

BUSINESS PLANNING
Final Drafting Assignment – Fall 2020

I. Overview

A. The Entity: Ann, Bev and Carl have decided to finance the restaurant project by forming a limited liability company and selling membership interests to investors. The managing member of the limited liability company will be a California ***statutory close corporation*** formed by Ann, Bev & Carl (see paragraph II(C) below).

B. Due Date: The assignment is due **Thursday December 3rd no later than 4:00 pm**. Submit the assignment via Canvas.

C. Collaboration: You are ***required*** to collaborate with at least one other classmate in preparing these documents. You should submit a single set of documents, with the I.D. numbers of all collaborators.¹

D. Marking of Documents: **You must mark your copies to show changes from the sample documents.** Use a highlighter pen, or underlining or **redlining** to show additions, and a "^^^" mark or ~~strikeout~~ to show deletions.² For deletions of a large paragraph or more, use "^^^".

Submit only one marked copy (if the markings were removed, it would be complete and ready for signature). You should save a clean copy for your files as a writing sample.

E. Definitions: For purposes of this assignment:

1. "LLC" means OCEANBYTE, LLC., a California limited liability company. OCEANBYTE, LLC will be doing business as "Carl's FishByte Restaurant."³
2. "OBMG" means OceanByte Management Group, Inc., a California statutory close corporation. OBMG is the manager of the LLC.
3. "NMM" means a person or entity that has been admitted as a non-managing member of the LLC.
4. "Manager" means OBMG.

1. This assignment is too complex to attempt alone.

2. The easiest way to do this is to keep the original copy of the files and save your changes in files with different names. You can then use Word to compare documents and mark the changes for you.

3 The phrase "doing business as" or "dba" means that the legal entity (OCEANBYTE, LLC) will use a fictitious name ("Carl's OceanByte Restaurant") in its day-to-day operations. This is a common occurrence. Most of the retail shops and restaurants you visit are using fictitious names for public relation purposes. Most cities, towns and counties require the filing of a "fictitious business name statement" so that patrons and creditors of the business can have access to the legal owner's information.

II. The Facts: The important facts are:

- A. Name: **OCEANBYTE, LLC**, a California limited liability company (hereinafter “the LLC”). This is the legal name of the entity, which will do business as “Carl’s OceanByte Restaurant.”
- B. Term: The term of the LLC is 30 years. The term can be renewed for another 30 years if, within the last six months of the term, a majority of NMM vote to renew the term.

Early Termination: Beginning 36 months after the start of regular restaurant operations, and every 24 months thereafter, Manager shall report to the Members whether or not operations have been profitable during the preceding 24 month period. If operations have not been profitable, Manager shall convene a meeting of the Members to conduct a vote on the issue of termination of the LLC. The LLC shall be terminated if:

- (i) There has been a net loss from operation of the restaurant for the 24 month period evaluated in the report (the “Net Profit Evaluation Period”); and,
- (ii) Holders of a majority in interest of the NMM4 membership units vote to terminate the LLC.

- C. Manager’s Contribution: Ann, Bev and Carl have formed a statutory close corporation under California law, named OceanByte Management Group, Inc. (“OBMG”) to acquire membership units in the LLC and manage the LLC. The shares of OBMG, Inc. will be owned by Ann (20%), Bev (40%) and Carl (40%). The shareholder agreement of OBMG will provide that Carl is vested with the power to manage and operate OBMG so long as he holds 40% of the shares of OBMG. The shareholders contributed the following property for their shares of stock in OBMG:

- Ann: \$300,000 in cash
- Bev: \$500,000 in cash
- Carl: \$200,000 in cash & \$300,000 in intellectual property⁵

OBMG will contribute \$1 million in cash to the LLC and receive 10 membership units.

OBMG is not contributing the intellectual property in exchange for its membership units in the LLC. The intellectual property will be *licensed* to the LLC for a nominal fee (see Paragraph J below).

4 Note that only non-managing members get to vote on the issue of early termination.

5. Carl will be *assign* to the manager, FBMG, all of Carl’s intellectual property rights in trademarks, copyrights, trade secrets, software and any related rights associated with his digital-themed fish restaurant concept. BMG will have an exclusive license except that Carl will retain rights to use of the intellectual property for his Berkeley restaurant.

- D. Manager & Employees of the LLC: OBMG will be the sole manager of the LLC. In addition, Carl and Bev will, independently, be employees of the LLC (see below).

The documents for the LLC will provide that, so long as OBMG is the Manager of the LLC. Carl and Bev must maintain their respective ownership and management positions in OBMG. Failure to maintain these interests in OBMG will be an event of default under the Operating Agreement.

The following events will be events of default by OBMG under the Operating Agreement:

1. A material change in OBMG's stock ownership that reduces Carl's or Bev's shareholder interests in OBMG.
2. The dissolution of OBMG.
3. Insolvency or bankruptcy proceedings instituted by or against OBMG, or
4. Any material adverse change in the finances, management or ownership of OBMG.

In the event of a default, the NMM's will have the right to remove OBMG as Manager as discussed in detail below.

- E. Non-managing Member's Contributions: The non-managing members of the LLC will contribute a total of \$4,000,000 (40 membership units @ \$100,000 each). Members will reside in several states.

The total capitalization for the LLC will be \$5,000,000 and there will be a total of 50 membership units (10 for the manager and 40 for the NMM's):

	Contribution	Units	Percentage Interest
OBMG (Manager)	\$1 million	10	20%
Investors	\$4 million (40 units @ \$100,000 each)	40	80% (2% per unit)
Total	\$5 million	50	100%

- F. Profits, Losses & Distributions: Initially, OBMG will have a 20% interest in the profits and losses of the LLC. The NMM'S, in the aggregate, will have an 80% interest.

The proportion of profits and losses will change when the NMM'S (other than OBMG) have received distributions from profits equal to the amount of their initial capital contributions. At that time, OBMG will have a 25% interest in the profits and losses, and the NMM's will have a 75% interest.

- G. Priority of Distribution Upon Sale or Liquidation: Upon sale, liquidation or dissolution of the LLC, the NMM's are entitled to return of their capital contributions in full before Manager receives any distribution regarding Manager's capital account.
- H. Management Fee: In addition to its membership interest in the LLC, OBMG will act as Manager of the LLC and will receive (after the restaurant begins operations) a management fee equal to 5% of the gross revenues of the restaurant.⁶ The fee includes overhead and office costs for managing the restaurant, which will not be separately charged to the LLC. Manager will not bill for any general administrative costs. However, the salaries of the *employees* of the LLC (including Carl and Bev) and restaurant operations will be paid by the LLC. Carl and Bev's employment contracts are with the LLC, not with OBMG.
- I. Anti-Competition Clauses. OBMG, as well as Ann, Bev and Carl, agree not to compete in the restaurant or food services business in the county of San Diego, during the term of the LLC. However, OBMG, Ann, Bev and Carl expressly reserve the right to open other restaurants, regardless of location, that do not:
1. offer fish entrees in excess of 20% of entree items offered for sale in the restaurant; nor,
 2. use a consumer oriented digital, computer gaming, or video-cam theme in the marketing or operation of their restaurant.

OBMG, Ann, Bev and Carl reserve the right to open other digital-theme restaurants if:

1. the restaurant is more than 75 miles from the restaurant in San Diego; and,
 2. more than three years have elapsed from the time of commencement of operations of the LLC's restaurant in San Diego.
 3. the names "Carl's," "Oceanbyte" or any similar name may not be used in connection with any other restaurant without the approval of 75% of the NMM's.
- J. Licensing Agreement: The manager, OBMG, is the owner of the trademarks, trade names, recipes, trade secrets and other intellectual property related to the operation of the restaurant.⁷ OBMG will be licensing this intellectual property to the LLC for the term of the LLC, including renewals, at an annual fee of one dollar. The license is irrevocable but not exclusive. OBMG may use the intellectual property for the operation of other restaurants outside of San Diego County if the conditions in the preceding paragraph have been satisfied.

6. This is a reasonable fee for managing a business of this type.

7. Carl transferred all of the intellectual property rights to BMG (including trademarks, trade names and copyrights) but retained the limited right to use the intellectual property solely in connection with the operation of his existing restaurant in Berkeley, California.

K. Capital Contributions: There will be no future capital calls (mandatory or permissive) from members. All capital contributions must be paid in full at the time of funding of the LLC.⁸ Contributions will be by certified check, to be held in escrow in short term certificates of deposit or treasury bills until the Closing Date (defined in the next paragraph). The escrow company holding the contributions will be the Escrow Department, Union Bank San Diego Main Branch, 601 B. St., San Diego, CA 92101.

L. Closing: Contributions will be released from escrow, and the LLC will begin operations if all the following conditions have been satisfied:

(a) The Closing Date for funding the LLC is on or before June 1, ~~2020~~ 2021 (the "Closing Date"). The closing will occur only if:

- at least 35 of the 40 NMM units (not counting the units owned by OBMG) have been subscribed and paid for, and
- OBMG has made its \$1 million capital contribution to the LLC.

(b) Prior to the Closing Date, OBMG will have the authority to extend the closing date to July 1, ~~2020~~ 2021 (the "Extended Closing Date") at the option of OBMG, if:

- at least 30 NMM membership units have been subscribed and paid for.

The closing will occur on or before the Extended Closing Date only if at least 35 NMM membership units have been subscribed and paid for, and OBMG has made its \$1 million contribution.

If the original Closing Date, or if extended, the Extended Closing Date, has passed and the closing has not occurred, or if the closing fails to occur for any reason, all funds contributed by NMM's will be returned to the NMM's together with any interest that has accrued on the funds. If the closing occurs, and the LLC is funded, any accrued interest is to be retained by the LLC.

M. Organizational Fees: OBMG will receive (in addition to equity interests referred to above) a Development/Organization fee of 1.75% of all capital contributions. This fee is to compensate OBMG for organizing the LLC and developing the restaurant venture. The fee will be paid on the date of the Closing.

8. Members may not defer payment for their membership units. Checks must be submitted with the Subscription Agreement.

N. Opening Date; Commencement of Operations; Lease; Liquor License:

(a) The proposed opening date of the *operations* of the restaurant is expected to be September 1, ~~2020~~ 2021.

(b) Four months ago, OBMG signed a *lease option* for the retail site of the restaurant. The property is owned by Carl and will be leased to the LLC at a fixed rental of \$25,000 per month (this is the fair market rental value). However, there is a six-month rent-free period for the first six months of the term (rent will not commence until six months after the commencement of the lease term). The option must be exercised no later than July 1, ~~2020~~ 2021 but may be exercised at an earlier time. All the terms of the lease have been negotiated and the option agreement has a lease form attached. The term of the lease will commence on the date of the exercise of the option. The term is 10 years, with renewal options for five additional terms of 10 years each (a total possible term of 60 years). OBMG will be assigning the option to the LLC at the Closing and the LLC will then exercise the option. The leased property includes a 10,000 square foot structure (currently vacant and the interior is unimproved) and parking. A security deposit of \$25,000 is required at the time of the exercise of the lease option.

(d) OBMG has already signed a \$750,000 construction contract with Buildcor, Inc. to build out the interior of the structure. The contract will be assigned from OBMG to the LLC (Buildcor, Inc. has consented to the assignment).

(c) A *liquor license* will be obtained following the closing. At the present time, Manager believes that a full “on-sale general”⁹ liquor license is available upon application to the Department of Alcohol Beverage Control (the “ABC”). The cost of the license (application fees, attorney fees, etc.) will be between \$20,000 to \$50,000. There is always a possibility that the license may be delayed or denied due to objections by the police department, the public, or the investigator for the ABC.¹⁰

9. Under the regulations of the ABC, this type of license authorizes the sale of all types of alcoholic beverages, including beer, wine and distilled spirits, for consumption on the premises, and the sale of beer and wine for consumption off the premises.

10. Liquor licenses of this type are granted at the discretion of the ABC after extensive investigation and input from the police department and the public. If there are objections by the police or public, the ABC may require additional information or operating concessions from the applicant.

O. Transferability:

1. NMM Membership Units: Membership units will be freely transferable under the LLC operating agreement. There is no right of first refusal being granted to the LLC or its members. However, there are limits on resale imposed under federal and state securities laws. Any pending transfer by an NMM must first be submitted to the Manager for approval, along with an attorney's opinion letter (in form and substance satisfactory to Manager) opining that the transfer does not violate securities laws, nor will the transfer violate the terms of any exemption for the issuance of membership units by the issuer. A transferee will not become a *member* of the LLC until: (i) the Manager approves, in writing, admission of the transferee to the LLC; and, (ii) the transferee signs the Operating Agreement.
2. OBMG's Units: OBMG's units are not transferable without the prior consent of the NMM's.
3. ***See Appendix A for helpful hints about transfers***

P. Manager Default; No Manager Right to Dissociate:

1. There is no right of withdrawal by the Manager. The Operating Agreement will provide that a withdrawal by Manager is a breach of the Operating Agreement.
2. OBMG will be appointed Manager in the Operating Agreement. There is no right to elect a new manager, unless: (i) Manager withdraws; (ii) Manager dissolves; (iii) Manager is removed; or (iv) there has been a material change in the ownership or management of OBMG as follows:
 - A material change in OBMG's stock ownership that reduces Carl's or Bev's shareholder interests in OBMG
 - The dissolution of OBMG.
 - Insolvency or bankruptcy proceedings instituted by or against OBMG, or
 - Any material adverse change in the finances, management or ownership of OBMG.

In the event of a default by Manager under the Operating Agreement, or the wrongful dissociation of Manager, the NMM's shall have the right to remove Manager.

Removal of the manager requires consent of a majority in interest of the NMM'S. Manager, or NMM's who are shareholders of Manager, shall have no right to vote.¹¹ If Manager withdraws, dissolves or is removed, a new manager may be appointed by a majority vote of the NMM'S.

Q. Miscellaneous

11. But see Paragraph C regarding a change in the share ownership of BMG.

1. The LLC will keep books and records on an accrual basis.
2. Carl is obligated to devote a reasonable amount of time and effort to the development and operations of the business. During the first two years following the Closing, Carl will devote at least three quarters of his working efforts to the affairs of the business. After two years, Carl will devote a reasonable amount of time and effort.
3. Exemption from Registration & Qualification:

Federal: Our law firm has suggested, and the client has confirmed, that the appropriate exemption from federal securities registration requirements is the "private placement" exemption in §4(a)(2) and the related safe harbor provisions of Rule 506(c). Because of the relatively large cost of each membership interest (\$100,000), the deal will be structured so that all purchasers will be "accredited investors" as that term is used in Rule 501.

State: Section 18 of the Securities & Exchange Act of 1933 precludes state regulation of securities that are exempt under §4(2). Therefore, there is no need to satisfy the requirements of California or other state law for an exemption (except for notice filing requirements). In view of §18(b)(4)(D) under federal law and Rule 260.102.13(g) under California law, the investors will not have to meet the "excluded investor" requirements of §25102(f).

4. Line of Credit.

OBMG will be specifically authorized to open an unsecured line of credit of up to \$250,000 for purposes of operating the restaurant but not for capital expenditures.

III. Additional Facts:

You will probably have additional questions about the transaction that will need to be answered from time to time. You will be able to ask these questions in class or by e-mail. Any additional facts that are provided in response to questions will be posted on the Class Web Site, so that the entire class has access to a consistent set of facts. Make sure you check the "Final Project" link on the Web Site from time to time for additional facts.

IV. The Assignment:

A limited liability company offering of this type would proceed in two phases:

- formation of the limited liability company; and,
- preparation of a complete package for offering the membership units to investors. There are many documents that need to be prepared – but your assignment is to prepare only *certain* documents indicated below.

The documents you submit should be in complete and final form, ready for signature by the clients or other parties.

1. **Formation Documents:** The formation documents that you should prepare are:

- a. Cover Letter. A letter to *the clients* from the law firm, outlining the requirements for an appropriate state and federal exemption from registration/qualification – and a short explanation of the importance of complying with exemption requirements. The cover letter should also list the documents that are being included for final review by the clients.

The Articles have been filed and returned to the law firm prior to submitting the documents to the clients.

- b. Management Agreement: *Normally, you would prepare a management agreement between the limited liability company and the Manager. You should not do so for this assignment.*

- c. Limited Liability Company Operating Agreement. The following sections of the Operating Agreement deal with tax aspects of Capital Accounts and should not be materially altered: §4.2(a) and (b); §4.3 through §4.5; §4.7 through §4.12

See Appendix A to these Instructions for some helpful suggestions about the buy-sell provisions in the Operating Agreement.

- d. Articles of Organization.

2. **Offering Documents for Investors:** The *investor package* for this limited liability company would, in a real transaction, include the following documents (or similar documents) which, when completed, would be bound together for distribution to potential investors. The *client* would be preparing some of these documents, with your help and advice, while you would prepare some of the documents with the clients' input. For this assignment, you need only prepare the documents indicated as your responsibility.

- a. **[clients' responsibility]** Overview of Offering and Business Plan (an in-depth discussion of the business concept, the market and marketing, the restaurant,

the food, the patrons, the competition, the management of the restaurant, OBMG and its shareholders, source of revenues, expenses).

- b. **[clients' responsibility]** Financial Information and Forecasts (an in-depth analysis of the current and projected: balance sheet, income and expenses, cash flow, projected profits and losses, etc.).
- c. **Risk Factors & Conflicts of Interest [your responsibility]:** A document disclosing the risks involved in investing in the LLC and the conflicts of interest that the Manager or its principals may have. You should review your class notes about our discussions of securities regulations and the importance of disclosing material information about risks and conflicts of interest.

3. Subscription documents [your responsibility]:

- a. **Investor Suitability Standards:** An information statement informing offerees about who may invest in the limited liability company under the applicable exemption(s) from registration/qualification of the limited liability company units. A sample document is online. See the “Final Project” link on the Business Planning Web Site.
- b. **Subscription Agreement:** A contract in which the investor subscribes for the purchase of one or more limited liability company units. A sample document is contained in the CEB materials for this course. A copy of the CEB form is online in the “Final Project” link on the Business Planning Web Site.
- c. **Investor Certificate:** A certificate or questionnaire designed to elicit information from each investor, sufficient to permit the offeror to reasonably conclude that the limited liability company units are exempt from registration and qualification requirements under appropriate state and federal exemptions. You worked on a similar document earlier in the semester. A sample investment certificate is online in the “Links to Course Documents” on the Business Planning Web Site. There is also a similar form in the CEB materials. A copy of the CEB form is online in the “Final Project” link on the Business Planning Web Site.

Some drafters include portions or all of the provisions of this Investor Certificate in the Subscription Agreement. If these matters are addressed in the Subscription Agreement, they do not need to be addressed in the Investment Certificate. On the other hand, if these matters are addressed in the Investment Certificate, they do not need to be addressed in the Subscription Agreement. For this assignment, prepare a separate Investor Certificate and remove and duplicative items from the Subscription Agreement.

V. Forms; Computer Data Files

You can use the forms I'm making available on-line, or you can use other forms you prefer. Listed below are the *origins* of the documents. Note: ***do not include a single phrase from these documents in your documents own unless it is suitable to the interests of your clients.***

1. Operating Agreement: The CEB limited liability company agreement contained in the materials for this course.
2. Subscription Agreement: CEB forms 12.56, 12.57 and 12.58 (subscription agreement, purchaser questionnaire and professional advisor questionnaire).
3. Investor Certificate: The CEB form is on line. There is also an online copy of the Model Form distributed by Prof. Ehrlich earlier in the semester. See the "Links to Course Documents" on the Business Planning Web Site.
4. Who May Invest:¹² An information letter clearly advising brokers and offerees as to who may invest in the limited liability company. This form was originally designed for the Midwest river boat gambling project (see below). You should feel free to coordinate this document with the Investment Certificate.
5. Risks of Investment: A statement disclosing the risks involved in investing in the venture. This form originally designed for the Midwest river boat gambling project (see below).

The "Who May Invest" and Risks of Investment" documents were prepared in connection with a riverboat gambling project in the Midwest. It involved a *limited partnership* offering of \$6.5 million dollars. The general partner was a corporation. That transaction was based on an exemption from the federal securities laws that *may* be different than the exemption applicable to this transaction. If this is true, you will have to carefully review these agreements to make sure the information and warranties by the subscribers are appropriate for the LLC and the exemptions the LLC will be relying on when issuing investment units. Make sure you review your notes on federal and state exemptions.

12 This document is sometimes referred to by the title "Investor Suitability Standards" or similar titles.

Appendix A

Some Helpful Suggestions about the Buy-Sell Provisions in the Operating Agreement

We don't need an option to purchase. We don't care if NMM's want to transfer their interests. If the manager wants to transfer, it requires approval of the NMM's. Therefore, the NMM's will either approve the transfer (if the transferee is desirable) or they won't. If they don't, then they will have the right to buy out OBMG or dissolve the LLC.

1. If OBMG dissolves, withdraws, is adjudicated in bankruptcy or similar insolvency proceedings, then the NMM's will have the right (upon a majority vote) to elect one of the following options, in their sole discretion:
 - a. Accept a substitute manager and allow the shares of OBMG to be transferred to that manager;
 - b. Buy the shares of OBMG based on a capitalization formula. The purchase price will be reduced by either the actual damages caused by OBMG's departure or a 30% liquidated damages amount, whichever the NMM's elect, in their sole discretion; or
 - c. Dissolve the LLC.
2. If Bev or Carl are voluntarily or involuntarily terminated under their employment agreements, or voluntarily or involuntarily divest all or a portion of their interests in OBMG, or die, become disabled, withdraw or are adjudicated in bankruptcy or similar insolvency proceedings, then the NMM's will have the (upon a majority vote) to elect one of the following options, in their sole discretion:
 - a. Accept a substitute individual to serve as successor to Bev or Carl. Any such substitute individual will sign an appropriate employment agreement with the LLC and acquire Bev or Carl's interest in OBMG;
 - b. Buy the shares of OBMG based on a capitalization formula. The purchase price will be reduced by either the actual damages caused by Bev or Carl's departure, if caused by death or disability. If the cause of the buyout is not the death or disability of Bev or Carl, then the purchase price will be reduced by either the actual damages caused by OBMG's departure or a 30% liquidated damages amount, whichever the NMM's elect, in their sole discretion; or
 - c. Dissolve the LLC.
3. The capitalization formula: You can find a sample capitalization formula in Chapter 8 of Ehrlich & Michaels.