Factual Scenario

You are a lawyer with a local law firm that specializes in formation and operation of business entities. Yesterday, you met with three potential clients, Ann, Bev and Carl (the "Promoters"). The Promoters intend to form a business entity that will construct and operate a large restaurant in your city. They want to employ your firm to represent them with respect to the formation of the business entity and related matters, including the drafting of employment contracts, real estate leases and/or real estate purchase agreements, loan agreements and buy-sell agreements. They came to your law firm because you have represented Bev in prior business transactions.

The Business Concept

Carl is the "idea man" and is proposing to open a large restaurant in your city called "Carl's Digital Fish House." Carl operates an existing restaurant by the same name in a major city about 400 miles away. The restaurant is highly computerized with computer monitors built into each table (flush with the surface). Patrons can view on the video monitors the process of preparing their food from live "fish cams" on the fishing boats through "cook cams" in the kitchen. The menu is a video game that is highly interactive, with PlayStation type graphics.

The food is copious and delicious. Carl has been in the fish-restaurant business for 37 years and has owned, in succession, six different restaurants. The original Carl's Digital Fish House was opened two years ago and has been wildly successful. The local restaurant will be modeled on the existing restaurant.

The venture will require approximately $4.6 million in capital investment. After formation, the plan is to borrow additional funds in the form of loans from local banks. The three Promoters will be contributing $1.6 million ($1.2 million in cash and $400,000 in services and personal property). The remainder of the capital, $3 million, will be raised by selling equity interests to investors. The three promoters have the following backgrounds and objectives:

> ***Ann*** is a single woman who has accumulated a significant net worth in her career. She is retired and travels extensively. Ann owns a $2 million home and the remainder of her wealth is in the form of stable and low-risk investments. Ann is willing to contribute $400,000 to the project. She is a long-term friend of the proposed chef and manager, Carl. Ann sees this venture as an opportunity to help a friend while increasing the usual return that she gets on her investments. Ann will be a "passive" investor and will not be actively

participating in the management of the business entity nor its operations. Her proposed $400,000 investment is approximately 10% of her net worth.[1] Ann wants to invest her money for a reasonable period but would like to be able to withdraw her original contribution as quickly as possible once the restaurant operations become profitable.

Bev is married with teenage children. She is a successful businesswoman and has accumulated a personal net worth in excess of $20 million, with many investments. She has been involved in numerous business ventures and has always taken an active and controlling role in the management and operation of the business. Bev will be contributing $800,000 to the venture. Bev wants to be able to protect her capital investment to the fullest extent possible and assure a priority of distribution from profits of the restaurant operation.

Carl is 55 years old and a successful restaurant operator. Over the years, he has acquired a succession of ever-larger restaurants. Most of his assets are wrapped up in his existing restaurant, which he does not intend to sell. He has abundant monthly income from the restaurant but has little money for a new venture. Carl will be contributing his services, expertise, good will, recipes, designs and intellectual property.[2] Years ago, Carl purchased a parcel of real estate that is a perfect location for the restaurant. At this stage, Carl is proposing to sell the real estate to the business entity or, in the alternative, lease it to the business entity.

Carl sees the new restaurant venture as a long-term investment that will provide

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1. "Net worth" is a term used to identify the value of all of a person's assets, less all of that person's liabilities. In the example in the following chart, note that even though Ann has assets worth almost $4 million, her net worth would be $2.5 million:

Assets	Value	Liabilities		Net
Home	$2,000,000	Mortgage debt	($1,200,000)	$800,000
Auto	$50,000	Auto loan	($40,000)	$10,000
Retirement Account	$1,000,000			$1,000,000
Stock Mutual Funds	$450,000	Margin loan	($160,000)	$290,000
Furnishings	$100,000			$100,000
Certificates of Deposit & Cash	$300,000			$300,000
Totals	**$3,900,000**		**($1,400,000)**	**$2,500,000**

2. Carl owns the rights to use valuable tradenames, trademarks and good will associated with his current restaurant. He also owns copyrights on computer software that assists him in operating the restaurant. Carl will retain ownership of these items of intellectual property but will license the property to the proposed venture at a nominal cost.

him with additional income into his retirement years. He expects to have a long-term employment contract with the business entity, as well as a comfortable retirement plan. Depending on his health and age, he may want the right to sell his interest in the business. He is also concerned about being able to sell out in the event of his death or disability.