and the preservation of the Business and the Company's property, or by reason of the fact that such Person is or was a Manager, officer, employee, or agent; provided: the Person to be indemnified acted in good faith and in a manner such Person believed to be consistent with the provisions of this Operating Agreement and in the best interests of the Company; and that with respect to any criminal action or proceeding, the Person to be indemnified had no reasonable cause to believe the conduct was unlawful.

(iii) The termination of any action, suit or proceeding by judgment, order, settlement, conviction, or upon a plea of *nolo contendere* or its equivalent shall not of itself create a presumption that indemnification is not available hereunder. The Company's obligation to indemnify any Manager, officer, employee, or agent hereunder shall be satisfied out of the Company's assets only, and if the Company's assets are insufficient to satisfy its obligation to indemnify any Manager, such Person shall not be entitled to contribution from any Member.

³³ C.R.S. § 7-80-407 provides for indemnification and advancement of expenses. This provides for a mandatory indemnification and advancement of expenses for managers, officers, employees, and agents. Also, note *Bernstein v. Tractmanager, Inc.*, CA 2763-VCL (Del. Ch. Nov. 20, 2007) where the court held that if the operating agreement did not provide for advancement of expenses, the LLC had no obligation to advance expenses.

No amendment of this provision for indemnification or advancement of expenses shall have the effect of limiting the rights of any person previously serving as a Manager, officer, employee or agent of the Company to indemnification or advancement of expenses pursuant to this section.³⁴

5.10 Removal and Resignation.

(a) At a meeting called expressly for that purpose, Members holding a Three-Fourths Interest may remove all or any lesser number of Managers, with or without cause.³⁵

(b) Any Manager of the Company may resign at any time by giving written notice to the Company. The resignation shall take effect upon receipt of notice thereof unless the Manager agrees to accept such resignation to be effective at a later time as shall be specified in such notice.

(c) The removal or resignation of a Manager who is also a Member shall not affect the Manager's rights as a Member, and shall not constitute a withdrawal of a Member.³⁶

5.11 Vacancies. To the extent a vacancy occurs within the number of Managers for any reason, the Managers may (but are not required) by a Vote of a majority of the remaining Managers fill such vacancy.

5.12 Compensation, Reimbursement, Organization Expenses.

(a) The Managers with the concurrence of Members holding at least a Majority Interest, may from time-to-time establish the compensation to be paid to the Managers and any officer, employee, or agent. Such compensation shall be paid from the Company's revenue before the Company makes any distributions to the Members.³⁷ No Person shall be

³⁴ This responds to *Schoon v. Troy Corp.*, 948 A.2d 1157 (Del. Ch. 2008) where the court found that, without such a provision, Troy had the right to amend its bylaws to eliminate the indemnification and advancement of expenses right to the detriment of a former director.

³⁵ This provision may not be adequate where the Manager has a significant interest himself. Consider requiring the vote to be "Three-Fourths [or a Majority] of the Remaining Members" where the "Remaining Members" is defined as "Persons holding Membership Interests other than the Manager and his Affiliates".

³⁶ Alternatively, where there is a very closely-held organization with unity between the Managers and the Members, the parties may want to continue to tie Membership with the person's role as a Manager. In that case, the following language may be more appropriate: "If a Manager is also a Member, the Manager's resignation shall also constitute such Person's withdrawal as a Member."

³⁷ As written, this would not permit payment of compensation from Capital Contributions. If this is intended, this provision should be written to permit it.

prevented from receiving such compensation by reason of the fact that he or she is also a Member of the Company.³⁸

(b) The Company shall reimburse its Managers, Members, and others who incur expenses on behalf of the Company as the Managers may from time-to-time authorize. It is not intended that the reimbursement of a Manager, Member or other Person result in a profit, however, reimbursement may include an overhead charge not to exceed 10% of the amount of the expenses to be reimbursed.

ARTICLE 6)

RIGHTS AND OBLIGATIONS OF MEMBERS AND ASSIGNEES

6.1 Limitation of Liability. Each Member's or Assignee's liability shall be limited to the maximum extent possible as set forth in this Operating Agreement, the Colorado Act and other applicable law.³⁹ A Member or Assignee shall not be personally liable for any debts or losses of the Company beyond his, her or its respective Capital Contributions (defined in Section 5.3 below). Any Member may, however, voluntarily agree to be liable on a debt or obligation of the Company by entering into a separate written agreement or other undertaking with an obligee or creditor of the Company; *provided, however*, no Member may commit another Member to be liable on a debt or obligation of the Company unless authorized to do so in writing by such other Member.

6.2 Company Debt Liability. Except as otherwise required by law or contract,⁴⁰ a Member or Assignee will not be personally liable for any debts or losses of the Company beyond

³⁸ Under §7-80-606(1), the LLC Act specifically provides that the term "'distribution' does not include payments to the extent that the payments do not exceed amounts equal to or constituting reasonable compensation for present or past services." Compensation paid to a person who is also a member would likely be considered a distribution for tax purposes unless it meets the guaranteed payment requirements of I.R.C. §707.

³⁹ This provision should be considered carefully, as it may actually expand the liability of Members. The goal would be to contract liability, as in the following sentence. The operating agreement and law will speak for themselves. Why risk incorporating them to possibly dilute the effect of the following sentence?

⁴⁰ Why would an operating agreement intentionally include a provision like this clause which would give an argument to plaintiffs to pierce the veil of an LLC? To the extent circumstances exist, they will be applied. "Piercing the veil" is specifically contemplated by the Colorado LLC Act; § 7-80-107(1) says: "In any case in which a party seeks to hold the members of a limited liability company personally responsible for the alleged improper actions of the limited liability company, the court shall apply the case law which interprets the conditions and circumstances under which the corporate veil of a corporation may be pierced under Colorado law." *See, also*, Lidstone, "Piercing the Veil of an LLC or a Corporation," 39 *The Colorado Lawyer*, no 8 at 71 (August 2010), updated and available at Lidstone, *Piercing the Corporate and LLC Veil* <http://ssrn.com/abstract=2207735>.

his respective Capital Contributions and any obligation of the Member or Assignee under Section 8.1 or 8.2 to make Capital Contributions.

6.3 Member Guarantee Provision. The Company (through its Managers) may, in the ordinary course of Business, request that one or more Members or Assignees guarantee all or a portion of the Company's indebtedness to a Bank as a condition of the Bank being willing to advance funds to the Company. To the extent that one or more Members or Assignees guarantee indebtedness to any Bank, the Company may pay compensation to such guarantors as the Managers deem appropriate in the circumstances. The Company agrees that to the extent any guarantor of the Company's indebtedness is obligated to pay any amount pursuant to such guarantee, the guarantor will have a claim against the assets of the Company that is in preference to the claim of any Member, Assignee or other holder of Units. The Managers do not have to offer an opportunity to guarantee the Company's indebtedness to any Member or Assignee.

6.4 Loans and Interest Bearing Advances. Members, Assignees, and Managers may make secured or unsecured loans and interest bearing advances to the Company. Any such loans or advances shall be approved unanimously by the Managers, be segregated in a loans payable account, and shall bear interest at the prime rate prevailing from time-to-time while such advances are outstanding, as reflected by the prime rate established by Wells Fargo Bank, Denver, Colorado, for loans to large borrowers or at such other rate as may be approved by the Managers.⁴¹ Any Member, Assignee or Manager who makes a loan to the Company which has been approved by the Managers as set forth herein will have the right to take a security interest in the Company's assets, enforce loan covenants, foreclose on collateral, and take other actions as a creditor without violating any statutory, fiduciary, contractual or other duty owed to the Company.

6.5 Members and Assignees Have No Agency Authority. Except as expressly provided by resolution of the Managers, No Member or Assignee (in their capacity as Members and Assignees) shall have any agency authority to take any action on behalf of the Company, whether or not such Person is a Member.

6.6 Units Are Governed by Article 8.⁴²

(a) By execution hereof, the Member hereby acknowledges and agrees that the Units issued and to be issued by the Company, whether held by Members or Assignees, shall

⁴¹ This is specifically authorized in § 7-80-404(5) as a result of the 2006 amendments.

⁴² See §4-8-103(c) which states "an interest in a partnership or limited liability company is not a security [for the purposes of Article 8] unless . . . its terms expressly provide that it is a security governed by this article . . ." If not governed by article 8, security interests over Membership Interests and Economic Interests in Colorado limited liability companies would usually be taken as general intangibles under article 9. On the other hand, adopting Article 8 imposes a number of obligations on the entity which should be considered.

constitute and be deemed a “security” within the meaning of C.R.S. 4-8-102(a)(15) of the Colorado Uniform Commercial Code, as from time to time amended and in effect (the “UCC”), and shall be governed by and subject to Article 8 of the UCC (C.R.S. §§ 4-8-101 *et seq.*) and the Uniform Commercial Code of any other applicable jurisdiction.

(b) The Company shall issue a certificate⁴³ evidencing the Member’s interest in the Company in such form as may be approved by the Manager; provided that such certificate shall be stamped or otherwise imprinted with legends substantially similar to the following (in addition to any legends evidencing restrictions required under other applicable federal or state laws):

THIS CERTIFICATE REPRESENTS UNITS OF LLC MEMBERSHIP INTEREST THAT ARE "SECURITIES" AS DEFINED IN AND GOVERNED BY ARTICLE 8 OF THE COLORADO UNIFORM COMMERCIAL CODE (AND THE CORRESPONDING PROVISIONS OF ANY OTHER STATE'S UNIFORM COMMERCIAL CODE), AS THE SAME MAY BE AMENDED.

(c) The foregoing is not intended to admit that a Unit is subject to the applicability of federal or state laws regulating the offer or sale of securities as that term is defined in such laws.⁴⁴

(d) This Section 6.6 shall not be amended by the Company, the Managers or the Members without the prior written consent of any lender of the Company that is a pledgee of any of the Company’s outstanding Units.

Alternatively: Units Are Not Governed by Article 8 of UCC. Units representing Membership Interests and Economic Interests are not intended to be governed by, Article 8 of the Uniform Commercial Code (“UCC”) as adopted in Colorado, C.R.S. §§ 4-8-101 *et seq.* Units will not be represented by a certificate.

6.7 Expulsion of Members. Upon recommendation by the Managers, Members holding a Three-Fourths Interest may (by consent or by vote) expel a Member from the

⁴³ Without this language, the Units will be “uncertificated securities” for the purposes of Articles 8 and 9 of the UCC. With this language in the operating agreement, the Units will be treated as “certificated securities” as defined in C.R.S. § 4-8-102(a)(4). Any Unit that is represented by a certificate should bear conspicuous legends restricted transferability and referring to the operating agreement. *See* Colo. Rev. Stat. §4-8-204 (requiring that a legend restricting transferability be conspicuous) and §4-8-202(a) (which makes any certificated security subject to the terms and conditions noted thereon or incorporated therein “by reference”, even “against a purchaser for value and without notice”).

⁴⁴ This self-serving statement likely will not be effective if the interests otherwise are “securities” within the applicability of such laws.

Company, provided that the Member being expelled has no personal liability on any debt of the Company. If a Member has personal liability on any debt of the Company, the Members may not expel such Member unless the Members approving the expulsion agree in writing to indemnify and hold the Member being expelled harmless from any liability resulting from such debt. An expelled Member shall be treated for all purposes as an Assignee.⁴⁵

ARTICLE 7)

MEETINGS OF MEMBERS⁴⁶

7.1 Meetings.

(a) The Members may meet at such times and places, either within or outside the State of Colorado, as may be determined by the Managers.

(b) The Managers shall call⁴⁷ a meeting of the Members promptly upon receiving the written request made by two or more Members holding Units entitled to Vote exceeding 10% of the outstanding Vote. Any written request will set forth the names and addresses of the Persons requesting the meeting and the subject matters that such Persons request be discussed at that meeting. The Persons requesting the meeting may present an explanation and discussion of the issues which, upon their request, the Managers will mail to the Members together with the Notice of the meeting.

(c) (i) When the Managers call a meeting, they shall provide at least 10 days' Notice (but not more than 60 days' Notice) of the date, time and place of the meeting to all Members, which Notice will include a description and (if the Managers deem it necessary or appropriate) a discussion of the issues to be discussed and/or Voted upon at the meeting.

⁴⁵ The statute has no provision for expulsion of a Member. By treating the expelled Member as an Assignee, the expelled member is being treated as though he/she resigned under §7-80-602.

⁴⁶ Note that the more formalized the meeting process and member participation process is (through meetings, reports, etc.), the more formalities will govern the LLC. In *Sheffield Services Company v. Trowbridge*, 211 P.3d 714 (Colo. App. 2009), the operating agreement required a number of formalities; when the LLC failed to comply with the formalities set forth in the operating agreement, the LLC gave the Court of Appeals another reason to permit piercing the veil of the LLC to hold Trowbridge (who managed the LLC, although he was not a manager) liable for the debts of the LLC to Sheffield. Had the operating agreement not included the formalities (which the members went on to ignore), the court would not have been able to rely on a lack of formalities which are not a requirement of the LLC Act.

⁴⁷ Note this requirement that, if the requisite number of Members seek a meeting, the Managers must call the meeting.

(ii) When the Managers call a meeting, they shall determine the matters to be considered at the meeting, and whether any Units other than the Units with the right to Vote, will be entitled to Vote at the meeting.

(d) Meetings will be conducted in a manner the Managers determine to be fair and reasonable in the circumstances. In conducting meetings the Managers may, but are not obligated to, refer to sources such as *The Modern Rules of Order* or other similar publication setting forth a method of parliamentary procedure.

(e) The Managers may provide that meetings be held by telephone, internet, or other form of telecommunication.

(f) The Company shall have no obligation to conduct annual or special meetings or to keep minutes thereof.

7.2 Manner of Acting.

(a) Whether at a meeting or otherwise, the affirmative Vote of Members holding a Majority Interest shall be the act of the Members unless Voting by Class or the Vote of a greater or lesser proportion or number is otherwise required by this Operating Agreement or by the Managers.

(b) Any action that may be taken by Members at a meeting may be taken by the written consent of Members holding the Percentage Membership Interests that would be required to approve such action at a duly held meeting.

(c) Unless otherwise expressly provided herein or required under applicable law or determined by the Managers, Members who have an interest (economic or otherwise) in the outcome of any particular matter upon which the Members Vote, may Vote upon any such matter and such Vote shall be counted in the determination of whether the requisite matter was approved by the Members.

7.3 Proxies. At all meetings of Members, a Member may Vote in person or by proxy executed in writing by the Member or by a duly authorized attorney-in-fact.⁴⁸ Such proxy shall be delivered to the Managers before or at the time of the meeting. No proxy shall be valid after eleven months from the date of its execution, unless otherwise provided in the proxy.

⁴⁸ Note that the statute specific provides that Members may vote by proxy. §7-80-706(2). The statute contains no comparable provision for managers who, under the law of agency, may only appoint a subagent “if the agent has actual or apparent authority to do so.” Restatement (Third) of Agency, § 3.15(2).

ARTICLE 8)

CONTRIBUTIONS TO THE COMPANY AND CAPITAL ACCOUNTS

8.1 Capital Contributions.

(a) Each Member has made his Initial Capital Contribution as follows, and has received Units, which Units are reflected on Exhibit A, attached hereto.

(b) Persons to whom the Managers determine to issue additional Units in the future will make Initial Capital Contributions as the Managers may require.

(c) The Managers will amend this Agreement and Exhibit A from time-to-time as necessary to reflect the admission of new Members (Sections 8.3 and 11.4(a)), issuance of additional Units (Sections 8.1(b) and 8.3), Additional Capital Contributions (Section 8.2), or other terms, conditions, rights and obligations of new and existing Members. Such amendments may be made pursuant to Section 13.1(a) hereof without the consent of the Members.

8.2 Additional Capital Contributions. The Company may not require any Member to make any Additional Capital Contribution.⁴⁹

8.3 Issuance of Additional Units and Options to Purchase Units.

(a) The Company may issue additional Units to new or existing Members for consideration, and on other terms and conditions, determined by the Managers, subject to the limitations and provisions of this Agreement, and the issuance of such Units may dilute the Vote and the Economic Interest of existing Units then outstanding.

⁴⁹ If the operating agreement gives the Managers the right to require additional Capital Contributions, the Managers will have to recognize the impact of federal and applicable state securities laws at that time. At the very least, this will require disclosure of the use of proceeds and the consequences of not making the additional Capital Contribution. The operating agreement should also recognize the risk that a Member may elect not to make an additional Capital Contribution or may default in his/her obligation to make an additional Capital Contribution. There are several possible remedies:

- Simple dilution of the Member's interest – where interests are based on Capital Accounts and not Units, a Capital Contribution by one Member not matched by another Member will change the ratio between the Members;
- Penalty dilution – where a Member is obligated to make a Capital Contribution but fails to do so, the defaulting Member suffers accelerated dilution in his/her Capital Account and membership Interest.
- Treatment as a loan – where the Members who contribute the defaulting Member's additional Capital Contribution treat the amount contributed as a loan secured by the Member's Capital Account and Membership Interest. For a further discussion, see §5.4.1 of the accompanying outline, *Taking Interests in LLCs and LLPs As Collateral For Debt Repayment*.

(b) In issuing such additional Units, the Managers may determine all restrictions and conditions applicable to such Units, including (without limitation) restrictions and conditions such as:

- (i) Whether the Units are Class A Units, Class B Units, or Units of a new Class or series;
- (ii) Whether the Units are entitled to Vote;
- (iii) Whether the Units or any portion thereof vest over time or are based on performance or other criteria;⁵⁰
- (iv) The consideration to be paid for the additional Units;
- (v) The economic terms of such Units (including, without limitation, their right to share in the Net Profits and Net Losses of the Company, whether the Units are entitled to a preferential or subordinated return, and any special allocations attributable to such Units);
- (vi) Whether the holders of existing Units have any preemptive rights to acquire the additional Units;
- (vii) The effective date of admission of the purchaser as a Member;⁵¹ and
- (viii) Other conditions of issuance or attributes of the Units (financial or otherwise) the Managers may determine to be appropriate in the circumstances.

(c) No Person who acquires additional Units may be admitted as a Member unless the Managers specifically approve such admission and unless such Person executes and agrees to be bound by the provisions of this Operating Agreement.

⁵⁰ Where Units are issued for services and are subject to vesting, the recipient and the LLC should consider the potential applicability of Code § 83(b). Unless the § 83(b) election is made, the unvested Units will be taxed only later when they vest – when the “substantial risk of forfeiture” lapses. At the time of the initial grant (especially if a booking-up has occurred and only a profits interest is granted), an immediate § 83(b) election should have no tax consequences to the recipient. Any § 83(b) election must be made within 30 days of the receipt of the taxable interest and must comply with Regulations § 1.83-2.

⁵¹ Note § 11.6(b) of the Operating Agreement which provides in part that transfers/admissions of Members are “deemed effective as of the last day of the calendar month in which the required approval thereto was given.” The Managers may choose a different effective date for the Transfer.

(d) The Company may issue options to purchase Units for consideration, and on other terms and conditions, determined by the Managers, subject to the limitations and provisions of this Agreement. In issuing options to purchase such Units, the Managers may determine all restrictions and conditions applicable to such Units as set forth in Section 8.3(b), above, the exercise price for such options, the term of such options, whether, upon exercise, the option holder will be admitted as a Member, and other terms and conditions as the Managers may determined to be appropriate. No Person who acquires additional Units pursuant to the exercise of an option may be admitted as a Member unless the Managers specifically approve such admission (either at the time of issuance of the option or upon exercise thereof) and unless such Person executes and agrees to be bound by the provisions of this Operating Agreement. No option holder will be treated as a Member or Assignee.

8.4 Capital Accounts. The Company will maintain a separate Capital Account for each Member and Assignee in accordance with the Code and the applicable Regulations. All provisions in this Agreement relating to the maintenance of Capital Accounts are intended to comply with Treasury Reg. §1.704-1(b) and §1.704-2 and shall be interpreted and applied in a manner consistent with these Regulations. In the event that Members shall determine that it is prudent to modify the manner in which the Capital Accounts, or any additions or subtractions to the Capital Accounts, are computed to comply with these Regulations, the Members may make appropriate modifications, provided that the modifications are not likely to materially affect the amounts distributable to any Member or Assignee upon the dissolution of the Company. The Members and Assignees shall also make (a) any adjustments that are necessary or appropriate to maintain equality between the Capital Accounts of the Members and Assignees and the amount of capital reflected on the Company's balance sheet, as computed for book purposes, in accordance with the applicable Treasury Regulations, and (b) any appropriate modifications in the event that this Agreement would otherwise not comply with Regulations § 1.704-1(b) and § 1.704-2. In addition, the Managers, in their discretion and in accordance with the Code and Regulations, may direct the Company to increase the Members' and Assignees Capital Accounts to reflect a revaluation of the Company property on the Company's books and records. Any such adjustment shall be made in accordance with the applicable Treasury Regulations.

8.5 Withdrawal or Reduction of Economic Interest owners' Contributions to Capital. A Member may withdraw or resign as a Member at any time.⁵² A Member's withdrawal or resignation shall cause the Member to be treated as an Assignee for all purposes. No withdrawal or resignation shall entitle the former Member or his or her successor to demand that the Economic Interest be liquidated. Any Member resigning or withdrawing from the Company that results in damage or injury to the Company will be liable to the Company for such damages which damages may be offset against the former Member's Economic Interest.

⁵² §7-80-603 provides that a "member who has resigned or withdrawn has no right to participate in the management of the business and affairs of the" company "and is entitled only to receive the share of the profits or other compensation by way of income and the return of contributions to which such member would have been entitled if the member had not resigned or withdrawn."

8.6 Limitation of Distributions. No person is entitled to receive a Distribution of any part of its Capital Contribution to the extent such Distribution would violate Section 9.2(d). No Member or Assignee, irrespective of the nature of its Capital Contribution, has the right to demand and receive property other than cash in return for its Capital Contribution.⁵³

8.7 No Pre-emptive Rights. No person has the pre-emptive right by reason of being a Member or Assignee to acquire any additional Units that the Company may issue.

8.8 Carry Over Capital Account. If any person transfers an interest in accordance with this Agreement, the transferee shall succeed to the Capital Account of the transferor to the extent it relates to such Units.

⁵³ This is consistent with the first sentence of §7-80-604. Note the contrary provision in Section 10.2(a)(i).

ARTICLE 9)

ALLOCATIONS, INCOME TAX, DISTRIBUTIONS, AND REPORTS

9.1 Allocations of Net Profits and Net Losses.

(a) Subject to Section 9.1(b), the Net Profits and Net Losses of the Company and each other allocable item included in the Company's tax return for each fiscal year will be allocated between each Member or Assignee in accordance with the Percentage Economic Interest of such holder.⁵⁴

⁵⁴ Note that where certain "money partners" desire a return of capital before distributions are made to "service partners", other allocation provisions should be considered, including an allocation of profits to reduce prior allocation of losses to the money partners. Otherwise the money partners' capital accounts may not reflect the economic deal for a return of their capital. The following is an example of such an allocation provision where the Class A Member is the "money partner" and the Class B Member is the management partner, but who has also provided a significant capital investment. In the following example, the parties agreed that each would receive a return of their Capital Contribution, then the money partner (Class A Members) would receive a 20% annualized "preferred return", and then share a 40-60 return.

Although the allocation provision is important, it is equally important that the distribution provisions in Section 9.2 mirror the allocation provisions. Distributions, after all, equal "cash in the pocket"; allocations do not.

9.1 Allocation of Profits and Losses. (a) Except as otherwise provided in this Article 9, the Company's Net Profits and Net Losses for any fiscal year of the Company shall be allocated to the Members as follows:

(i) **Net Profits.** Net Profits for any fiscal year shall be allocated in the following order and priority:

(A) First to all Members until the cumulative Net Profits allocated pursuant to this Section 9.1(a)(i)(A) are equal to the cumulative Net Losses allocated pursuant to Section 9.1(a)(ii) for all periods;

(B) Second, to the Class A Members and Class B Member until the cumulative Net Profits allocated pursuant to this Section 9.1(a)(i)(B) are equal to their Capital Contributions (such amounts to be allocated among the Members in the ratios in which their respective Capital Contributions for each Member bear to one another);

(C) Third, ninety-nine percent (99%) to the Class A Members (in the ratios in which their Capital Contributions bear to one another), 1% to the Class B Member, until the cumulative Net Profits allocated to the Class A Members pursuant to this Section 9.1(a)(i)(C) are in excess of their Capital Contributions and up to an amount equal to a Preferred Return of 20% from the inception of the Company to the end of such fiscal year;

(D) The balance, if any, 40% to the Class A Members and 60% to the Class B Member.

(ii) **Net Losses.** Net Losses for any fiscal year shall be allocated in accordance with their Percentage Economic Interests.

(b) Guaranteed Payments and Regulatory Allocations

(i) *Guaranteed Payments.* To the extent the Company pays guaranteed payments or compensation (as described in Section 5.12 or otherwise) or interest earned on money the Company borrowed from a Member or Assignee under Section 6.4, and if such guaranteed payment, compensation, or interest is later held to be a distribution, the Company will specially allocate Net Profits to the Member or Assignee who received such guaranteed payment, compensation, or interest in a positive amount equal to the amount of such guaranteed payment, compensation, or interest that was reclassified as a distribution.

(ii) *Qualified Income Offset.* In the event any Member or Assignee has a Deficit Capital Account at the end of any year or if any Member or Assignee unexpected receives any adjustments, allocations or distributions that results in a Deficit Capital Account, each such Member or Assignee shall be specially allocated items of Company income and gain in the amount of such Deficit Capital Account as quickly as possible, provided that an allocation pursuant to this Section 9.1(b)(ii) shall be made only if and to the extent that such Member or Assignee would have a Deficit Capital Account in excess of such sum after all other allocations provided for in this Section 9.1 have been made as if Section 9.1(b)(ii) was not in the Operating Agreement. This Section 9.1(b)(ii) is intended to constitute a “qualified income offset” within the meaning of Regulations § 1.704-1(b)(2)(ii)(d)(3) and shall be interpreted to comply with the requirements of such Regulation.

(iii) *Non-recourse Deductions.* Deductions attributable to non-recourse debt incurred by the Company shall be specially allocated among the Members and Assignees in proportion to such Person’s Percentage Economic Interest and in accordance with Regulations §1.704-2(c).

(iv) *Code § 754 Adjustment.*⁵⁵ The Managers may cause the Company to make a §754 election when, in their discretion, they deem it appropriate to do so. To the extent an

⁵⁵ Section 754 basis adjustment applies when a partnership interest change hands, either by sale or exchange or upon death of a partner or when a partnership makes a distribution. If a partnership has a §754 election in effect, the partnership will adjust its inside basis with respect to the transferee partner only.

Whether or not to make a §754 election when available is a question for qualified tax practitioners. Willis, *et al.*, *Partnership Taxation* (Warren, Gorham & Lamont, 5th Ed. 1997) at ¶12.03[1] describes the §754 election as follows: “Section 743(b) provides for adjustments to the basis of partnership property as the result of a sale or exchange of a partnership interest or the transfer of a partnership interest on the death of a partner if a §754 election is in effect. Without such an election, the purchaser of the partnership interest typically has a basis (outside basis) for that interest which differs from the purchasing partner’s share of the bases of the assets in the partnership (inside

adjustment to the adjusted tax basis of any Company asset pursuant to Code § 734(b) or Code § 743(b) is required (pursuant to Regulations § 1.704-1(b) or otherwise) to be taken into account in determining Capital Accounts, the amount of such adjustment to the Capital Accounts shall be treated as an item of gain (if the adjustment increases the basis of the asset) or loss (if the adjustment decreases such basis) and such gain or loss shall be specially allocated to the Members and Assignees in accordance with their interests in the Company or to the Member or Assignee to whom such distribution was made as may be required by Regulations § 1.704-1(b) or otherwise.

(v) *Minimum Gain Chargeback.* Notwithstanding any other provision of this Section 9.1, if there is a net decrease in the Partnership Minimum Gain during a taxable year of the Company, then, the Capital Accounts of each Member and Assignee shall be allocated items of Net Profits for such year (and if necessary for subsequent years) equal to that person's share of the net decrease in the Partnership Minimum Gain. This Section 9.1(b)(v) is intended to comply with the minimum gain chargeback requirement of Regulations § 1.704-2 and shall be interpreted consistently therewith. If in any taxable year that the Company has a net decrease in the Partnership Minimum Gain, if the minimum gain chargeback requirement would cause a distortion in the economic arrangement among the holders of Economic Interests and it is not expected that the Company will have sufficient other income to correct that distortion, the Managers may in their discretion (and shall, if requested to do so by a Member) seek to have the Internal Revenue Service waive the minimum gain chargeback requirement in accordance with Regulations § 1.704-2(f)(4).

(vi) *Curative Allocations.* The allocations set forth in Sections 9.1(b)(ii) through (v) (the "Regulatory Allocations") are intended to comply with certain requirements of the Regulations. It is the intent of the Members that, to the extent possible, all Regulatory Allocations shall be offset either with other Regulatory Allocations or with special allocations of Net Profits and Net Losses and other items of Company income, gain, loss, or deduction pursuant to this Section 9.1. Therefore, notwithstanding any other provision of this Article 9 (other than the Regulatory Allocations), the Managers shall make such offsetting special allocations of Net Profits and Net Losses and other items of Company income, gain, loss or deduction in whatever manner they determine appropriate so that, after such offsetting allocations are made, each Member's and Assignee's Capital

basis). Such disparities can also lead to income tax consequences for the acquiring partner with respect to pre-acquisition appreciation or depreciation of the partnership's assets.

With a §754 election in effect, the §743(b) adjustment will eliminate many of these adverse consequences to the purchaser." However, once a §754 election is made, it cannot be revoked with the consent of the IRS. It also requires the partnership entity to separately track each partner's inside basis as compared to tax basis, and future transfers of partnership interests will result in a §754 adjustment. For a good discussion of the pro's and con's of the §754 adjustment, see Zisman and Daniel, *IRC §754 and the Probate Practitioner*, 36 The Colo. L. 45 (June 2007).

Account balance is, to the extent possible, equal to the Capital Account balance such Member or Assignee would have had if the Regulatory Allocations were not part of the Operating Agreement and all Company items were allocated pursuant to Section 9.1(a). In exercising their discretion under this Section 9.1(b)(vi), the Managers shall take into account future Regulatory Allocations that, although not yet made, are likely to offset other Regulatory Allocations previously made.

(vii) *Other Allocation Rules.*

(A) *When Allocations Are Made.* Net Profits and Net Losses and any other items of income, gain, loss or deduction shall be allocated to the Members and Assignees pursuant to this Section 9.1 as of the last day of each year; provided that Net Profits and Net Losses and such other items shall also be allocated at such times as the Fair Market Values of the Company's property are adjusted.

(B) *Varying Interest.* For purposes of determining the Net Profits and Net Losses or any other items allocable to any period, Net Profits and Net Losses and any such other items shall be determined on a monthly, or other basis, as determined by the Managers using any permissible method under Code §706 and the Regulations thereunder.

(C) *Consistent Reporting of Allocations.* The Members and Assignees are aware of the income tax consequences of the allocations made by this Section 9.1 and hereby agree to be bound by the provisions of this Section 9.1 in reporting their respective share of Net Profits and Net Losses and other allocable items for income tax purposes, except to the extent otherwise required by law.

(D) *Sharing Excess Non-recourse Liabilities.* Solely for purposes of determining a Member's or Assignee's proportionate share of the "excess non-recourse liabilities" of the Company within the meaning of Regulations § 1.752-3(a)(3) (if any), the Members' and Assignees' interests in Company profits are in proportion to such Person's Percentage Economic Interest.

(E) *Treatment of Distributed Loan Proceeds.* To the extent permitted by Regulations § 1.704-2(h)(3), the Managers shall endeavor not to treat distributions of cash available for distribution as having been made from the proceeds of a non-recourse liability or a Member non-recourse debt.

(F) *Part Year Allocations with respect to Transferred Interests.* No Person shall be entitled to any retroactive allocation of Net Profits or Net Losses incurred by the Company. At the time a Transfer of any Units occurs pursuant to the requirements of this Agreement, the Managers may, at their option, close the Company books (as though the Company Fiscal Year had ended) or make a *pro rata* allocation of Net Profits and Net

Losses to the transferor for that portion of the Fiscal Year during which the transferor was an owner of an Unit.

(ix) *Tax Allocations: Code § 704(c).*⁵⁶

(A) *Code § 704(c) Allocations.* (i) In accordance with Code §704(c) and the Regulations thereunder, income, gain, loss, and deduction with respect to any property contributed as a Capital Contribution to the Company shall, solely for tax purposes, be allocated among the Members and Assignees so as to take account of any variation between the adjusted basis of such property to the Company for federal income tax purposes and its Fair Market Value at the time of contribution.

(ii) The Capital Accounts of the Members shall be increased or decreased to reflect a revaluation of Company property (including intangible assets such as goodwill) on the Company's books in connection with a Revaluation Event. Upon such revaluation:⁵⁷ (1) the book value of Company property shall be adjusted based on the Fair Market Value of Company property (taking Code § 7701(g) into account) on the date of the Revaluation Event; and (2) the unrealized income, gain, loss, or deduction inherent in such Company property (that has not been reflected in the Capital Accounts previously) shall be allocated among the Members as if there were a taxable disposition of such Company property for such fair market value on the date of the Revaluation Event.

For the purposes of this paragraph, the term *Revaluation Event* means:

(A) The acquisition of an interest in the Company by any new or existing Member or Assignee in exchange for more than a *de minimis* Capital Contribution, or

(B) The liquidation of the Company or a distribution by the Company to a Member or

⁵⁶ Section 704(c) requires that taxable income and deductions “with respect to property contributed to the partnership by a partner shall be shared amongn the partners so as to take account of” any basis/value difference at the time of the contribution. This ability to “book-up” may be important if an LLC issues an Economic Interest to a person at the time when there is appreciated property in the LLC. If there are two Members with a \$1 million basis in property worth \$2 million at the time they want to issue an Economic Interest to a partner (service or cash), this allows them to avoid allocating a portion of the unrealized appreciation to the new partner. This also benefits the new partner who would possibly be receiving taxable income to the extent of his share of the unrealized appreciation. Since most cash partners will be paying for a percentage of the unrealized appreciation, this is less significant than to a new service partner who will have no basis in the newly-issued Economic Interest.

⁵⁷ This is also referred to as “booking-up”, an optional, but frequently appropriate revaluation of capital accounts to protect the economic rights of existing members when new members are admitted, and to prevent unintended allocation of ordinary income to a services member joining an LLC or partnership. For a more detailed discussion of ‘booking-up,’ see Lidstone, “*Admitting New Members to an LLC and ‘Booking-Up’ Capital Accounts,*” 37 The Colo. L. no. 4 at 19 (April 2008) available at <http://www.cobar.org/index.cfm/ID/20017/The-Colorado-Lawyer>.

Assignee of more than a *de minimis* amount of Company property as consideration for an interest in the Company, or

(C) The grant of an interest in the partnership (other than a *de minimis* interest) as consideration for the provision of services to or for the benefit of the partnership by an existing partner acting in a partner capacity, or by a new partner acting in a partner capacity or in anticipation of being a partner, or

(D) as may otherwise be permitted by Regulations § 1.704-1(b)(2)(iv)(f).

Subsequent allocations of Profits and Losses with respect to such property shall take account of any variation between the adjusted basis of such property for federal income tax purposes and its Fair Market Value in the same manner as under Code § 704(c), using any method described in Regulations § 1.704-3 as determined by the Managers. The foregoing adjustments shall be made only if they are necessary or appropriate to reflect the relative economic interests of the Members and Assignees in the Company.

(B) *Elections.* Any elections or other decisions relating to such allocations shall be made by the Managers in any manner that reasonably reflects the purpose and intention of this Operating Agreement, provided that the Company shall elect to apply the traditional allocation method permitted by the Regulations under Code § 704(c). Allocations pursuant to this Section 9.1(b)(ix) are solely for purposes of federal, state, and local taxes and shall not affect, or in any way be taken into account in computing, any Person's Capital Account, ownership of Units, or distributions pursuant to any provision of this Operating Agreement.

(C) *Residual Allocations.* Except as otherwise provided in this Operating Agreement, all items of Company income, gain, loss, deduction, and any other allocations not otherwise provided for shall be divided among the Members and Assignees in accordance with such Person's Percentage Economic Interest.

9.2 Distributions.

(a) Except as provided in Sections 9.2(b) or 10.2, all distributions of Distributable Cash shall be made to the Members and Assignees in accordance with such person's Percentage Economic Interest.⁵⁸

⁵⁸ The method of making distributions is an economic decision – whether first to return Capital Accounts (i.e., investments, and perhaps a return on investment) or to make distributions in accordance with ownership percentage (which may be significantly different). In the first note associated with section 9.1 of this Operating Agreement, there is a possible allocation provision favoring an early return of Capital Contributions. If this is intended, the distribution provisions should mirror the allocations so that Distributable Cash is similarly paid to those who contributed Capital to the LLC ahead of those who contributed services.

(b) The Company shall make such distributions of Distributable Cash at such time or times as the Managers determine in their sole discretion. To the extent the Managers can do so without materially adversely affecting the Business, the Managers will cause the Company to make distributions to Members and Assignees to compensate them for taxes they may have to pay as a result of any allocations made to the Members and Assignees.⁵⁹ For the purpose of this requirement (and unless otherwise required this Operating Agreement (including, without limitation, Section 10.2)), each Member and Assignee will be treated identically to the extent of such holder's Percentage Economic Interest, and the Managers may determine the appropriate amount of distribution to be made.⁶⁰

(c) The Managers may compel the Members and Assignees to accept distributions from the Company in a form other than cash provided the person's Percentage Economic Interest in the distribution is equal to the percentage in which the Member or Assignee shares in distributions as provided in this Section 9.2.⁶¹

(d) The Company will not make any distribution if such distribution would violate the Colorado Act.⁶²

⁵⁹ Alternatively, the Operating Agreement can state that distributions equal to a specified percentage of net income will be made – mandatory instead of advisable.

⁶⁰ This provision provides an asset-protection planning consideration where the LLC commits to make tax payments on behalf of its members. *In re Kenrob Information Technology Solutions, Inc.*, 474 B.R.799, 2012 WL 2819315, Bkrcty.E.D.Va., July 10, 2012. In the *Kenrob* case, the bankruptcy trustee attempted to recover from the U.S. Treasury as a fraudulent transfer payments made by the S corporation directly to the IRS on behalf of its shareholders (which payments were mandated by what the court described as “an undocumented shareholders’ agreement” but “pursuant to an established course of dealing”). According to the court, the shareholders’ agreement “required Kenrob to reimburse each shareholder with sufficient cash to fund the payment of federal and state income tax liabilities.” The Treasury defended the fraudulent transfer case by claiming that it (the United States) had provided valuable consideration by reduction of tax liabilities and penalties. Arguably as written, the “distributable cash” undertaking may not be sufficient to achieve this asset protection benefit since it is not a requirement or the agreement and if (as in *Kenrob*) the LLC were considering bankruptcy, there probably is no distributable cash. In the S corporation context, extra care has to be taken that any payment directly of income taxes is always proportionate to share ownership to avoid losing the S election; in the LLC context, the payments should also be in accordance with ownership interests to avoid an argument that the parties disregarded the agreement.

⁶¹ § 7-80-604 provides that a member may not be compelled to accept a distribution of any asset in kind from an LLC to the extent that the percentage of the asset distributed to the member exceeds a percentage of that asset that is equal to the percentage in which the member shares in distributions from the LLC. *Compare with* § 7-64-402 under CUPA which provides that a partner “may not be required to accept a distribution in kind.”

⁶² Note § 7-80-606 which prohibits a distribution “to the extent that at the time of distribution, after giving effect to the distribution, all liabilities of the . . . company, other than liabilities to members on account of their limited liability company interests and liabilities for which the recourse of creditors is limited to a specific property of the limited liability company, exceed the fair value of the assets of the limited liability company.” The section goes on to provide that property value which exceeds the liability against the property can be included in the

9.3 Accounting Principles. The Net Profits and Net Losses of the Company and other allocable items shall be determined in accordance with accounting principles applied on a consistent basis using the cash or accrual method of accounting as the Managers may determine to be appropriate.

9.4 Interest On and Return of Capital Contributions. No Member or Assignee shall be entitled to interest on his Capital Contribution or to return of his Capital Contribution.

9.5 Accounting Period. The Company's accounting period (also referred to herein as the Company's fiscal year) shall be the calendar year.

9.6 Withholding. All Distributions to owners of an Economic Interest will be subject to withholding if required by the Code or other applicable law. All amounts so withheld nonetheless will be deemed to have been distributed to such owner.

9.7 Inspection of Books and Records.⁶³

(a) Upon reasonable Notice to the Company, the Members (at their own expense) shall have the right to inspect the Company's books and records during normal business hours in a manner the Managers reasonably believe will minimize any adverse impact of such inspection on the Business and to minimize the disclosure of Confidential Information.

(b) If requested by any Member in writing and at the Member's expense, the Managers, acting on behalf of the Company, shall choose and hire a qualified independent auditor to conduct an audit of the Company's financials (not more than once per fifteen month period). Upon completion of such audit, the Company shall make the results and any reports available to all Members. If the audit reveals discrepancies of greater than 10% with respect to any material item (such as annual revenues or net income) from the financial statements prepared by the Company for the period in question, the Company will reimburse the Member for the costs of the audit.

calculation of the fair value of the assets. Distributions under §7-80-606(1) does not include reasonable compensation for present or past services.

Importantly, under §7-80-606(2), a Member who receives a distribution in violation of the statute and **who knew** of the violation is liable to the company for the full amount of the distribution. On the other hand, a Member who receives a distribution in violation of the statute and **who did not know** of the violation is (under the statute) **not liable**. Where liability exists, it extends for three years from the date of the distribution. §7-80-606(3).

⁶³ C.R.S. § 7-80-408 provides inspection rights for Members, but not Assignees. These rights can be reasonably explained, but not waived.

9.8 Reports. The Managers shall prepare and provide such reports for the Members as the Managers determine necessary or appropriate in the circumstances. Such reports shall include financial information regarding the Company, but such financial information does not need to be audited. To the extent the Managers determine it appropriate to provide a copy of the budget and operating plan to the Members, the Managers may summarize information contained therein to prevent the disclosure of Confidential Information. The Managers will provide reports to Assignees permitted under this Operating Agreement to the same extent that the Managers provide reports to Members.

ARTICLE 10)

DISSOLUTION AND TERMINATION

10.1 Dissolution. The Company shall be dissolved:

- (a) upon the Vote of Members holding a Three-Fourths Interest;
- (b) The sale, transfer, or assignment of all or substantially all of the assets of the Company;
- (c) there being no Members unless, within 91 days after the termination of the membership of the last Member, the Assignees of the last Member holding at least a Majority Interest in the Company held by the last Member at the time of his or her withdrawal, resignation, or death, have admitted at least one person as a Member;⁶⁴ and
- (d) as otherwise required by law.⁶⁵

10.2 Winding Up, Liquidation and Distribution of Assets Upon dissolution, the Company shall prepare an accounting of the accounts of the Company and of the Company's assets, liabilities and operations, from the date of the last previous accounting until the date of dissolution. The Managers may continue to conduct the Business in a manner to maximize the liquidation proceeds of the Business to the Company, and shall immediately proceed to wind up the Company's affairs.

⁶⁴ The statute (§ 7-80-701(2)) requires unanimity of the assignees or transferees of the last remaining member of the LLC, but this can be reduced by the operating agreement. If the interest holders do not admit a Member, the statute provides that the Company will dissolve on "the ninety-first day after the limited liability company ceases to have members unless, prior to that date, a person has been admitted as a member." §7-80-801(1)(c)(I). Section 7-80-108(d.5) provides that the operating agreement may extend this 91 day period to "not later than the first anniversary of the date of the termination of the membership of the last remaining member."

⁶⁵ Consider adding a provision by which a court, in an action for judicial dissolution, may fashion a less drastic remedy. This may be useful where a minority believes he/she is being oppressed, but the business is operating well and dissolution would not be in any party's best interest.

(a) If the Company is dissolved and its affairs are to be wound up, the Managers shall:

(i) Sell or otherwise liquidate all of the Company's assets as promptly as practicable (except to the extent the Managers may determine to distribute any assets to the Members and Assignees in kind) and, if any assets of the Company are to be distributed in kind (*pro rata* or in such other manner as the Managers may determine appropriate in the circumstances),⁶⁶ the net Fair Market Value of such assets as of the date of dissolution shall be determined by negotiation among the Members (requiring the consent of a Majority Interest of the Members to whom the assets are not being distributed) or by independent appraisal. Such assets shall be deemed to have been sold as of the date of dissolution, and any Net Profits or Net Losses resulting from such sales or deemed sales shall be allocated to the Members' and Assignees' Capital Accounts in accordance with Article 9 hereof;

(ii) Discharge all liabilities of the Company, including liabilities to Members and Assignees who are also creditors, to the extent otherwise permitted by law, other than liabilities to Members and Assignees for distributions and the return of capital, and establish such reserves as may be reasonably necessary to provide for the Company's contingent liabilities (for purposes of determining the Capital Accounts of the Members and Assignees, the amounts of such reserves shall be deemed to be an expense of the Company); and

(iii) Distribute the remaining assets in the following order:

(A) Distribute to the Members and Assignees the remaining assets in accordance with the positive balance (if any) of each Member's and Assignee's Capital Account (as determined after taking into account all Capital Account adjustments for the Company's taxable year during which the liquidation occurs), either in cash or in kind, as determined by the Managers, with any assets distributed in kind being valued for this purpose at their Fair Market Value. Any such distributions to the Members and Assignees in respect of their Capital Accounts shall be made in accordance with the time requirements set forth in the Regulations.⁶⁷

⁶⁶ § 7-80-604, second sentence, provides that members may not be compelled to accept a distribution of any asset in kind "to the extent that the percentage of the asset distributed to the member exceeds" that member's proportionate interest in the company. This can be modified by the operating agreement.

⁶⁷ This is probably the most important provision in the operating agreement from a tax perspective – this is the provision that gives any special allocations contained above "substantial economic effect" – at the end of the day, upon liquidation, there will first be a return of Capital Accounts before other distributions are made. Since allocations and distributions have affected Capital Accounts during the operation of the LLC, this may or may not result in a return of cash contributions.

(B) Thereafter distribute to the Members and Assignees in accordance with their Percentage Economic Interests.

(b) Notwithstanding anything to the contrary in this Operating Agreement, upon a liquidation within the meaning of Regulations § 1.704-1(b), if any Member or Assignee has a deficit Capital Account (after giving effect to all contributions, distributions, allocations and other Capital Account adjustments for all taxable years, including the year during which such liquidation occurs), such Member or Assignee shall have no obligation to make any Capital Contribution, and the negative balance of such Member's or Assignee's Deficit Capital Account shall not be considered a debt owed by such Member or Assignee to the Company or to any other Person for any purpose whatsoever.

(c) Upon completion of the winding up, liquidation and distribution of the assets, the Company shall be deemed terminated.

(d) The Managers shall comply with any applicable requirements of applicable law pertaining to the winding up of the affairs of the Company and the final distribution of its assets.

10.3 Return of Contribution Non-recourse to Other Members. Except as required by law or as expressly provided in this Operating Agreement, upon dissolution, each Member and Assignee shall look solely to the assets of the Company for the return of his Capital Contribution. If the Company property remaining after the payment or discharge of the debts and liabilities of the Company is insufficient to return the Capital Contribution or any preferential return of one or more Members and Assignees, such Members or Assignees shall have no recourse against any other Member or Assignee.⁶⁸

ARTICLE 11)

BUY-SELL PROVISIONS

11.1 Transfers Void; Effect.

(a) Except as contemplated in Section 11.1(b) and 11.1(c), should any Member or Assignee attempt to sell, transfer, assign, or in any way alienate all or any portion of his Economic Interest by charging order⁶⁹ against the Member or Assignee, or otherwise

⁶⁸ While the Members can contractually agree that return of capital is non-recourse to the other Members, §7-80-607 provides for potential liability of Members receiving a return of their contributions to the Company for six years when the return of capital is made in violation of the Operating Agreement or the LLC Act.

⁶⁹ There are a number of issues when a charging order is granted against a member's interest in a multi-

(“Transferred Interest”) to a Person not then a Member, whether now owned or hereafter acquired, without the prior written consent of the Managers (whether such transfer is voluntary or involuntary, by operation of law, by court order or otherwise) during the period ending _____ years after the date the Company was formed (the “Restricted Period”), such attempted sale, transfer, assignment, or other form of alienation shall be deemed to be void *ab initio*, and this shall be considered to be a “Terminating Event.”⁷⁰

(i) After the Restricted Period, all transfers must be accomplished in accordance with the requirements of federal and applicable state securities laws, compliance with which must be established to the satisfaction of the Managers.

(ii) For the purposes of this Article 11, where a Member or Assignee is an entity, the term “transfer” includes a transfer of ownership of such Member or Assignee resulting in the direct or indirect owners thereof owning less than 75% ownership interest in such Member or Assignee. It is the intent of this provision, where an entity is a Member or Assignee of the Company, to require the direct or (where an entity Member or Assignee is owned by one or more other entities) indirect ownership of the owners of

member LLC. One thought is to organize in states where the charging order is a sole remedy, but this may or may not be effective if litigation is brought in another state. See Lidstone, *Single Member LLCs and Asset Protection*, 41 The Colo. L., No. 3 at 39 (Mar. 2012) and Bishop & Kleinberger, *Limited Liability Companies: Tax and Business Law* (Warren Gorham & Lamont, 1994, Supp. 2011-2), para. 5.04[2]c[[iii], entitled *Which court and which law?*, Practice Pointer.

⁷⁰ Transferability restrictions are usually important in small businesses where the proprietors want to choose their partners. Since an interest in an LLC or an LLP is considered to be “personal property,” [C.R.S. § 7-80-702(1) [LLC], § 7-64-502 [CUPA], and § 7-60-126 [CUPL]] it is transferable as is personal property, subject to contractual and legal restrictions. Contractual restrictions may include a buy-sell agreement contained in the operating agreement, partnership agreement, or other agreement. *Condo v. Conners*, ___ P.2d. ___, 10SC703 (Colo. Dec. 19, 2011), citing *Parrish v. Rocky Mountain Hosp. & Med. Servs. Co.*, 754 P.2d 1180, 1182 (Colo. App. 1983). See, also, *Parrish Chiropractic Centers, P.C. v. Progressive Casualty Insurance Co.*, 874 P.2d 1049 (Colo. 1994).

In *Condo v. Conners*, the trial court granted summary judgment to an LLC and its members when it refused to permit the transfer of a membership interest to the member’s ex-wife as part of the divorce settlement. The LLC’s operating agreement contained an anti-assignment clause requiring the written approval of all members. The ex-wife sued for tortious interference with a contract when the LLC refused to recognize her as a member. The wife claimed that, while the operating agreement’s anti-assignment clause might subject the husband who violated the contractual provision to damages, it does not negate the assignment itself which remains effective. In rejecting the wife’s claim, the Colorado Supreme Court accepted what it described as the “classic approach” which interprets an anti-assignment clause “as a restriction on the power of any member to assign an interest, and thus any nonconforming assignment has no legal effect.” Opposing the “classic approach” is the so-called “modern approach” described in *Rumbin v. Utical Mutual Insurance Co.*, 757 A.2d 526, 534 (Conn. 2000). This case provides that, absent the “magic words” stating that any nonconforming assignment is “void” or “invalid,” an anti-assignment clause merely imposes a contractual duty upon each member to refrain from assigning any contractual interest, but any assignment in breach of that duty is effective. *Condo*, at n. 4. This provision contains the “magic words.”

the entity Member or Assignee to remain substantially as at the time such entity became a Member or acquired its interest as an Assignee.⁷¹

(b) Notwithstanding the restrictions set forth in Section 11.1(a), a Member may transfer his Membership Interest by will, by laws of descent and distribution, and *inter vivos*, in each case to the Member's descendants at law (whether naturally-born or adopted). Furthermore, a Member that is an entity may transfer its Membership Interests to persons who are equity owners of such Member provided that such distribution is upon dissolution of such Member and provided further that such transfer does not result in a dissolution of the Company for tax purposes or a violation of federal or applicable state securities laws. Any transferee pursuant to this Section 11.1(b) will be considered to be an "Assignee" unless and until such person executes and returns to the Company this Operating Agreement (as it may be amended in the future) at which point such person will be deemed admitted as a Member pursuant to this Operating Agreement. This right only applies to the transferee receiving its interest directly from such Member, and does not apply to subsequent transferees.

(c) If a Member or Assignee (the "Selling Owner") wishes to dispose of its Membership Interest or Economic Interest or any portion thereof (the "Offered Units") through a voluntary sale or other disposition,⁷² including but not limited to a sale to another Member⁷³:

⁷¹ This "change of control" provision is appropriate where entities are admitted as Members or permitted to be Assignees. Otherwise, ownership of an LLC interest by an entity can avoid the transferability restrictions of the operating agreement by transferring an interest in the ownership entity in lieu of transferring an interest in the Company.

⁷² Note that if a Member sells all of its Economic Interest in an LLC, the Person ceases to be a Member. C.R.S. § 7-80-702(2).

⁷³ See *Achaian, Inc. v. Leemon Family LLC*, 25 A.3d 800 (Del. Ch. 2011) where a 30% member transferred his entire interest to a 20% member, thus creating a deadlock with the 50% member. The 50% member attempted to treat the assignee as merely an economic interest holder with respect to the 30% received in the assignment – a position not upheld by the Delaware Chancery Court. In opposition to *Achaian*, William Callison (Faegre Baker Daniels) made the following comments by email on April 23, 2013:

In the deep for what it is worth category, when I read *Achaian* I thought it was wrong and that member consent should be needed for transfers of non-economic interests even if the transfer is to someone who is already a member. I think members bargain for a particular deal (not just particular people), and transfers that create deadlock can be antithetical to that deal. Of course operating agreement provisions can permit nonconsensual inter-member transfers, but that was not *Achaian* facts. I have not re-read *Achaian*, but I would be surprised if I changed my mind on a re-read. Delaware can say whatever Delaware says, but in other states I would not rely on *Achaian* and would be careful to delineate power in an operating agreement if consent is not required. If there were no operating agreement provision, I would argue against *Achaian* application.

If this is an issue in the operating agreement or among the members, whether an existing member is a permitted transferee should be addressed.

(i) The Selling Owner shall first notify the Company, and the Company shall in turn notify the other Members (and in the discretion of the Managers, the Economic Interest Owners who are not Members) of the identities of the Selling Owner and the proposed purchaser or purchasers, the number of Offered Units and the proposed price and other terms of sale. The Selling Owner shall provide copies of the offer and other related documents to the Company and to the other Members and Assignees.

(ii) The Company shall have a right of first refusal (but not the obligation) to purchase the Offered Units or any portion thereof at the Buy-Out Price (as set forth in Section 11.2) and on the terms set forth in Section 11.3, or at the price and on the terms offered by the proposed purchaser, whichever the Company may select.

(iii) The Company shall exercise its right to purchase the Offered Units by giving notice to all Members and Assignees, indicating the number of Offered Units it will purchase, within 20 days following receipt of the notice from the Selling Owner, and shall complete the purchase in accordance with the terms hereof within 50 days after the expiration of the 20 day period.

(d) If the Company does not exercise its right to purchase with respect to all of the Offered Units, the other Members (and, in the discretion of the Managers, the other Economic Interest holders who are not Members) shall have the right (but not the obligation) to purchase any of the Offered Units not purchased by the Company at the same prices and terms as were available to the Company.

(i) In order to exercise their purchase rights, the other Members and Assignees shall, within 20 days after receiving notice from the Company that it intends to purchase fewer than all of the Offered Units, deliver to the Company a written election to purchase so many of the “Remaining Offered Units” as each may desire to purchase, specifying that such Person will purchase at the Buy-Out Price and pursuant to the terms set forth in Section 11.3, or at the price and terms offered by the proposed purchaser, and shall complete the purchase in accordance with the terms hereof within 30 days after the expiration of the 20 day period.

(ii) If the total number of Units that all other Members and Assignees desire to purchase exceeds the number of Remaining Offered Units, each such other Member and Assignee shall have priority, up to the number of Membership Interest set forth in its written election, to that fraction of the Remaining Offered Units in which the numerator is the number of Membership Interest owned by the purchasing Member and the denominator is the number of Membership Interest owned by all Members who elect to purchase. That portion of the Remaining Offered Units not purchased on such a priority basis shall be allocated in one or more successive allocations to those Members who have indicated in their written elections that they desire to purchase more than the number of

Membership Interest to which they have a priority right, with the allocation determined by the fraction, the numerator of which is the number of Membership Interest owned by such purchasing Member and the denominator is the number of Membership Interest owned by all such purchasing Members.

(e) If the Company and the other Members and Assignees do not purchase all of the Offered Units pursuant to Sections 11.1(c), they will not be entitled to purchase any of the Offered Units without the agreement of the Selling Owner.⁷⁴ Furthermore, subject to Section 11.1(f), Section 11.1(g), Section 11.1(h) and Section 11.1(i) hereof, the Selling Owner shall be free for a period of 30 days thereafter to sell all (but not less than all) of the Offered Units to the same purchaser or purchasers who offered to purchase the Offered Units, at the same price and on the same terms set forth in the Selling Owner's notice of intended sale.

(f) If the number of Offered Units exceeds 20% of the total number of Units outstanding and if the Company or the remaining Members and Assignees do not purchase all of the Offered Units pursuant to Section 11.1(c), above, the remaining Members and Assignees must be willing and able to sell all of the Membership Interest and Economic Interest that each owns to the purchaser⁷⁵ at the same price and on the same terms and conditions set forth in the Selling Owner's notice of intended sale (except that to the extent the price and terms offered to the Selling Owner contain any non-cash items or a deferred obligation, such non-cash items or deferred obligation must be monetized to present value for the benefit of the Members other than the Selling Owner and the transaction must result in cash being paid to the other Members and Assignees at the closing in lieu of any non-cash item or deferred payment obligation). The purchaser shall give notice to the remaining Members and Assignees of its intention to exercise this right not later than the date that the purchaser completes the transaction with the Selling Owner, and the remaining Members shall have a minimum of 30 days to complete the transaction.⁷⁶ The completion of the sale by the Selling Owner must occur at the same time as or after the completion of the sale by any other Members or Assignees who elect to accept the purchaser's offer pursuant to this Section 11.1(f).⁷⁷

⁷⁴ This is a questionable provision – Members and Assignees can more easily make a sale unattractive to the purchaser (and therefore to the Selling Owner) where they purchase only a portion of the Offered Units. The question then is whether that is fair to the Selling Owner or consistent with the business understanding of the parties. As written, this requires that the Company and purchasing Members give the Selling Owner the full benefit of his/her anticipated bargain with the purchaser, rather than only a portion of the benefit which may result in the purchaser being unwilling to proceed.

⁷⁵ As noted in Section 11.1(a), these provisions only apply in sales to persons other than Members.

⁷⁶ This is a “come-along” right – an option for the other Members and Assignees to sell their Units to the purchaser acquiring Units from the Selling Owner. As discussed, an LLC, like a partnership, is an association of people wanting to do business together. Bringing in a third party may make the business less attractive to the remaining owners. This “come-along” provision gives them the right to exit the business. Clearly this is something that a purchaser (who is not already a Member of the LLC) should know about and negotiate in advance.

⁷⁷ It is important that the purchaser purchase the “come-along” members for cash value, since the Selling

(g) If a Selling Owner desires to sell all (and not less than all) of the Units it owns (which Units amount to more than 30% of the total number of Units outstanding) and if the other Members and Assignees do not purchase all of the Offered Units, the purchaser may require that all of the other Members sell all Units they then own on the same per share price and terms as the purchaser acquires the Offered Units (except that to the extent the price and terms offered to the Selling Owner contain any non-cash items or a deferred obligation, such non-cash items or deferred obligation must be monetized to present value for the benefit of the Members other than the Selling Owner and the transaction must result in cash being paid to the other Members and Assignees at the closing in lieu of any non-cash item or deferred payment obligation).⁷⁸

(h) In the case of a transaction under Sections 11.1(f) or 11.1(g), The Company and the other Members shall cooperate with reasonable requests for due diligence investigations by prospective purchaser, *provided, however:*

(i) The purchaser provides the Company and the other Members information reasonably satisfactory to the Company and to the other Members that it is financially capable (directly or with borrowings) of completing the purchase of all of the outstanding Units; and

(ii) The purchaser enters into confidentiality and non-use agreements as to any confidential or non-public information about the Company that the purchaser may receive in its due diligence investigation, which confidentiality and non-use agreements must be satisfactory to the Company and to the other Members in their reasonable discretion.

(iii) The purchaser makes all appropriate disclosure to the Company and to the other Members regarding its ability to complete the purchase, the source of funds for such purchase, the persons who beneficially own the proposed purchaser, and other information the other Members may reasonably request.

(i) In all cases, all transfers must be accomplished in accordance with the requirements of Section 11.6, below. In all cases, if the purchaser does not meet its requirements under Section 11.1(f), above, the sale by the Selling Owner to the purchaser, if completed, will be considered void *ab initio*.

Owner may have negotiated other arrangements which should be monetized. It is also important that the purchaser acquire the “come-along” interests first or at the same time as the Offered Units. Otherwise the purchaser may be able to take advantage of the situation.

⁷⁸ This is a “drag-along” right which forces other Members to sell to the purchaser where the purchaser is making a large-enough commitment to warrant it. Whether 30% is the appropriate number is debatable.

11.2 Should any Terminating Event occur, the Member or Assignee whose actions cause the Terminating Event shall automatically and without further action be deemed to have:

- (a) resigned as a Manager of the Company;
- (b) resigned as an officer of the Company;
- (c) resigned or withdrawn as a Member of the Company;⁷⁹
- (d) ceased having the authority to sign checks on behalf of the Company; and
- (e) offered the Transferred Interest or (in the discretion of the Managers) his entire Economic Interest (including all Units and interest in any Capital Account) to the Company (or, in the discretion of the Managers, to the Members) for a per Unit purchase price as set forth below (the “Buy-Out Price”) which offer must be accepted, if at all, by the Company or some or all of the Members within 60 days after the Company first receives written notification of the Terminating Event.

11.3 (a) The Buy-Out Price shall be calculated as unanimously agreed among the Managers (not including the withdrawing Member if a Manager) and the withdrawing Member or, if the parties are unable to agree, by an independent third party (the “Appraiser”) selected by the Managers (not including the withdrawing Member, which Appraiser shall have professional accounting valuation experience or other experience as the Managers (not including the withdrawing Member) determine appropriate).

(b) The Appraiser shall calculate the Fair Market Value of the Company as a whole, then apply a 35% discount from the Fair Market Value of the Company as a whole for lack of marketability and minority interest, and then determine the withdrawing Member’s or Assignee’s portion of the resulting Buy-Out Price.⁸⁰ Furthermore, the Appraiser will give no value to goodwill,⁸¹ trade names, or other intangible assets.

⁷⁹ There is an argument that, even if a Member transfers his or her entire Economic Interest in the LLC it does not change the person’s status as a Member with the non-economic rights to participate. It is important to note that resignation as a Member does not forfeit the individual’s Economic Interest. § 7-80-603. If the resignation violates other provisions of the operating agreement, the resigning member may be liable for damages. §7-80-602. This is similar to a wrongful dissociation in a general partnership under CUPA (§ 7-64-602).

⁸⁰ In the absence of an agreement, discounts are generally applicable for estate planning purposes. They are frequently not applicable in the context of a shareholder buy-out, corporate dissolution, dissenters’ rights, and similar transactions. See *Pueblo Bancorporation v. Lindoe Inc.*, 63 P.3d 353 (Colo. 2003). In that case, the issue revolved around whether to apply a discount to reflect “lack of marketability” in determining “fair value” under the Colorado dissenters’ rights statute (Colo. Rev. Stat. § 7-113-101 et seq.). The Colorado Supreme Court held that, for the purposes of the dissenters’ rights statute, “fair value . . . means the shareholder’s proportionate interest in the value of the corporation. Therefore, no marketability discount may be applied.” Were there a buy-sell agreement in place specifying the applicability of discounts, that decision might have been different.

(c) Upon the request of the withdrawing Member or Assignee, the Company shall (at the expense of the withdrawing Member or Assignee) obtain a second valuation by an independent third party (who must meet the selection criteria and must apply the marketability and minority interest discount established above). Thereafter, the two determinations of the Buy-Out Price shall be averaged and the resulting valuation shall be binding.

11.4 The Company (or the remaining Members in proportion to their Membership Interests) may pay such amount to the withdrawing Member or Assignee within six months of the date the Company first receives written notification of the Terminating Event by any of the following methods, or a combination thereof:

(a) distributing to the former Member or Assignee assets the former Member or Assignee (or his predecessor) contributed to the Company (at the then current Fair Market Value thereof as the Managers and the former Member or Assignee may agree or as may be established by third party appraisal if the Managers and the former Member or Assignee are not able to agree);

(b) cash or,

By contrast in the context of a divorce proceeding, the Colorado Supreme Court distinguished *Pueblo Bancorporation v. Lindoe* “because of the specific statutory scheme at issue in *Pueblo*” (that is, dissenters’ rights), as compared to “the discretion afforded to trial courts in marriage dissolution proceedings, we decline to adopt a *per se* rule against marketability discounts and instead hold that trial courts may, in their discretion, choose to apply such discounts when valuing an ownership interest in a closely held business in a divorce proceeding.” The Supreme Court noted that the dissenter’s rights statute uses the term “fair value” (see C.R.S. §7-113-206(1)), while the dissolution of marriage statute directs the court to divide marital property “in such proportions as the court deems just after considering all relevant factors” (see C.R.S. §14-10-113(1)). Thus a divorce court is not limited to fair value whereas a court in the dissenter’s rights context is. See *In re Marriage of Thornhill*, ___ P.3d ___, 2010 WL 2169086 at *3-*4 (Colo. 6/1/2010).

In a partnership buy-out following dissociation, the Jefferson County District Court, the opinion stated that in determining fair market value of the partnership interest, “a 20% discount for a minority interest and a 30% discount for lack of marketability are appropriate.” See *Wilson v. Pinon Family Practice Professional LLP*, 2004 WL 3605606 (Jefferson Cty, Colo. D.Ct. Feb 20, 2004) (Not reported in P.3d). Notably the Jefferson County case did not discuss or distinguish the *Pueblo Bancorporation* case decided the year earlier.

Where there is an agreement as to discounts as proposed in this form, it should be enforceable.

⁸¹ Note that if goodwill is included in the buy-out price, consideration should be given to IRC § 736(b)(2)(B). Unless there is a specific election in the Operating Agreement or partnership agreement, payments for goodwill of a retiring partner will be treated under IRC § 736(a) – generally as income taxable to the partner and deductible to the partnership or LLC (subject to basis issues). If the partnership makes an affirmative election to treat goodwill under § 736(b) (as is permitted in § 736(b)(2)(B)), payments for goodwill will be treated as a capital item and not deductible to the partnership or LLC.

(c) to the extent the amount payable in cash exceeds \$25,000, giving the former Member an unsecured promissory note payable from 15% of the Distributable Cash (or such lesser amount equivalent to the Selling Owner's Percentage Economic Interest), bearing interest at the prime rate prevailing from time-to-time as reflected by the prime rate established by Wells Fargo Bank, Denver, Colorado, for loans to large borrowers (compounded annually): (i) payable in full one year after the date the promissory note is issued (if the note is from \$25,000 to \$60,000); or (ii) two years after the note is issued (if the note is greater than \$60,000 to \$500,000) or (iii) five years after the note is issued (if the note is greater than \$500,000).

11.5 (a) Assignees may be admitted as Members of the Company upon the approval of Members holding at least a Three-Fourths Interest [or upon approval of the Managers], subject to the additional conditions set forth in Section 11.6.⁸² Members who purchase the Membership Interests pursuant to Section 11.4 hereof will be deemed admitted as Members to the extent of the Membership Interest purchased.⁸³

(b) Rights of Assignees who are not admitted as Members.

(i) Any Assignee which has been transferred in accordance with this Operating Agreement will, on the effective date of the transfer,⁸⁴ have only those rights of an assignee as specified in the Colorado Act and this Operating Agreement unless and until such Assignee is admitted as a Member pursuant to this Operating Agreement. This provision limiting the rights of an Assignee will not apply if such Assignee is already a Member.

(ii) No Assignee has the right:

(A) to participate or interfere in the management or administration of the Company's Business or affairs,

(B) to Vote or agree on any matter affecting the Company or any Member,

(C) to require any information on account of Company transactions, or

⁸² The question here is, how difficult do the initial Members want to make it for the admission of Members in the future.

⁸³ In light of *Achaian, Inc. v. Leemon Family LLC*, 25 A.3d 800 (Del. Ch. 2011), this seems to be a fair provision which can be modified by the parties.

⁸⁴ Note §11.6(b) which provides in part that transfers/admissions of Members are "deemed effective as of the last day of the calendar month in which the required approval thereto was given." Under §8.3(b)(vi), the Managers may choose a different effective date for the Transfer.

(D) to inspect the Company's books and records.

(iii) The only right of an Assignee is to receive the allocations and distributions to which the transferor was entitled (to the extent of the Units transferred). To the extent of any Units transferred, the transferor Member does not possess any right or power as a Member and may not exercise any such right or power directly or indirectly on behalf of the Assignee.⁸⁵

(iv) However, each Assignee (including both immediate and remote Assignees) will be subject to all of the obligations, restrictions and other terms contained in this Operating Agreement as if such Assignee were a Member.

11.6 Additional Conditions to Recognition of Transferee.

(a) If a Selling Owner transfers an Economic Interest to a Person who is not already a Member, as a condition to recognizing the effectiveness and binding nature of such Transfer (subject to this Article XI), the Managers may require the Selling Owner and the proposed Assignee to execute, acknowledge and deliver to the Managers such instruments of transfer, assignment and assumption and such other certificates, representations and documents, and to perform all such other acts which the Managers may deem necessary or desirable to accomplish any one or more of the following:

⁸⁵ To some extent, this is a spendthrift provision that is intended to limit the rights of a creditor. This is based in the statute (C.R.S. § 7-80-702) and is similar to provisions found in CUPL, § 7-60-127(1); CULPL, § 7-61-120(3); and CULPA, § 7-62-702; CUPA, § 7-64-503(1)(c) [no right to participate in management] and § 7-64-503(2) [to receive distributions]. Consequently, should a creditor obtain a charging order or seek to foreclose on a member's interest (both contemplated in § 7-80-703), the recipient creditor has only the rights of an assignee and an Economic Interest Owner, without any management, governance or inspection rights. This provision probably would not serve to limit a creditor's rights in a single-member LLC since, upon foreclosure the single member "ceases to be a member upon assignment of all the member's membership interest" (§ 7-80-702(2)), and if there are no members, the assignees "upon the unanimous consent of all the persons holding by assignment or transfer any of the membership interest of the last remaining member of the limited liability company, one or more persons, including an assignee or transferee of the last remaining member, may be admitted as a member or members." § 7-80-701(2). Thus the purchaser in a foreclosure sale of a single-member LLC interest would be the assignee of the former member (who would be deemed to have resigned) and could appoint itself member.

- (i) Constitute such Assignee as a Member as to the interest assigned (even if the Assignee is a Member as to other Membership Interests unless Section 11.4(a) is applicable);⁸⁶
- (ii) Confirm that the proposed Assignee as an Economic Interest Owner, or to be admitted as a Member, has accepted, assumed and agreed to be subject to and bound by all of the terms, obligations and conditions of this Agreement, as the same may have been further amended (whether such Person is to be admitted as a new Member or will merely be an Assignee);
- (iii) Preserve the Company after the completion of such transfer under the laws of each jurisdiction in which the Company is qualified, organized or does business;
- (iv) If, in the reasonable judgment of the Manager the transfer may result in a termination of the Company for tax purposes under Code § 708(b)(1)(B), prevent such termination and declare such transfer is void;
- (v) Maintain the status of the Company as a partnership for federal tax purposes;
- (vi) Assure compliance with any applicable state and federal laws, including Securities Laws and regulations; and
- (vii) Prevent the Company being treated (or in the reasonable judgment of the Manager may result in the Company being treated) as a publicly-traded partnership within the meaning of Code § 7704.

⁸⁶ See *Achaian, Inc. v. Leemon Family LLC*, 25 A.3d 800 (Del. Ch. 2011) where a 30% member transferred his entire interest to a 20% member, thus creating a deadlock with the 50% member. The 50% member attempted to treat the assignee as merely an economic interest holder with respect to the 30% received in the assignment – a position not upheld by the Delaware Chancery Court. In opposition to *Achaian*, William Callison (Faegre Baker Daniels) made the following comments by email on April 23, 2013:

In the deep for what it is worth category, when I read *Achaian* I thought it was wrong and that member consent should be needed for transfers of non-economic interests even if the transfer is to someone who is already a member. I think members bargain for a particular deal (not just particular people), and transfers that create deadlock can be antithetical to that deal. Of course operating agreement provisions can permit nonconsensual inter-member transfers, but that was not *Achaian* facts. I have not re-read *Achaian*, but I would be surprised if I changed my mind on a re-read. Delaware can say whatever Delaware says, but in other states I would not rely on *Achaian* and would be careful to delineate power in an operating agreement if consent is not required. If there were no operating agreement provision, I would argue against *Achaian* application.

If this is an issue in the operating agreement or among the members, whether an existing member is a permitted transferee should be addressed.

(b) Any transfer of an Economic Interest and admission of a Member in compliance with this Article XI shall be deemed effective as of the last day of the calendar month⁸⁷ in which the required approval thereto was given. The Selling Owner hereby indemnifies the Company and the remaining Members against any and all loss, damage, or expense (including tax liabilities or loss of tax benefits) arising directly or indirectly as a result of any transfer or purported transfer in violation of this Article XI.

(c) No transfer is valid if it would result in more than ____ Persons having an Economic Interest in the Company or otherwise result in the Company being treated as a “publicly traded partnership” taxable as a corporation for federal income tax purposes.

(d) Any person that transfers an Unit (the “Selling Owner”) shall notify the Company of the transfer in writing within 30 days of the transfer, or, if earlier, by March 31 following the transfer, and must include the names and addresses of the transferor and Assignee, the taxpayer identification numbers of the Selling Owner and the Assignee, and the date of the transfer.

11.7 Gifts of Ownership Interests. Subject to compliance with Sections 11.5 and 11.6, a Gifting Owner may Gift all or any portion of its Economic Interest provided, however, that the successor-in-interest (“Donee”) is either the Gifting Owner’s spouse, former spouse, lineal descendant (including adopted children) or to an entity in which day-to-day voting control is directly or indirectly held by the Gifting Owner. In the event of the Gift of all or any portion of a Gifting Owner’s Economic Interest to one or more Donees who are under 25 years of age, one or more trusts shall be established to hold the Gifted Ownership Interests for the benefit of such Donees until the respective Donees reach the age of at least 25 years. A “transfer” will be deemed to have occurred for the purposes of this Article XI if the day-to-day voting control over the Economic Interest becomes vested in some Person other than the Gifting Owner without the prior written consent of the Managers.⁸⁸

11.8 Member Designation. A Member may designate, in writing, a beneficiary to receive such Member’s interest in the Company upon such Member’s death. The written designation shall be fully revocable by the Member and may be changed by subsequent writings from time-to-time, in the sole discretion of the Member. Any beneficiary so designated shall be subject to all the terms of this Agreement and shall receive the Member’s interest in the Company subject to any purchase option, any buy-sell agreement, or any other agreement potentially affecting such interest. Such beneficiary shall be admitted as a Member

⁸⁷ The issue here is ease for accounting treatment. See the provision for allocation of varying interests in §9.1(b)(viii)(B). Under §8.3(b)(vi), the Managers may choose a different effective date for the Transfer.

⁸⁸ Consider whether these estate planning provisions are appropriate.

automatically upon the beneficiary accepting this Agreement in writing, without any further action of the Manager.⁸⁹

ARTICLE 12)

DISPUTE RESOLUTION

12.1 Disputes. Except for the specific performance remedy set forth in Section 13.5, in the event a dispute of any kind arises out of, in connection with, or relating to this Operating Agreement or the operations of the Company hereunder (including any dispute concerning its construction, performance or breach), the parties to the dispute (who may be any combination of the Company and any one or more of the Members and Assignees) will attempt to resolve the dispute as set forth in Section 12.2 before proceeding to arbitration as provided in Section 12.3. Each Member, each Assignee, and the Company waive all rights to seek remedies in any court (including the right to seek dissolution by decree of court), and the right to jury trial.⁹⁰ All documents, discovery and other information related to any such dispute, and the attempts to resolve or arbitrate such dispute, will be kept confidential to the fullest extent possible.⁹¹

12.2 Negotiation. If a dispute arises, any party to the dispute will give Notice to each other party. If the Company is not a party to the dispute, Notice will also be given to the Company. After Notice has been given, the parties in good faith will attempt to negotiate a resolution of the dispute.

12.3 Arbitration. If, within 45 days after the Notice provided in Section 12.2 has been given, a dispute is not resolved through negotiation or mediation, the dispute will be arbitrated. The parties to the dispute agree to be bound by the selection of an arbitrator, and to settle the dispute exclusively by binding arbitration in accordance with the following provisions:⁹²

⁸⁹ This is a method by which the Member's interest may avoid probate. Whereas it probably is suitable for a single member LLC, it may not be suitable in all cases for a multi-member LLC.

⁹⁰ If the parties desire to ensure that Members and Assignees are included in the arbitration provisions, it must be clearly stated. In *Andrews v. Ford*, 990 So.2d 820 (Miss. App. 2008), arbitration under the operating agreement was denied because the operating agreement arbitration provision only referred to Members.

⁹¹ Special care must be given when considering dispute resolution provisions for operating agreements involving two-member LLCs. Note that unless the parties can agree on the operation of the LLC, C.R.S. § 7-80-810(2) provides for the only statutory remedy – judicial dissolution – in the event of a deadlock. Note that the deadlock provision does not require wrongdoing by any party – simply a lack of agreement.

⁹² For a further discussion of drafting arbitration provisions in an operating agreement, see Dominick T. Gattuso, "Drafting Arbitration Provisions for LLC Agreements," 2009 *Business Law Today* (ABA) (March-April 2009) at 53. See also *Mathers Family Trust v. Cagle*, 2011 WL 1797222 (Colo. App. 2011), cert. granted 2011 WL 5040998 (Colo. 10/24/2011), where plaintiffs alleged that the defendants had participated in the sale of securities in violation of the Colorado Securities Act. The plaintiffs had signed participation agreements which provided for

(a) All parties to the dispute will collectively select one arbitrator. If they fail to do so within 45 days after the Notice provided in Section 12.2, one or more parties will request the Judicial Arbitrator Group, Inc. (“JAG”), Denver, Colorado, to submit a panel of five arbitrators from which the choice will be made. The party requesting the arbitration will strike first, followed by alternative striking until one name remains. A similar procedure will be followed if there are more than two parties. The parties may by agreement reject one entire list, and request a second list. If selection by the above method is not completed within 90 days after the Notice provided in Section 12.2, or if there are more than four parties, then the arbitrator will be selected by JAG. The arbitrator so selected will then arbitrate the dispute in Denver, Colorado, and issue an award.

(b) To the extent consistent with the provisions of this Section 12.3, the arbitration will be conducted under the rules that JAG or the arbitrator may impose and in accordance with the Colorado Arbitration Act. The arbitrator’s decision will be made pursuant to the relevant substantive law of the State of Colorado. The award of the arbitrator will be final, binding and non-appealable. Judgment on the award may be entered in any court, state or federal, having jurisdiction.

(c) The fees and expenses of the arbitrator, and the other direct costs of the arbitration, will be shared, initially, by the parties to the dispute who are Members or Assignees in proportion to their Percentage Economic Interests and (if the Company is a party to the dispute) by the Company in such proportion as the arbitrator may determine just and equitable. Each party to the dispute will bear all other costs and expenses as provided in Section 13.9. If one or more Members or Assignees are included in the arbitration because of his, its or their current or former ownership of an Economic Interest, such group will collectively be treated as one party to the dispute (through the Company as a party). The Arbitrator, as part of his final award, within his sole discretion, shall have the power, but not the obligation, to allocate direct and indirect costs and fees against any and all parties as he deems equitable.

ARTICLE 13)

GENERAL PROVISIONS

13.1 Amendment and Power Of Attorney.

(a) The Managers may amend this Operating Agreement or the Articles of Organization of the Company without the consent of the Members provided that such

Texas law and venue. The plaintiffs were not Colorado residents, although the primary defendants (Cagle and HEI Resources, Inc.) were. The Colorado district court had dismissed the plaintiffs’ complaint because of the forum selection clauses; the Court of Appeals said that the forum selection provisions violated the anti-waiver provisions of § 11-51-604(11) of the Colorado Securities Act and were, therefore, void.

amendments are administrative in nature, are otherwise permitted by this Agreement or are required to comply with the Code or the Colorado Act.

(b) The Members holding at least a Majority Interest of the Units entitled to Vote voting as a single class (or otherwise as the Managers may determine appropriate) may amend this Operating Agreement or the Articles of Organization of the Company as they deem necessary or appropriate in the circumstances (except that a Majority Interest may not amend any provision herein requiring the vote of more than a Majority Interest). If there are no Members, persons who will be admitted as Members⁹³ holding at least a Majority Interest following such admission may amend this Agreement, and such amendment may be effective immediately before the admission of new Members.⁹⁴

(c) Any amendment will become effective upon the required approval unless otherwise provided. Any duly adopted amendment to this Operating Agreement is binding upon, and inures to the benefit of, each Person (whether a Member or Assignee) who holds an Economic Interest at the time of such amendment, without the requirement that such Person sign the amendment or any republication or restatement of this Operating Agreement.

(d) To the extent that any such amendment restricts the rights of or imposes duties on Persons other than Members, no such amendment can become effective without the consent of such Persons acting by a Vote of a majority of the Economic Interests held by such Persons except to the extent permitted by §7-80-108(2)(e) of the Colorado Act.

(e) *Tax Matters Partner.* The Manager shall elect the Company's tax matters partner as defined in Code § 6231 ("Tax Matters Partner"). The Tax Matters Partner shall have all powers and responsibilities provided in Code § 6221, *et seq.* The Tax Matters Partner shall keep the Manager and all Members informed of all notices from government taxing authorities that may come to the attention of the Tax Matters Partner. The Company shall pay and be responsible for all reasonable third-party costs and expenses incurred by the Tax Matters Partner in performing those duties. Each Member and Assignee shall be responsible for any costs incurred by the Member or Assignee with respect to any tax audit or tax-related administrative or judicial proceeding against any Member or Assignee, even though it relates to the Company. The Tax Matters Partner may not compromise any dispute with the Internal Revenue Service without the approval of an affirmative vote of a Majority Interest.

⁹³ C.R.S. § 7-80-401(2) provides that, when an LLC has no members, the unanimous consent of all Assignees "of the last remaining Member" may admit one or more persons as Members. *See* § 10.1(c) of this Agreement which reduces the requirement to a majority. Even then, however, where amendments are unreasonable, arbitrary, capricious, or clearly intended to disadvantage one Member with respect to others, courts may find the amendment to be unenforceable.

⁹⁴ C.R.S. § 7-80-401(3) provides that, when an LLC has no members, persons who will be admitted as members of an LLC may, by unanimous consent, amend the operating agreement to be effective immediately prior to their admission.

(f) (i) Each Member and Assignee hereby makes, constitutes, and appoints each Manager, with full power of substitution and resubstitution, its true and lawful attorney-in-fact in its name, place, and stead and for its use and benefit, to sign, execute, certify, acknowledge, swear to, file, and record: (A) all certificates and instruments which the Manager may deem necessary or appropriate to form, qualify, or continue the business of the Company as a limited liability company; (B) any and all amendments or changes to this Agreement and the instruments described in clause (A) above which the Manager may deem necessary or appropriate to effect a change or modification of the Company in accordance with the terms of this Agreement, including, without limitation, amendments or changes to reflect: (I) the exercise by any Manager of any power granted to it under this Agreement, (II) the issuance of Units and admission of any additional or substituted Member, and (III) the disposition by any Member or Assignee of its Units; (C) all certificates of cancellation and other instruments which the Manager deems necessary or appropriate to effect the dissolution and termination of the Company pursuant to the terms of this Agreement; and (D) any other instrument which is now or may hereafter be required by law to be filed on behalf of the Company or is deemed necessary or appropriate by the Manager to carry out fully the provisions of this Agreement in accordance with its terms.⁹⁵

(ii) Each Member and Assignee authorizes each such attorney-in-fact to take any further action which such attorney-in-fact shall consider necessary or advisable in connection with any of the foregoing, hereby giving each such attorney-in-fact full power and authority to do and perform each and every act or thing whatsoever requisite or advisable to be done in connection with the foregoing as fully as such Member or Assignee might or could do personally, and hereby ratifying and confirming all that any such attorney-in-fact shall lawfully do or cause to be done by virtue thereof or hereof.

(iii) The power of attorney granted pursuant to this Article: (A) is a special power of attorney coupled with an interest and is irrevocable; (B) may be exercised by any such attorney-in-fact by listing the Members and Assignees executing any agreement, certificate,

⁹⁵ Note that any power of attorney executed while the person is in Colorado must comply with Uniform Power of Attorney Act (C.R.S. §15-14-701 *et seq.*) adopted by the Colorado legislature in 2009 (H.B. 09-1198) or its predecessor found at C.R.S. §15-14-601 *et seq.* This act provides that where the signature of the principal (in this case, the member) is notarized, it is “presumed to be genuine.” §15-14-705. Where the operating agreement is to be executed in other states, the power of attorney must comply with the laws of those other states to be effective in Colorado. §15-14-706(3). Other states have other laws with varying degrees of specificity for the effectiveness of a power of attorney. For example, Title 15 of Article 5 of the General Obligation Law of New York (GOL §5-1501 *et seq.*) requires that (among other things) to be valid a power of attorney must be “typed or printed using letters which are legible or of clear type no less than twelve point in size,” and contain certain specified wording as set forth in §5-1501B. §5-1512 recognizes the effectiveness of powers executed by individuals (wherever domiciled) outside of New York if effective under local law. Thus it is important to know where the power of attorney is executed to judge its effectiveness. While a notary acknowledgement for a power of attorney executed in Colorado is not required, it makes proof of its execution easier if challenged.

instrument, or other document with the single signature of any such attorney-in-fact acting as attorney-in-fact for all such Members and Assignees; and (C) shall survive the bankruptcy, insolvency, dissolution, or cessation of existence of a Member or Assignee, and shall survive the delivery of an assignment by a Member or Assignee of the whole or a portion of its Units, except that where the assignment is of such Member's or Assignee's entire Unit and the Assignee is admitted as a substituted Member, the power of attorney shall survive the delivery of such assignment for the sole purpose of enabling any such attorney-in-fact to effect such substitution.

(iii) Whenever any Manager executes a document as attorney-in-fact for a Member or Assignee, the Manager must promptly provide a copy of such document to each Member or Assignee, although a failure to provide such copy does not invalidate the action taken.⁹⁶

13.2 Confidentiality. Except as contemplated hereby or required by a court of competent authority, each holder of an Economic Interest shall keep confidential and shall not disclose to others and shall use his or her reasonable efforts to prevent any Affiliates and any of his, her or its, or any of their Affiliates', present or former employees, agents, and representatives from disclosing to others without the prior written consent of the Managers any information which

(a) pertains to this Operating Agreement, any negotiations pertaining thereto, any of the transactions contemplated hereby, or the business of the Company, or

(b) pertains to confidential or proprietary information of any holder of an Economic Interest or the Company or which any holder has labeled in writing as confidential or proprietary; provided that any holder may disclose to its Affiliates' employees, agents, and representatives any information made available to such holder; or

(c) is Confidential Information.

13.3 Unregistered Interests. Each Member and Assignee:

(a) Acknowledges that the Units are being offered and sold without registration under the Securities Act of 1933, as amended, or under similar provisions of state law,

(b) Acknowledges that such Person is fully aware of the economic risks of an investment in the Company, and that such risks must be borne for an indefinite period of time,

⁹⁶ Powers of attorney can make the maintenance of an LLC easier, but frequently Members do not know what has been signed on their behalf. The power of attorney should only be used for administrative corrections and changes, and not for substantive changes.

(c) Represents and warrants that such Person is acquiring an Economic Interest for such Person's own account, for investment, and with no view to the distribution of the Economic Interest or any interest therein,

(d) Represents that such Member or Assignee is an accredited investor as that term is defined in SEC Rule 501(a), has consulted with such legal, tax, investment, financial, and other advisors regarding such Person's acquisition of the Units as such Person has deemed necessary or appropriate in the circumstances, and that such Person has made provision for any federal, state, or local tax obligations arising or that may arise from the acquisition or holding the Units, and

(e) Represents that such Member or Assignee has received and reviewed such information about the Business (and proposed Business), assets, financial condition, management, risks relating to the Company and the Business and proposed Business, and such other information regarding the acquisition of the Units as the Member or Assignee has (in consultation with such advisors as the Member or Assignee has deemed appropriate) determined to be necessary or appropriate in the circumstances;

(f) Agrees not to transfer, or to attempt to transfer, all or any part of such Economic Interest without registration under the Securities Act of 1933, as amended, and any applicable state securities laws, unless the transfer is exempt from such registration requirements.

13.4 Waiver of Partition Right. Each Member and Assignee waives and renounces any right that such Person may have prior to dissolution and liquidation to institute or maintain any action for partition with respect to any real property owned by the Company.

13.5 Waivers Generally. No course of dealing will be deemed to amend or discharge any provision of this Operating Agreement. No delay in the exercise of any right will operate as a waiver of such right. No single or partial exercise of any right will preclude its further exercise. A waiver of any right on any one occasion will not be construed as a bar to, or waiver of, any such right on any other occasion.

13.6 Equitable Relief. If any Person proposes to transfer all or any part of such Person's Economic Interest in violation of the terms of this Operating Agreement, the Company or any Member may apply to any court of competent jurisdiction for an injunctive order prohibiting such proposed transfer except upon compliance with the terms of this Operating Agreement, and the Company or any Member may institute and maintain any action or proceeding against the Person proposing to make such transfer to compel the specific performance of this Operating Agreement. Any attempted transfer in violation of this Operating Agreement is null and void, and of no force and effect. The Person against whom such action or proceeding is brought waives the claim or defense that an adequate remedy at law exists, and

such Person will not urge in any such action or proceeding the claim or defense that such remedy at law exists.

13.7 Remedies for Breach. The rights and remedies of the Members set forth in this Operating Agreement are neither mutually exclusive nor exclusive of any right or remedy provided by law, in equity or otherwise. Subject to the dispute resolution provisions of Article 12, the Members and Assignees agree that all legal remedies (such as monetary damages) as well as all equitable remedies (such as specific performance) will be available for any breach or threatened breach of any provision of this Operating Agreement.

13.8 Notices. All Notices under this Operating Agreement will be in writing and will be either delivered or sent addressed as follows:

(a) If to the Company, at the Company's principal place of Business and to its registered office in Colorado; and

(b) If to any Member or Assignee, at such Person's home or business address as then appearing in the records of the Company.

In computing time periods for the purposes of this Section and the following Section, the day of Notice will be included. A day means a business day in Denver, Colorado and shall not include Saturday, Sunday, or days when banks are generally closed for transacting business with the public.

13.9 Deemed Notice. All Notices given to any Person in accordance with this Operating Agreement will be deemed to have been duly given:

(a) On the date of actual receipt if personally delivered or if delivered by electronic mail;

(b) Three days after being sent by registered or certified mail, postage prepaid, return receipt requested;

(c) When sent by confirmed electronic facsimile transfer; or

(d) One day after having been sent by a nationally recognized overnight courier service.

13.10 Costs. If the Company or any Member or Assignee retains counsel for the purpose of enforcing or preventing the breach or any threatened breach of any provision of this Operating Agreement or for any other remedy relating to it, then the prevailing party will be entitled to be reimbursed by the non-prevailing party for all costs and expenses so incurred

(including reasonable attorney's fees, costs of bonds, and fees and expenses for expert witnesses) unless the arbitrator or other trier of fact determines otherwise in the interest of fairness.

13.11 Indemnification.

(a) Each Member and Assignee hereby indemnifies and agrees to hold harmless the Company, each Manager, and each other Member and Assignee from any liability, cost or expense arising from or related to any act or failure to act of such Member which is in violation of this Operating Agreement.

(b) A Manager shall not be personally liable to the Company or its Members or Assignees for monetary damages for breach of fiduciary duty as a Manager; except that this provision shall not eliminate or limit the liability of a Manager to the Company or its Members for monetary damages otherwise existing for:

- (i) any breach of the Manager's duty of loyalty to the Company or to its Members; or
- (ii) acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law;
- (iii) any transaction from which the Manager directly or indirectly derived any improper personal benefit.

(c) The Company shall, to the fullest extent permitted by law, indemnify any and all persons whom it shall have power to indemnify under this section (the "Indemnitee") from and against any and all of the expenses, liabilities or other matters referred to in or covered by said section, and the indemnification provided for herein shall not be deemed exclusive of any other rights to which those indemnified may be entitled under any agreement, vote of Members or disinterested Managers or otherwise, both as to action in his or her official capacity and as to action in another capacity while holding such office, and shall continue as to a person who has ceased to be a Manager, officer, employee or agent and shall inure to the benefit of the heirs, executors and administrators of such a person. The Company shall pay in advance of the final disposition of such Indemnitee upon the receipt of an undertaking by or on behalf of such Indemnitee to repay such amount if it shall ultimately be determined that he is not entitled to be indemnified by the Company as authorized in this Section 13.11(d).

13.12 Partial Invalidity. Wherever possible, each provision of this Operating Agreement will be interpreted in such manner as to be effective and valid under applicable law. However, if for any reason any one or more of the provisions of this Operating Agreement are held to be invalid, illegal or unenforceable in any respect, such action will not affect any other provision of this Operating Agreement. In such event, this Operating Agreement will be construed as if such invalid, illegal or unenforceable provision had never been contained in it, and any court or other body determining any provision to be invalid shall interpret the remaining

portions of this Agreement to give maximum effect to the intention of the parties as expressed herein, including such invalid provision.

13.13 Entire Agreement. This Operating Agreement contains the entire agreement and understanding of the parties and Persons who may in the future become Members or Assignees with respect to its subject matter, and it supersedes all prior written and oral agreements. No amendment of this Operating Agreement will be effective for any purpose unless it is made in accordance with Section 13.1.

13.14 Benefit. The contribution obligations of each Member will inure solely to the benefit of the other Members and the Company, without conferring on any other Person any rights of enforcement or other rights. Without limiting the generality of the foregoing, none of the provisions of this Operating Agreement shall be for the benefit of or enforceable by any creditors of the Company or of any Member.

13.15 Binding Effect. This Operating Agreement is binding upon, and inures to the benefit of, the Members and their permitted successors and assigns; provided that, Assignees will only have the rights set forth in Section 11.4 unless admitted as a Member in accordance with this Operating Agreement.

13.16 Further Assurances. Each Member and Assignee agrees, without further consideration, to sign and deliver such other documents of further assurance as may reasonably be necessary to effectuate the provisions of this Operating Agreement.

13.17 Headings. Article and Section titles have been inserted for convenience of reference only. They are not intended to affect the meaning or interpretation of this Operating Agreement.

13.18 Terms. Terms used with initial capital letters will have the meanings specified, applicable to both singular and plural forms, for all purposes of this Operating Agreement. All pronouns (and any variation) will be deemed to refer to the masculine, feminine or neuter, as the identity of the Person may require. The singular or plural include the other, as the context requires or permits. The word include (and any variation) is used in an illustrative sense rather than a limiting sense.

13.19 Non-Circumvention Agreement. *[If necessary]* Each of the Members agrees that, for a period of 180 days from the date of this Operating Agreement, and for so long thereafter as the Company is diligently pursuing the development of the Property, it will not enter into any discussions or negotiations with any person regarding the purchase or development of the Property other than through the Company as contemplated by this Agreement. Notwithstanding the foregoing, the agreement set forth in this Section 13.19 will expire sooner than the date set forth above if the Managers determine that the Company will not be able to acquire the Property on commercially reasonable terms or cease their efforts to acquire the Property.

13.20 Legal Representation. The Members agree that the law firm of _____, P.C., represents only the Company in connection with the preparation of this Agreement, and has not offered any Member or other person any advice regarding the advisability of entering into this Agreement. Each person executing this Agreement further acknowledges and agrees that such person:

- (a) Has been advised to retain independent legal, tax, and accounting advice of their own choosing for purposes of representing their individual interests with respect to the subject matter hereof;
- (b) Has been given reasonable time and opportunity to obtain such advice; and
- (c) Has obtained such independent advice as they have deemed necessary and appropriate in the circumstances at his or her own expense without expecting the Company to reimburse such person for such fees or other expenses.

13.21 Governing Law. This Operating Agreement will be governed by, and construed in accordance with, the laws of the State of Colorado without considering Colorado choice of law provisions.⁹⁷ Any conflict or apparent conflict between this Operating Agreement and the Colorado Act will be resolved in favor of this Operating Agreement except as otherwise required by the Colorado Act.⁹⁸

13.22 Creditors; No Third Party Beneficiaries. None of the provisions of this Agreement shall be for the benefit of, or enforceable by, any creditor of the Company or other person, including (without limitation) any Member in such Member's capacity as a creditor. No person not a party hereto is intended to be a third party beneficiary of this Agreement.

⁹⁷ While this generally refers to the law interpreting the Colorado Act, to the extent that it attempts to limit governing law, jurisdiction and venue for a securities issue, *see Mathers Family Trust v. Cagle*, 2011 WL 1797222 (Colo. App. 2011), *cert. granted* 2011 WL 5040998 (Colo. 10/24/2011), alleged that the defendants had participated in the sale of securities in violation of the Colorado Securities Act. The plaintiffs had signed participation agreements which provided for Texas law and venue. The plaintiffs were not Colorado residents, although the primary defendants (Cagle and HEI Resources, Inc.) were. The Colorado district court had dismissed the plaintiffs' complaint because of the forum selection clauses; the Court of Appeals said that the forum selection provisions violated the anti-waiver provisions of § 11-51-604(11) of the Colorado Securities Act and were, therefore, void.

⁹⁸ Why would any agreement provide for such an obvious result? The problem here is that this sentence creates confusion. CRS § 7-80-108(4) provides that the intent of the Colorado Act is to give maximum effect to the principles of freedom of contract and to the enforceability of operating agreements. The "except as otherwise required by the Colorado Act" in this sentence can only add confusion – does that mean that only the non-waivable provisions specified in CRS § 7-80-108 control over conflicting provisions in the Operating Agreement, or all statutory provisions control over the operating agreement? While the interpretation of the word "required" would lead to the former, why take the risk of someone attempting to interpret the latter?

13.23 Counterparts. This Operating Agreement may be executed in counterparts, each of which shall be deemed an original but all of which shall constitute one and the same instrument. At least one original copy of this Operating Agreement will be placed in the Company records. A photocopy of this Operating Agreement, as signed, will be delivered to each Member and each such photocopy will be deemed to be an original document.

CERTIFICATE

The undersigned hereby agree, acknowledge and certify that the foregoing Operating Agreement constitutes the Operating Agreement of the Company adopted by the Managers and by the Members of the Company.

NEWCO, LLC

MANAGERS:

John Doe, Manager

Jane Roe, Manager

MEMBERS:⁹⁹

ABC Company, Member
By its president

XYZ, Inc., Member
By its president

⁹⁹ To the extent the Operating Agreement includes powers of attorney granting the Manager the authority to execute documents (including an amendment to the Operating Agreement) on behalf of Members, the drafter may want to consider including a notary acknowledgement of the Member signing. See Section 13.1(f)(i) and the note at the end of that subsection.

SIGNATURE PAGE FOR ASSIGNEES and MEMBERS

The undersigned, following consultation with his, her, or its legal, financial, investment, tax and other advisors to the extent the undersigned deemed appropriate and having read the Operating Agreement for the Company dated _____, 2011 to the extent deemed necessary or appropriate, hereby accepts the terms of said Operating Agreement in accordance with the terms thereof.

(Where Assignees are to be admitted as Members, or where a § 704(c) book-up occurs, consider the following:) The Members hereby acknowledge that, effective _____, 200x, the signatories listed below have been admitted as Members of the Company and, immediately prior to his admission as a Member, the Company has booked up Capital Accounts pursuant to Treas. Reg. § 1.704-1(b)(2)(iv)(f) to the Fair Market Value of the Company as permitted by Section 9.1(b)(ix)(A) of this Agreement.¹⁰⁰ The parties agree that at the time of the Person's admission as a Member, the Fair Market Value of the Company was \$_____.¹⁰¹

(Where Assignees are not to be admitted as Members, and where a § 704(c) book-up occurs, consider the following:) The Assignee hereby acknowledge that, effective _____, 200x, the signatories listed below have not been admitted as Members of the Company but will be treated as Assignees, and, immediately prior to his acceptance as an Assignee, the Company has booked up Capital Accounts pursuant to Treas. Reg. § 1.704-1(b)(2)(iv)(f) to the Fair Market Value of the Company as permitted by Section 9.1(b)(ix)(A) of this Agreement.¹⁰² The parties agree that at the time of the Person's acceptance as an Assignee, the Fair Market Value of the Company was \$_____.¹⁰³

MEMBER or ASSIGNEE:

Name:

Co-owner (if any)

¹⁰⁰ Where the Company will be making a book-up under § 704(c), that changes the economics from the case where the Company does not make a book-up at the time a new Member is admitted. Consequently, it is advisable to make that disclosure here or in the subscription agreement (if a separate document is used). For a more detailed discussion of 'booking-up,' see Lidstone, "Admitting New Members to an LLC and 'Booking-Up' Capital Accounts," 37 The Colo. L. no. 4 at 19 (April 2008) available at <http://www.cobar.org/index.cfm/ID/20017/The-Colorado-Lawyer>.

¹⁰¹ This identification of Fair Market Value is not necessary, but may avoid later disputes.

¹⁰² Where the Company will be making a book-up under § 704(c), that changes the economics from the case where the Company does not make a book-up at the time a new Member is admitted. Consequently, it is advisable to make that disclosure here or in the subscription agreement (if a separate document is used).

¹⁰³ This identification of Fair Market Value is not necessary, but may avoid later disputes.

Exhibit A
Capital Contributions
As of _____, 200X¹⁰⁴

This Exhibit shall be amended from time-to-time to reflect the issuance, transfer, or repurchase of Units.

Member's Name & Address And Social Security Number	Class	Membership Interest (# Units)	Percentage Interest
	A	100	20%
	B	100	80%
Economic Interest Holders Who Are Not Members			
None.			

Signatures:

¹⁰⁴ This should be updated as new Assignees or Members are accepted. Note §11.6(b) which provides in part that transfers/admissions of Members are “deemed effective as of the last day of the calendar month in which the required approval thereto was given.” Under § 8.3(b)(vi) of the Operating Agreement, the Managers may choose a different effective date for the Transfer.