TAINTED LOVE: STARTING A BUSINESS WITHOUT AN OPERATING AGREEMENT

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In honor of Valentine's Day, I'd like to share a twist on a classic love story – two young, naïve individuals meet, find they have common interests, and start dreaming about their future. Eventually, these like-minded individuals decide that they are ready to take the "plunge" and enter into a long-term commitment. After months of planning and preparation, they finally take the next step - **they start their business!** Like most new business owners, the business is their "baby" – demanding most of their time, attention, and money for the next several years. As a result of their hard work (and with a bit of luck), the business grows and matures over the years, eventually expanding into a successful venture.

Unfortunately, as in some marriages, this love story does not have a happy ending. After years together, the honeymoon is over. The business owners realize they have different long-term goals and, due to their irreconcilable differences, they decide to go their separate ways. Much like children, businesses cannot be easily shared between feuding owners. As a result, a lengthy (and expensive) custody battle ensues over who gets to keep the business with each owner feeling that they have the best interest of the business in mind. Certainly, this is not the outcome anyone was hoping for – and this "business divorce" is not healthy for either the divorcing owners or for their

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business and employees.

The good news is that this unfortunate outcome could have been prevented if the owners had entered into a well-crafted Operating Agreement. Businesses (like marriages) are often successful because of open and honest communication, proper planning, and flexibility. By planning for membership or shareholder disputes at the start of your relationship you have a better chance of minimizing the pain and duration of a breakup.

Will you still love me tomorrow?

Why an Operating Agreement is Critical

A comprehensive Operating Agreement is a critical tool in this planning process. Such an agreement can both assist business owners in resolving issues as they arise and can act as a "prenup" to ease the process of separating ownership in the event of a "business divorce." For example, a well-drafted Operating Agreement would provide mechanisms for the following situations:

Decision Making Rights

- In any business relationship, it is important to have a clearly defined protocol for how decisions are made. Often, more than one protocol is required. For example, your business might grant a Manager with sole decision-making authority for day-to-day decisions, but may require approval from a majority of the owners before making certain major decisions. An Operating Agreement that clearly defines which decisions require unanimous or supermajority member approval, can help you to avoid arguments down the road.

Additional Capital Needs

- As businesses grow, they often require additional capital. Disagreements can arise if there is not an agreement in advance as to where this additional funding will come from. Your Operating Agreement should lay out who is – and is not – responsible for contributing additional capital and what the consequences are for members who do not contribute as required.

Resolving Deadlocks

- Even when you have clearly established protocols for making important decisions, decision-making deadlocks are inevitable - particularly in businesses that are owned 50-50. Your Operating Agreement should proactively establish a fair method for resolving such deadlocks.

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- In the event that the business owners truly have irreconcilable differences and can no longer carry on the business together, a business divorce may be the only viable solution. There are several creative mechanisms that can be included in your Operating Agreement to provide for a fair and swift divorce that leaves the business intact.

Like a marriage, even the best-laid plans do not guarantee a happy ending – but by having a comprehensive Operating Agreement in place, you can dramatically decrease the chances that Tainted Love will ruin your business's happily ever-after.

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