

**KEYTLAW, L.L.C.**

ATTORNEYS

3001 East Camelback, Suite 130  
Phoenix, Arizona 85016  
(602) 906-4953  
www.keytlaw.com

RICHARD KEYT  
Tel: (602) 906-4953, ext.1  
Fax: (602) 297-6890  
Email: rk@keytlaw.com

Estate Planning  
Entity Formation  
Business Law  
Real Estate Law  
Contracts

March 11, 2011

Homer Simpson, Manager  
World Wide Widgets AZ, LLC  
4512 East Hampton Drive  
Springfield, Illinois 21022

Re: The Proposed Buy Sell Agreement of World Wide Widgets AZ, LLC, an Arizona limited liability company

Dear Homer:

This letter accompanies the first draft of the proposed Buy Sell Agreement of World Wide Widgets AZ, LLC, an Arizona limited liability company (the "Company"). A Buy Sell Agreement is a very important agreement between the Members of the Company and the Company. In practicing business law in Arizona since 1980, I have learned that the Buy Sell Agreement is the single most important document for most multi-member LLCs. Whenever I mention multi-member LLCs in this letter, I mean LLCs that have more than one Member, but not an LLC that has only two Members who are husband and wife.

The Buy Sell Agreement contains the Members' exit strategy. Without an exit strategy, there is no easy way for a multi-member LLC to carry out a company divorce when one or more of the Members wants to part ways or one or more Members want to get rid of a "problem" Member. As you can see from reviewing the Table of Contents of your Buy Sell Agreement, it covers a lot of territory. Arizona law does not require that the Members of an Arizona LLC enter into a Buy Sell Agreement, but I think it is a big mistake for multi-member LLCs to fail to enter into a well-thought out Buy Sell Agreement.

The enclosed Buy Sell Agreement is not yet ready for the signatures of the Members because it needs to be customized for your Company and it contains several optional clauses that require the Members to tell us which optional clause they want to retain in the Buy Sell Agreement. Here is a summary of the Buy Sell Agreement:

**Article 1**

This Article states the Percentage Interests of each Member.

**Article 2 Definitions**

This Article defines the terms that are capitalized in the Agreement. Capitalized terms in this letter have the meanings stated in Article 2.

### **Article 3 Membership Interest Transfer Restrictions**

In general, Members may not Transfer or Encumber all or a portion of their Membership Interests except as provided in the Buy Sell Agreement. Section 3.3 states the conditions that must be satisfied before a Transferee may become a Member. Section 3.8 states that the donee (the recipient) of a gift of a Membership Interest can become a Member without the approval of the Members. Is this ok or do you want to prevent donees from becoming a Member unless the donee is approved by the Members?

### **Article 4 Right of First Refusal**

This Article gives the Company first and the other Members second, an option to purchase all of the Membership Interest of a Member who proposes to transfer the Member's Membership Interest to a non-Member. The terms of the purchase will be the same as the terms applicable to the proposed Transfer to the non-Member.

### **Article 5 Drag Along Sale of Membership Interests**

This Article provides that if a sufficient number of Members vote to sell their Membership Interests, the remainder of the Members must sell their Membership Interests on the same terms and conditions.

### **Article 6 Adverse Acts**

This is one of the most important parts of the Buy Sell Agreement because it lists acts or omissions of Members (called Adverse Acts) that can cause a Member to become an Adverse Member. The consequences of becoming an Adverse Member include the loss of the right to vote and giving the Company and then the Nonadverse Members the option to purchase the entire Membership Interest of the Adverse Member. Please carefully review each of the acts listed in Section 6.3 that can cause a Member to become an Adverse Member.

The Members must tell me which of the subsections of 6.3, if any, they want to delete or modify. If there are any other acts or omissions that the Members want to add to the list of Adverse Acts in Section 6.3, tell us on the **Buy Sell Agreement Modification Instructions**. We can add anything to Section 6.3 that the Members want as long as it is not a violation of law or public policy. For example, if the Members want, we add a provision that says a Member will become an Adverse Member if the Member purchases season tickets to the Arizona Cardinals football games.

### **Article 7 Redemption or Purchase of Membership Interests**

This Article contains the provisions that govern the actual purchase of the Membership Interest of an Adverse Member such as how the Purchase Price is determined, when the closing of the sale will occur, the amount due at closing and the terms and conditions applicable to the balance of the Purchase Price evidenced by a promissory note. Section 7.3 provides the Company first and then the Nonadverse

Members second have an option to purchase the interest of a Member if the Member were to die. **The Members must tell us in the Buy Sell Agreement Modification Instructions to do one of the following with respect to Section 7.3:**

- A. **Eliminate the option to purchase on death entirely**, or
- B. **Require the Company and then the Members to purchase the Membership Interest of a deceased Member**, i.e., make this a mandatory requirement rather than an option.

Section 7.3 contains a provision that some people want and others do not. It provides for an adjustment in the Purchase Price if the buyer under Section 7.3 resells the purchased Membership Interest within two years for an amount greater than 20% of the Purchase Price. If you do not want this provision, indicate that choice on the **Buy Sell Agreement Modification Instructions**.

**One of the most important Sections in the entire Buy Sell Agreement is Section 7.6 because it is the Section that defines how the Purchase Price will be determined.** Section 7.6 contains six different methods for determining the Purchase Price. The six methods are: (i) stated dollar amount, (ii) CPA appraisal, (iii) average of two appraisals, (iv) book value, (v) capitalized X years' earnings, and (vi) weighted capitalization of X years' earnings. **The Members must select one of these six methods and indicate their choice on the Buy Sell Agreement Modification Instructions.** The Members may also modify one of the six methods or give us an entirely different method for determining the Purchase Price.

### **Article 8 Life Insurance**

This Article will apply only if the Company or the Members purchase life insurance to fund the purchase of the Membership Interest of a deceased Member. This is an excellent way to fund the purchase of a deceased Member if insurance can be purchased on the life of the Member for a acceptable amount. Under Article 8 the option to fund a buy-out on death is there in standby mode until the Company and/or the Members decide to purchase life insurance for this purpose. If life insurance is purchased, the Members must amend Exhibit C to add the name(s) of the insured and the information about the insurance company and the life insurance policy on the life of the member(s).

Using life insurance to fund a buy out of a deceased Member can benefit buy the buyer and the seller. If the Members are interested in purchasing life insurance to fund a purchase, I recommend the Members contact a good life insurance agent who has experience with this type of insurance to discuss the procedure, the cost of insurance and other options that can be used with this funding method.

The Members must tell us now which of the two optional paragraphs to use in Section 8.3. The purpose of this Section is state what happens to the excess life insurance proceeds when the amount of the insurance exceeds the Purchase Price. Should the excess life insurance money go to: (i) the beneficiary of the policy, the purchaser of the Membership Interest, (ii) or to the estate of the deceased, the seller of the Membership Interest? Indicate on the **Buy Sell Agreement Modification Instructions** which of the two options to put in the final Buy Sell Agreement.

### **Article 9 Involuntary Buy Out of a Member**

Article 9 could be called the “shot gun” buy out procedure. This alternate name is derived from the phrase a “shot-gun wedding,” meaning a forced marriage. The shot gun buy out clause gives each Member a method to effect a company divorce when none of the other buy out situations under the Buy Sell Agreement applies. The provisions contained in Article 9 give every Member the option to start a process that will end in one Member buying the entire Membership Interest of another Member. The shot gun buy out clause is a built-in exit method. It is a method by which every Member has the option to force an involuntary company divorce at any time for any reason or no reason.

**The Members must read and consider Article 9 and decide to keep or delete it. If the choice is to keep Article 9, the Members may also modify it.**

The shot gun buy out provisions give each Member (the “**Electing Member**”) an option to start the buy-out procedure at any time by notifying any other Member (the “**Nonelecting Member**”) and naming the price for one Percentage Interest in the Company (the “**Percentage Interest Price**”). The Nonelecting Member will have sixty days to decide to either sell all of the Nonelecting Member’s entire interest to the Electing Member or buy all of the Electing Member’s interest in the Company. The Purchase Price is the Percentage Interest Price designated by the Electing Member multiplied by the number of Percentage Interests being sold. The closing of the sale will be within thirty days after the buyer and seller are determined. A Member who is in default under the Operating Agreement may not invoke the Shot Gun Buy Out Procedure.

Many people do not want a Shot Gun Buy Out procedure in their Buy Sell Agreement for various reasons. A common reason people do not want the procedure is because it gives an Electing Member who has money the ability to force an involuntary buy out of the interest of a Nonelecting Member who the Electing Member knows cannot raise the funds needed to purchase the interest of the Electing Member. Another reason people do not include this type of forced-involuntary buy out procedure is because of the fear of the unknown, i.e., they fear that they could be forced to sell or buy when they might not want to do either on terms that they may not find acceptable.

Other people want a forced buy out procedure in the Buy Sell Agreement so that Members who do not agree and/or who cannot get along will have a method to cause a company divorce without resorting to costly and uncertain litigation. **The Buy Sell Agreement contains many situations that can give the Company or the Members the option to purchase the Membership Interest of a Member, but it does not contain buy outs for all situations that might arise, including the two most common company divorce situations: (i) one or more members just wants out or (ii) one or more members cannot agree with one or more other members on anything.** Without a forced buy out method like the one in Article 9, Members who want and need a Company divorce must continue their unhappy and stressful co-ownership of the Company indefinitely unless somebody sues for judicial dissolution of the company.

I urge all the Members to read Article 9 carefully and discuss whether to retain the Shot Gun Buy Out, modify it or eliminate it entirely. Let me know if the Members would like to modify the procedure or delete it. If the Members want to delete the entire procedure, indicate that choice on the **Buy Sell Agreement Modification Instructions**.

#### **Article 10 Noncompetition & Nonsolicitation of Employees**

This Article prohibits Members from competing with the actual business in which the Company is engaged while a Member and for three years after ceasing to be a Member. This Article also prohibits a Member or former Member from hiring employees of the Company or taking the Company's customers or clients. Paragraph d provides for liquidated damages of \$10,000 a month for any month in which the Member or former Member violates Article 10.

#### **Article 11 Termination**

This Buy Sell Agreement terminates upon: (i) the written Agreement of all of the parties; or (ii) the dissolution of the Company.

#### **Article 12 Miscellaneous Provisions**

The Article contains the "boiler plate." Make sure the addresses for notices sent to the Members in Section 12.1 are correct. If any address is incorrect, mark the page and fax or email it to us or indicate the correction on the Buy Sell Agreement Modification Instructions.

#### **What You Must Do to Finalize Your Buy Sell Agreement**

The Buy Sell Agreement enclosed with this letter is not intended to be the final Buy Sell Agreement. Before the Members are able to sign the Buy Sell Agreement, they must first review it and decide as a group which optional provisions in the Buy Sell Agreement they want and if they want to modify the Agreement. The instructions below explain what the Members must do to finalize the Buy Sell Agreement.

There are two ways to answer the questions posed above and make other changes to the Buy Sell Agreement, and both methods require that a Manager complete the Buy Sell Agreement Modification Instructions found on our website at [www.keytlaw.com/bsa.pdf](http://www.keytlaw.com/bsa.pdf). Here is what the Members and Manager must do before we can send you the final version of the Buy Sell Agreement for the signatures of the Members:

1. A Manager must give each Member a copy of this letter and the proposed Buy Sell Agreement.
2. Each Member must read this letter and the Buy Sell Agreement and mark any questions or desired changes on the Agreement.

Homer Simpson, Manager  
March 11, 2011  
Page 6

3. A Manager must complete the Buy Sell Agreement Modification Instructions, sign it and deliver it to us using one of the two delivery methods listed in the next paragraph. Indicate on the Buy Sell Agreement Modification Instructions whether or not the Members want to have an actual meeting or a phone conference with Jeana Morrissey to discuss the Buy Sell Agreement and answer questions about it. If the Members do not need a conference, indicate that fact on the Buy Sell Agreement Modification Instructions. A Manager must sign the Buy Sell Agreement Modification Instructions before returning it to us.
4. Deliver the Buy Sell Agreement Modification Instructions and any pages of the Buy Sell Agreement that are marked by a Member with changes or questions as follows:

**Fax the pages to:** KEYTLaw business and real estate law attorney Jeana Morrissey at 602-798-7682, or

**Email the pages to:** Jeana Morrissey at [jrm@keytlaw.com](mailto:jrm@keytlaw.com) with a copy to Jeana's legal assistant Milena at [mac@keytlaw.com](mailto:mac@keytlaw.com).

5. If the Buy Sell Agreement Modification Instructions indicates that the Members want a conference to discuss the Buy Sell Agreement, the Manager must call KEYTLaw legal assistant Milena at 602-424-4159 to schedule an appointment with Jeana Morrissey to discuss the Buy Sell Agreement. The conference can be over the phone or in our office. The purpose of the conference is to answer Members' questions about the Buy Sell Agreement and for the group to discuss and agree on any changes the Members want to make to the document. Your purchase of the Buy Sell Agreement includes up to one hour of attorney time modifying and answering questions about the Buy Sell Agreement.

After we get your completed and signed Buy Sell Agreement Modification Instructions and the Members have their conference with Jeana (if requested), we will make any requested changes to the Buy Sell Agreement then email it to the Manager to obtain the signatures of the Members.

Sincerely,



Richard Keyt

enclosures