Burns Figa & Will P.C.

HERRICK K. LIDSTONE, JR.
720 493 3195
hklidstone@bfw-law.com

LLC or Inc.?

Entity Selection for a Small or Medium-Sized Business

Herrick K. Lidstone, Jr., Burns, Figa & Will, P.C.

Greenwood Village, Colorado

Entrepreneurs and other business owners have a variety of choices when it comes to choosing the legal entity through which to implement a new venture. In Colorado, those choices are found in Title 7 of the Colorado Revised Statutes and include:

- Limited partnerships formed under the Colorado Uniform Limited Partnership Act of 1981 ("CULPA")[1]
- Limited partnership associations formed under the Colorado Limited Partnership Association Act ("CLPAA")[2]
- General partnerships formed under the Colorado Uniform Partnership Act ("CUPA")[3]
- Limited liability companies formed under the Colorado Limited Liability Company Act ("Colorado LLC Act")[4]
- Business corporations formed under the Colorado Business Corporation Act ("CBCA")[5]

In choosing among the various entities, there are several frequently asked questions that business owners and investors raise. What type of entity should I choose? What kind of protection do I need to shield my personal assets from the liabilities of the business? Do I need to protect the assets of one segment of the business from the liabilities of another segment of the business? How will I be taxed on the profits of the business? Will I be able to claim the tax benefits of any losses generated by the business?

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[1] C.R.S. § 7-62-101, *et seq.* Limited partnerships can no longer be formed under the Colorado Uniform Limited Partnership Law of 1931 ("CULPL") found at § 7-61-101, *et seq.*

[2] C.R.S. § 7-63-101, *et seq.*

[3] C.R.S. § 7-64-101, *et seq.* General partnerships can no longer be formed under the Colorado Uniform Partnership Law ("CUPL") found at § 7-60-101, *et seq.*

[4] C.R.S. § 7-80-101, *et seq.*

[5] C.R.S. § 7-101-101, *et seq.*

While there is no "one size fits all" answer to these questions, the right answer is usually either a business corporation formed under the CBCA or a limited liability company formed under the Colorado LLC Act.

In reaching the decision as to which is preferable, one must ask a number of additional questions. Who is expected to invest in the entity? How will the entity be capitalized? Will the entity borrow money from its owners or from third parties, such as a bank or other lender? Do the projections anticipate that the entity will be profitable in the near future, or not? Is there a desire for pass through tax treatment or not? The answers to each of these questions could affect the choice of entity.

What Form of Entity is Best for Your New Business?

By D. Sean Velarde, Esq.
Burns, Figa & Will, P.C.
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Introduction

If you desire to protect your personal assets from creditors, or you desire to minimize the tax consequences to your new business and to yourself as an owner of the business, then the legal entity you choose for your business is very important. You and your advisors must consider many factors to insure that your goals are achieved. An attorney or an accountant may appear smart by quickly stating that a particular business form is suitable for every new business. However, the proper choice of entity cannot be determined until you and your attorney explore several factors, including the purposes for forming the entity together with your desire, if any, for a limited liability and tax savings.

You must also carefully consider the legal requirements and regulations applicable to the business or its industry, the choice of jurisdiction for the new business, and your short-term and long-term goals, including ownership succession or the future potential sale of the business. The ability to sell your ownership interest in a business, the ease of raising capital, the relationship between co-owners, and liability for the business's tax or legal problems are all dependent upon the choice of entity.

Business owners can be held personally responsible – as opposed to just the business being sued – for liabilities and injuries by anyone who believes they have been harmed in any way by the business. Owners may also be held personally responsible for certain contracts and other agreements entered into on behalf of the business. With proper planning, your personal assets can be protected from those risks and your taxes minimized. Deciding on what entity to use is one of the most important decisions made by the owner of a new business.

This article outlines several types of entities available and some of the more important factors that should be considered when choosing the best form of entity for your new business. This article provides summaries of those factors and should not be relied upon as comprehensive. Each particular circumstance is unique and requires its own independent analysis.

There are numerous types of entities for the new business owner to consider. The options include the sole proprietorship, the general partnership, various types of limited partnerships, a C-corporation, an S-corporation, or a limited liability company.

Sole Proprietorship

An unincorporated, sole-proprietorship is one option for a new business when there is a single owner who is not concerned about limiting the owner's liability for operating the business or his or her taxes in connection with the business. There is no legal separation between the owner and the business. Therefore, the owner is personally liable for all business-related debts, obligations, and judgments obtained against the business.

Formation of the sole proprietorship is easy and inexpensive. No filing with the secretary of state is required to form a sole proprietorship. However, the business may be required to register with certain state and local agencies and obtain applicable licenses and permits. All profits and losses from the business must be reported on the business owner's personal tax return. Sole proprietorships have difficulty raising capital because they cannot sell interests in the business. If the owner sells a partial interest in the business, he or she and the new owner have formed a general partnership.

Given the relatively modest expense in creating an entity recognized by statute that will provide substantial protection for various personal liabilities and may also provide favorable tax treatment for the new business owner, sole proprietorships are generally viewed as an unwise choice. The single business owner who is not intentional in forming an entity with limited liability and favorable tax treatment may unwittingly operate the business as a sole proprietorship with all its attendant risks and disadvantages.

Partnerships

Generally, when two or more people associate to carry on, as co-owners, a business for profit, they have formed a partnership, whether they know it or not. Like a sole proprietorship, no filing with the secretary of state is required to form a general partnership. Again, the business may be required to register with certain state and local agencies and obtain applicable licenses and permits. Partnerships have many benefits, but can increase the risk of personal loss for business owners without proper planning. In a general partnership, all of the partners are personally exposed to the actions of the partnership and the other partners.

It is possible to form a general partnership without intending to do so. General partnerships generally are disfavored these days because each partner in a general partnership has unlimited liability for the obligations of the partnership and the acts of the other partners. If limited liability is desired, another type of entity is more desirable. For income tax purposes, general partnerships are a pass-through entity unless the partnership elects otherwise.

Each state has adopted rules regarding how partnerships operate in their state and most states have several different types of partnerships. Depending on the limited liability and tax goals of the owners, limited partnerships are often preferable to general partnerships.

In many states, a limited liability partnership is a general partnership that has elected for most or all the partners to have their liability limited to the amount of property and money they have contributed to the partnership. A limited partnership is a partnership which has at least one general partner who has unlimited liability for the obligations of the partnership, and at least one limited partner that has liability limited to his or her contribution to the limited partnership. Management of a limited partnership is vested in the general partner and may be governed by a partnership agreement or the applicable state statutes.

To form a limited partnership, the owners or the organizer of the partnership must file the appropriate articles or registration statement with the secretary of state in the state of organization. Limited liability limited partnerships, limited partnership associations, and other types of partnerships may be available depending on the state of organization and may provide unique benefits to the business owner. Limited liability partnerships, limited partnerships, limited liability limited partnerships, and limited partnership associations all are pass-through entities for tax purposes.

Corporations

A corporation is a separate legal entity owned by one or more co-owners, legally referred to as "shareholders" or "stockholders." A corporation is formed by filing articles of incorporation with the secretary of state in the state of incorporation and paying the appropriate filing fee. Each state requires that certain information be included in the articles of incorporation, although those requirements vary from state to state. Each state also allows the incorporator to add other permissive and discretionary provisions to articles of incorporation which may be very important to the governance of the business and limiting risk.

A corporation is an independent legal entity distinct from its shareholders. The corporation has a legal authority to enter into contracts, own property, litigate disputes, and transact other business consistent with its purposes. A corporation generally is characterized by providing limited liability for its shareholders, perpetual existence independent from its shareholders, transferability of ownership interests, and centralized management by its officers and directors.

Limited liability means that shareholders are not typically liable for the obligations of the corporation. Instead, their liability is limited to the amount of their investment in the stock of the corporation. Shareholders may be liable for corporate obligations if corporate formalities are not followed and a creditor can convince a court that it was appropriate to "pierce the corporate veil" to reach the shareholder's personal assets. A shareholder may also be responsible for corporate obligations arising out of the shareholder's own bad acts, such as breaching a legal duty to other shareholders or the corporation. Finally, a shareholder may voluntarily waive some of the limited liability protection offered by a corporation by personally guaranteeing certain obligations of the corporation like a line of credit or lease.

A corporation is governed by its articles and its bylaws. Like articles of incorporation, bylaws may include various permissive and discretionary provisions which may be very important to the governance of the business and limiting risk. A corporation must also follow "corporate formalities" such as keep minutes of annual and special meetings of its shareholders and directors to avoid having its corporate veil pierced. The shareholders may also desire to have certain management and shareholder agreements like a buy-sell agreement which restricts the shareholders' ability to sell his or her ownership. Buy-sell agreements determine how business owners may later part ways and can prevent the remaining owners from having to be in business with someone not of their choosing.

Management of the corporation as governed by its bylaws unless no bylaws are prepared, in which case it is governed by state statute. Management of a corporation is entrusted to its directors who are elected by its shareholders. Directors may delegate certain duties of management to officers. In new, small, and closely-held corporations, the shareholders often appoint themselves as directors and officers. In that case, the shareholders should avail themselves of many of the permissive and discretionary provisions which may be included in the corporation's articles and bylaws. Some of the optional provisions include providing for the indemnification and elimination of liability of directors in certain circumstances.

A common type of corporation is the C-corporation which is a for-profit, state-incorporated business. C-corporations can take advantage of corporate benefit plans, health plans, and retirement plans that are not available to some non-corporate businesses. Also, the C-corporation is easiest entity for raising capital. The primary disadvantage of a C-corporation is that it is subject to double taxation. That is, the corporation's income is taxed at the corporate level and then, when its shareholders receive dividends or other distributions, taxed again on the shareholders' personal tax returns.

Under the Internal Revenue Code, Subchapter S, certain corporations may elect "S-corporation" treatment. An S-corporation is a corporation that elects not to have its income taxed at the corporate level. Rather, it is a "pass-through" entity which means its shareholders are allocated a pro rata share of the corporation's net income that they then must report on their individual tax returns. To qualify for S-corporation treatment, the corporation must have a limited number of shareholders who generally must be U.S. citizens or resident aliens, must have no more than one class of stock, and generally may not have any entities as shareholders. Further, all of the corporation's shareholders must approve the election to be taxed as an S-corporation and file the appropriate IRS forms within seventy-five days after incorporation. The S-corporation offers the same limited liability protection for its shareholders, perpetual existence independent from its shareholders, and centralized management. However, given the Internal Revenue Service regulation, transferability of ownership interests is not as easy as that of a C-corporation.

Limited Liability Companies

Limited liability companies (LLCs) provide limited liability to its owners, usually referred to as "members." An LLC is formed when it files articles of organization with the secretary of state in the state of organization and pays the appropriate filing fee. Like partnerships, most limited liability companies are pass-through entities for federal income tax purposes. However, its members may elect corporate tax treatment. If an LLC has only one member, the member can elect to have the entity disregarded for federal tax purposes. The LLC will enjoy state provided limited liability, but sole proprietorship tax treatment.

An LLC may be managed by its members or managers chosen by its members. Depending on the owner's desires, the election of how the LLC is managed from the beginning can be very important. The governing document for an LLC is its operating agreement – the rough equivalent of corporate bylaws. An operating agreement need not be in writing, but most state statutes offer the LLC and its members additional limited liability and other permissive provisions that must be specifically included in the operating agreement for the LLC to avail itself of the maximum possible protection. Operating agreements may also include a buy-sell agreement and a management agreement within the document.

- Employee stock ownership plans
- Whether the company is required to register to do business in foreign jurisdictions
- Employee and independent contractor issues, agreements, handbooks, and policies
- Intellectual property protection for copyrights, trademarks, patents, and trade secrets
- Employee benefits (including owner-employees) such as ERISA benefit plans, health insurance plans, vacation and leave policies
- Various business insurance

Most lawyers tend to have two types of clients: the first type of client is the client who is willing to seek and pay for preventative legal measures to limit future risks and taxes; the second type of client is the one who is unwilling to seek advice and plan in advance.

Depending on the level of planning up front, which in some instances may be perceived as expensive, the first type of client almost always pays a small fraction in legal fees than the second type of client. This is true because it often is the second type of client who later finds himself or herself in expensive, unpredictable, and largely uncontrollable litigation possibly resulting in a judgment against the business and, in some instances, the owners themselves.

Good planning with competent legal counsel from the beginning can help you protect your business, your personal assets, and (like preventative medicine or car maintenance) can save you significant money later.

LLC versus a Corporation: What are the Principal Non-Tax Differences?

All corporations formed under the CBCA have certain common structural characteristics, and any deviations can be found in the corporation's articles of incorporation. On the other hand, LLCs formed under the Colorado LLC Act are primarily contractual creatures that can be designed to fulfill the organizers' intentions. The following table sets some of this information forth:

	Corporation	**LLC**
Formation	Filing articles of incorporation with the Secretary of State ("SOS") §7-102-102	Filing articles of organization with the SOS §7-80-204
Transparency	Material provisions regarding capitalization, board of directors, limitation of liability, and other provisions included in articles or statutory default	No material provisions included in articles. Statutory default is likely unacceptable
Bylaws/Operating Agreement	Bylaws may contain some material provisions (such as nominating procedure for directors), but generally not material to governance §7-102-107	Operating agreement is the contract between the members. May be oral, but statute of frauds issue.
Unauthorized assumption of powers	§7-102-104	§7-80-105
Capital Structure	Set forth in articles, but generally common stock and perhaps preferred stock	"Membership interest" defined by reference to the investment, unless otherwise set forth in the operating agreement
Capitalization	Defined capital structure in articles (authorized shares by number and class) §7-106-101, -102	Usually unlimited capital structure, but subject to definitions in operating agreement
Issuance of Equity	Defined requirements §7-106-202	Established in operating agreement
Profit motive	Corporation must have a profit motive.	LLC need not

	Corporation	LLC
Purposes	Can be narrow or broad; more often purposes should be broadly written	Can be narrow or broad; more often purposes should be narrowly written
Limitations of Liability of Equity Owners	Statutory §7-106-203, "unless otherwise provided in articles", and §7-108-402 (exoneration)	§7-80-705 (applies to members and managers)
Exceptions	Persons own acts or conduct	Same
	Unpaid portion of subscription §§ 7-106-201, 203	§7-80-502
	Wrongful distributions § 7-106-401, §7-108-403	§7-80-606
Standards of conduct	§7-108-401 (generally the duty of care) and §7-108-501 (duty of loyalty)	§7-80-108, 404. All duties can be waived or modified except the contractual obligation of good faith and fair dealing
Piercing the veil to impose liability on owner	Common law	Statutory (§7-80-107 applies corporate common law)
	No preemptive rights unless granted in articles §7-106-301	No preemptive rights unless set forth in operating agreement
Owner action	Generally a majority of shares voting; occasionally a majority of the outstanding §7-107-206	Generally unanimous unless agreed otherwise; exception is for removal of manager which requires a majority of members (not membership interest §7-80-402)
		See §7-80-401 requiring vote of a majority of the members or managers, as applicable
	Generally vote by number of voting shares §7-107-202	Generally *per capita* vote unless otherwise agreed §7-80-401

	Corporation	**LLC**
	All holders of a class of stock entitled to vote are entitled to vote	Must be a member to exercise the rights to vote. Assignees who have not been admitted do not have right to vote
Collective action	Board acts collectively §7-108-101; officers within the scope of their authority §7-108-301	Managers (or members of member-managed) are agents for the purpose of the business of the LLC §7-80-405
Rights of creditor against owner	Foreclosure resulting in rights of a shareholder	Charging order or foreclosure of membership interest (resulting in rights of assignee) § 7-80-703
Security interest	Pledge of certificated interests under article 8 of the UCC	Must elect article 8 treatment, and then still must perfect under article 9 (a control agreement, generally required)
Derivative proceedings	§7-107-401 *et seq.*	§7-80-713 *et seq.*
Voluntary dissolution	§7-114-101 *et seq.*	§7-80-801 *et seq.*
Judicial dissolution	§7-114-301 *et seq.*	§7-80-810 *et seq.*
Administrative dissolution	None; delinquency in §7-90-901 *et seq.*	Same
Annual meetings	Required §7-107-101	Only if required by agreement

Statutory law bears an important role in the choice of form and structure decision. The statutes of a jurisdiction in which an organization is formed (the "organic statutes") are increasingly important in the choice of form and structure of business organizations. The organic statutes in Colorado for the purposes of this paper are the Colorado LLC Act and the CBCA. They attempt to codify, or in some cases change, the common law. The Colorado LLC Act and the CBCA also contemplate an agreement among owners and managers that may modify the rules otherwise applicable under the Colorado LLC Act and the CBCA and the common law.

There are other laws that are potentially applicable to entities formed under the CBCA, the Colorado LLC Act, and the other Colorado organic statutes. These include

statutes that describe the application of other laws to the entity, such as tax statutes, bankruptcy law, securities regulation, and laws regulating specific activities or businesses.

The existence and operation of any business organization is governed by a combination of organic statutes, these other laws and regulations, agreements of the owners and managers, and common law. In most cases, the organic statutes provide the legal basis for the existence of the organization as a legal entity and provide rules which govern the relationship of the owners and managers *inter se* and the manner in which the organization acts with respect to third parties, *i.e.*, the agency and decision-making authority of the constituents of the entity. The organic statutes include rules that can be modified by the agreement of the owners and managers ("default rules") and rules that may not be varied by agreement ("mandatory rules").

Mandatory rules set forth in organic statutes such as the CBCA and the Colorado LLC Act generally prevail over any contrary agreements among parties and have the effect of overruling contrary common law. Similarly, organic statutes may allow the owners of an organization to take action even if such action would have been proscribed under common law in effect before the adoption of the organic statute. Thus, for example, the organic statutes may modify the duties owed by owners or managers to each other under common law in effect before the adoption of the organic statute. Some more recent organic statutes, such as the Colorado LLC Act, transform some existing common law into default rules that may be modified by the owners and managers by their agreement.

Organic statutes generally set forth rules regulating more mundane aspects of the entity sometimes referred to as "plumbing."[6] These plumbing issues include such matters as the contents of filed documents, annual reporting, and permissible names for the entity. Among other functions, plumbing rules generally constitute a statutory rubric under which business entities may be found and kept track of by the state filing officer and provide a framework under which certain types of transactions may be accomplished. As noted above, many states are combining many "plumbing" issues into multi-form statutes that provide common statutory provisions to different forms of entity. In Colorado, these are found in the Colorado Corporations and Associations Act.[7]

Perhaps the most significant aspect of the organic statutes is the degree to which they consist of default rules that can be modified by agreement or mandatory rules that are non-waivable. The Colorado LLC Act provides the ability to waive a number of duties that might be referred to as fiduciary,[8] while the CBCA does not provide for such waivers.

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[6] *See*, Keatinge, *Plumbing And Other Transitional Issues*, 58 Bus. Law. (ABA) 1051 (May 2003).

[7] Colo. Rev. Stat. § 7-90-101, *et seq.*

[8] Colo. Rev. Stat. § 7-80-108.

In a purely contractual arrangement such as is contemplated for an LLC, the ability to modify the relationship by agreement is limited only by considerations such as fraud or public policy, illegality or other contractual policing techniques that would make a contract otherwise unenforceable.[9] Ordinarily a purely contractual agreement does not entail fiduciary duties. If, however, one party agrees to act as an agent for another, or one party resides trust and confidence in another, such agreement may create the fiduciary duties that ordinarily accompany an agency or common law fiduciary relationship.

In an LLC, members may draft relationships among themselves in an operating agreement. Notwithstanding the legislative desire to give maximum effect to the principle of freedom of contract,[10] the Colorado LLC Act does contain some restrictions on the ability of the operating agreement to reflect the member's agreement.[11] An operating agreement may not:

- Unreasonably restrict the rights of members and managers for access to books and records of the LLC under C.R.S. § 7-80-408.
- Eliminate the "contractual obligation of good faith and fair dealing" under C.R.S. § 7-80-404(3).
- Restrict rights of, or impose duties on, persons other than the members, their assignees and transferees, and the limited liability company without the consent of such persons.

Furthermore, no operating agreement may vary any requirement under the Colorado LLC Act that a particular action or provision be reflected in writing unless the variance is approved as the written operating agreement requires.[12]

Unlike the current versions of the uniform unincorporated acts such as the Colorado LLC Act, the Delaware Limited Liability Company Act (the "DLLCA"):

- permits a limitation or complete elimination of fiduciary duties,[13]

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9 *See* Restatement (Second) of Contracts § 179 (1981).

10 C.R.S. § 7-80-108(4).

11 C.R.S. § 7-80-108(2).

12 C.R.S. § 7-80-108(3)(d).

13 6 Del. Code § 18-1101(d) (a member's or manager's duties may be "expanded or restricted or eliminated" provided that the agreement may not "eliminate the implied contractual covenant of good faith and fair dealing."

- protect partners, members, and managers relying in good faith on the agreement,[14] and

- allow the members to provide contractual limitation of liability for good faith breach of the agreements.[15]

While many of the governing provisions of corporate law may be modified by agreement in the articles of incorporation, bylaws, or a shareholder's agreement, the overarching managerial structure and fiduciary duties of corporate management are less flexible than the infrastructure of an LLC. Thus typically in corporate law:

- shareholders have one vote per share;

- the board of directors has primary authority to manage the business and affairs of the corporation until the next annual election; and

- the officers serve as agents of the corporate enterprise at the behest of the board.

In a corporation, there are two principal types of vicarious liability with which owners and managers must be concerned:

* personal liability of an owner or manager to the organization's creditors for obligations of the organization whether by reason of the person's status as an owner or manager or by reason of some action of the owner or manager, and

* liability of owners to contribute to the organization or to restore wrongful distributions (i.e., a "clawback" obligation).

Members and managers in an LLC are not liable for any debt, obligation, or liability of the LLC except to the extent a member (or in some judicial decisions a manager) can be held liable under the theory of piercing the veil or for wrongful distributions.[16]

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[14] 6 Del. Code § 18-1101(e) (a member or manager shall not be liable to a LLC or to another member or other person bound by the agreement for acts taken in good faith reliance on the provisions of the agreement).

[15] 6 Del. Code § 18-1101(f) (a member's or manager's liabilities for breach of contract and breach of duties (including fiduciary duties) to a LLC or to another person that is a party to or is otherwise bound by a limited liability [operating] company agreement may be limited or eliminated, that the agreement "may not limit or eliminate liability for any act or omission that constitutes a bad faith violation of the implied contractual covenant of good faith and fair dealing").

[16] *See, generally,* Lidstone, "Piercing the Veil of an LLC or a Corporation," 39 *The Colorado Lawyer*, no 8 at 71 (August 2010); Chapter 32, "*Piercing the Corporate Veil*," Rozansky and Reichert, *The Practitioner's Guide to Colorado Business Organizations* (CLE in Colorado, 2008).

The shareholders, directors, and officers are not, as such, liable for the obligations of the corporation. Directors, however, are personally liable to shareholders, to the corporate enterprise for waste and breach of fiduciary duties, and possibly creditors if the corporation is insolvent.[17]

The organic statutes providing the default rules for financial relationships differ considerably among the forms of entity. As a general matter, unincorporated organizations such as LLCs base their economic relationship on the capital account system whereby each owner has an account that is increased by the contributions made by the owner as well as the owner's share of profit and is decreased by distributions to the owner and the owner's share of losses. These "sharing ratios" can be changed by agreement.

Corporations, on the other hand, declare "dividends," which are distributed *pro rata* based on the number of shares of stock owned unless there are special classes of stock.

Both the Colorado LLC Act and the CBCA limit distributions when the organization is, or as a result of the distribution will become, insolvent.

The Colorado LLC Act and the CBCA provide a variety of rules governing decision-making. Absent a contrary provision in the operating agreement the Colorado LLC Act provides for consent by a majority of the members on a *per capita* basis.[18] The default rules under the Colorado LLC Act require unanimous consent for certain extraordinary transactions.[19] The LLC Act specifies certain provisions that directly or indirectly address when LLC members and managers are entitled (or required) to vote:

- § 7-80-401(1) states the general rule that, unless an agreement provides otherwise and unless the LLC is manager-managed, "decisions with respect to a limited liability company shall be made by a majority of the members."[20]

- § 7-80-706 sets forth the general provision establishing the right to vote to members as may be set forth in the operating agreement, "subject to the provisions of this article that require majority or unanimous consent.

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17 *Alexander v. Anstine*, 152 P.3d 497 (Colo. 2007), footnote 9.

18 C.R.S. § 7-80-

19 *See e.g.*, C.R.S. § 7-80-801(1)(a) (dissolution).

20 C.R.S. § 7-80-102(9) defines the term "member" as a person; § 7-80-102(10) defines the term "membership interest." The statutory voting provisions use the term "member," not "membership interest." The may lead to an unusual result that two 1% owners could outvote a 98% owner absent an agreement to the contrary.

- § 7-80-101(11) provides that the operating agreement is the agreement of **all** members – requiring unanimity.

- The statute provides that a unanimous vote of the members is required to take the following actions, unless the operating agreement provides otherwise:
  - § 7-80-209(1.5) – To amend articles of organization
  - § 7-80-401(2) – To amend articles or operating agreement, or take any action that is not in ordinary course
  - § 7-80-502 – To compromise obligation of member to make contribution
  - § 7-80-701 – To admit new members to the LLC
  - § 7-80-801 – To approve the dissolution of the LLC

- § 7-80-402 provides that (unless otherwise provided in the operating agreement) a majority of members (not "membership interest") to designate or remove managers.

The operating agreement can generally change any of the foregoing voting requirements, including adding circumstances where manager vote is also required and changing the *per capita* voting to a membership interest voting provision. The statute does not specifically require any manager approval.

Under the Colorado LLC Act, the managers of a manager-managed LLC and the members of a member-managed LLC each has the power to bind the entity when apparently carrying on the business of the organization in the usual way.[21] On the other hand, the DLLCA permits both members and managers to retain agency power notwithstanding the internal organization of the LLC.[22] Like most corporate acts, the CBCA provides that the board of directors will act as a group and no director has the power to act individually unless authorized to do so by the Board of Directors. Officers of a corporation generally have apparent authority to act on behalf of the corporation, but their actual authority can be limited or expanded by resolution of the Board.

The agency issues deserve greater treatment. *Water, Waste & Land, Inc. d/b/a Westec v. Lanham*[23] is a case from the Colorado Supreme Court that arose shortly after LLCs became a frequently-used business entity. Lanham and Clark were members and managers of Preferred Income Investors, LLC ("Preferred"). Clark contacted and contracted with Westec for engineering services. Clark's business card included his name, address, and the initials "PII", but not the name of the LLC or his title. On Clark's instructions, Westec sent a written proposal to Lanham, but commenced work on Clark's oral authorization. Westec never received the signed contract and, when the work was done, never received

[21] C.R.S § 7-80-405.

[22] 6 Del. Code § 18-402 ("Unless otherwise provided in a limited liability company agreement, each member and manager has the authority to bind the limited liability company.").

payment. Westec sued both Clark and Lanham as well as Preferred. Preferred admitted liability while Clark and Lanham defended based on the shield provided by Preferred. In reaching its decision in this case, the Supreme Court said that agency law applies in the LLC context, "notwithstanding the LLC's statutory notice rules," continuing:

> Under the common law of agency, an agent is liable on a contract entered on behalf of a principal if the principal is not fully disclosed. . . . If both the existence and identity of the agent's principal are fully disclosed to the other party, the agent does not become a party to any contract which he negotiates…. But where the principal is partially disclosed (i.e., the existence of a principal is known but his identity is not), it is usually inferred that the agent is party to the contract.[24]

The Court went on to say, "The duty of disclosure clearly lies with the agent alone; the third party with whom the agent deals has no duty to discover the existence of an agency or . . . the identity of the principal." As a result, the Court reversed the judgment of the District Court and reinstated the judgment of the County Court which had held Lanham and Clark personally liable as agents for (at best) a partially disclosed principal.

C.R.S. § 7-80-405(1)(a) provides that a member "has no authority to bind the [LLC] solely by virtue of being a member" of an LLC where the articles of organization provide that the LLC is to be managed by managers. C.R.S. § 7-80-405(1)(b) goes on to state that any manager of a manager-managed LLC does have the right to bind the LLC. Thus, each and every manager of an LLC is an agent for the LLC and can bind the LLC, with two exceptions:

- First, the act taken by the manager must be "for apparently carrying on in the ordinary course of business of the [LLC]."[25]

- Second, if the articles of organization or the operating agreement limit any manager's ability to act for the LLC and the third party had notice of the limitation, the manager's act would be invalid.[26]

The first limitation can be defined by the LLC's course of business over a period of time. Where a manager of an LLC conducting business as a hardware store decides to sell the property underlying the store, such an action can reasonably be seen as not for the purpose of "carrying on in the ordinary course." There may be many other actions that are a

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23 955 P.2d 997 (Colo. 1998).

24 955 P.2d at 1001.

25 C.R.S. § 7-80-405(1)(b).

26 C.R.S. § 7-80-405(1)(b).

much closer call, such as a bulk sale of inventory. C.R.S. § 7-80-405(1)(b) appears to place the risk of determining whether the manager's action is "in the ordinary course" on the third party, however.

The second limitation is problematic. Many LLCs want to restrict their managers as a board of directors – not giving any manager the ability to act on behalf of the LLC individually, but only collectively. Limitations such as this can be written in the articles of organization or in the operating agreement – but no such limitation has any effect unless the other party to the contract has actual notice of the limitation. Neither the articles of organization (which are filed with the Secretary of State) nor the operating agreement (which is not) provide constructive notice.

C.R.S. § 7-80-405(2) describes the relationship of members in an LLC managed by members similarly.

- The act of any member "for apparently carrying on in the ordinary course of business of the [LLC]" binds the LLC.

- "unless the member had no authority to act for the [LLC] in the particular matter and the person with whom the member was dealing had notice that the member lacked authority."

Notably, in an LLC managed by the members, even non-voting members would have the ability to bind the LLC if the actions are "apparently" for the purpose of carrying on the LLC's business.

The most important limitation on the ability of managers and members to act for an LLC with the authority given by C.R.S. § 7-80-405 is found in C.R.S. §7-80-404(3) and discussed above – the requirement that members and managers each discharge his or her "duties to the [LLC] and exercise any rights consistently with the contractual obligation of good faith and fair dealing." This is, of course, subject to the member's rights to "determine the standards by which the performance of the obligation is to be measured, if such standards are not unreasonable."[27] The comparable rules applicable to corporations under the CBCA are the director's duties of care and loyalty which are higher standards and which cannot be modified by contract.

The contractual obligation of good faith and fair dealing applies to each member (whether in a member-managed or manager-managed LLC) and to each manager. This obligation is a basic tenet of contract law in Colorado.[28] Colorado law provides that every

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[27] C.R.S. § 7-80-108(2)(d).

[28] C.R.S. § 7-80-108(2)(d). *See, e.g., Cary v. United of Omaha Life Insurance Company*, 68 P.3d 462, 466 (Colo. 2003); *Mahan v. Capitol Hill Internal Medicine, P.C.*, 151 P.3d 685, 690 (Colo. App. 2006)

contract, including an operating agreement, contains an implied duty of good faith and fair dealing in each party's performance and enforcement.[29] The doctrine exists under Colorado law to effectuate the parties' intentions and honor their reasonable expectations, and violating the duty of good faith and fair dealing may give rise to a claim for breach of contract.[30] Of course, determining whether a violation occurred because one of the parties breached its obligations of good faith and fair dealing is a factual question.[31] Delaware law provides similarly; in *Kelly v. Blum*,[32] the covenant of good faith and fair dealing was held to require parties to refrain from arbitrary or unreasonable conduct that prevents the other party from receiving the fruits of the contract.

"In the narrow context governed by principles of good faith and fair dealing, [the Delaware Supreme] Court has recognized the occasional necessity of implying such terms in an agreement so as to honor the parties' reasonable expectations. [*Citation omitted*] But those cases should be rare and fact-intensive, turning on issues of compelling fairness" and should be "a cautious enterprise."[33] While the cases the Delaware Court relied on were employment cases, the Court went on to say: "This Court should be no less cautious or exacting when asked to imply contractual obligations from the written text of a limited partnership agreement."[34] There the Court found that the unambiguous terms of the limited partnership agreement defeated the plaintiff's case and, therefore, there was no need to address the plaintiff's claim further.

In Colorado, the Court of Appeals noted that the "duty of good faith and fair dealing may be relied upon 'when the manner of performance under a specific contract term allows for discretion on the part of either party.'" [35]"Discretion in performance occurs 'when the

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[29] *Cary v. United of Omaha Life Insurance Company*, 68 P.3d 462, 466 (Colo. 2003); *Amoco Oil Co. v. Erwin*, 908 P.2d 493, 498 (Colo. 1995); *Mahan v. Capitol Hill Internal Medicine, P.C.*, 151 P.3d 685, 690 (Colo. App. 2006); *Wells Fargo Realty Funding Advisors, Inc. v. Uioli, Inc.*, 872 P.2d 1359, 1362 (Colo. App. 1994).

[30] *City of Golden v. Parker*, 138 P.3d 285, 292 (Colo. 2006); *Bloom v. Nat'l Collegiate Athletic Assn*, 93 P.3d 621, 624 (Colo. App. 2004). *Bloom* cited various authorities for the proposition that the duty of good faith and fair dealing requires that a party vested with contractual discretion exercise that discretion reasonably, not arbitrarily, capriciously, or in a manner inconsistent with the reasonable expectations of the parties.

[31] *Platt v. Aspenwood Condominium Assn*, 214 P.3d 1060, 1066 (Colo. App. 2009).

[32] 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)].

[33] *Cincinnati SMSA Ltd. P'Ship v. Cincinnati Bell Cellular Sys. Co.*, 708 A.2d 989, 992 (Del. 1998).

[34] *Cincinnati SMSA Ltd. P'Ship v. Cincinnati Bell Cellular Sys. Co.*, 708 A.2d 989, 992 (Del. 1998).

[35] *New Design Construction Company, Inc. v. Hamon Contractors, Inc.*, 215 P3d 1172 (Colo. App. 2008). There the Court of Appeals stated that "Hamon's interpretation of the contract documents-that it had the power to dictate how, when, and where NDCC performed its work-without incorporating the implied covenant of good faith and fair dealing could lead to an absurd result. . . . As NDCC pointed out, if the implied

parties, at formation, defer a decision regarding performance terms of the contract' leaving one party with the power to set or control the terms of performance after formation."[36] The Court of Appeals has found that a breach of the contractual covenant may occur "[w]hen one party uses discretion conferred by the contract to act dishonestly or to act outside of accepted commercial practices to deprive the other party of the benefit of the contract."[37]

The covenant of good faith and fair dealing in the LLC Act and the implied covenant in contracts truly comes into play when a contract is ambiguous or when the mechanism or timing for the exercise of discretion is not well defined. Whether a contract is ambiguous is a question of law.[38] Courts have held that a contract is ambiguous when it is reasonably susceptible of more than one meaning.[39] "The mere fact that the parties differ on their interpretations of an instrument does not of itself create an ambiguity."[40] The law implies the covenant to prevent one party from unfairly taking advantage of the other party. Therefore, by definition the covenant does not apply to modify or to enforce violations of express provisions of the operating agreement. The duty of good faith and fair dealing does require that a party vested with contractual discretion exercise that discretion reasonably, not arbitrarily, capriciously, or in a manner inconsistent with the reasonable expectations of the parties.[41] In *Hamon*, the Court of Appeals accepted evidence as to the custom in the industry for defining performance obligations.[42]

Where, as in the LLC Act, there is great flexibility given to the contract, "implying obligations based on the covenant of good faith and fair dealing is a cautious enterprise," and the implied covenant is not a safety net for less-than-prescient drafting.[43] Courts have

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covenant of good faith and fair dealing were not incorporated into the contract documents, Hamon could have required it 'to perform its paving work at midnight using teaspoons.'" *Citing City of Golden v. Parker*, 138 P.3d 285, 292 (Colo. 2006) (quoting *Amoco Oil Co. v. Ervin,* 908 P.2d 493, 498 (Colo.1995)).

[36] *Id.* (quoting *Amoco Oil Co.,* 908 P.2d at 498). *Cf. Tricon Kent Co. v. Lafarge North America, Inc.,* 186 P.3d 155, 158 (Colo. App. 2008).

[37] *Wells Fargo Realty Funding Advisors, Inc. v. Uioli, Inc.*, 872 P.2d 1359, 1363 (Colo. App. 1994), *citing* Restatement (Second) of Contracts, § 205 cmt. A (1981).

[38] *Pub. Serv. Co. v. Meadow Island Ditch Co. No. 2,* 132 P.3d 333, 339 (Colo. 2006).

[39] *Ad Two, Inc. v. City & County of Denver,* 9 P.3d 373, 376 (Colo. 2000).

[40] *Fibreglas Fabricators, Inc. v. Kylberg,* 799 P.2d 371, 374 (Colo. 1990).

[41] *Bloom v. Nat'l Collegiate Athletic Assn*, 93 P.3d 621, 624 (Colo. App. 2004).

[42] *New Design Construction Company, Inc. v. Hamon Contractors, Inc.*, 215 P3d 1172, 1182 (Colo. App. 2008).

[43] *Cincinnati SMSA Ltd. P'Ship v. Cincinnati Bell Cellular Sys. Co.*, 708 A.2d 989, 992 (Del. 1998).

described the implied covenant of good faith and fair dealing as “a judicial convention designed to protect the spirit of the agreement when, without violating an express term of the agreement, one side uses oppressive or underhanded tactics to deny the other side the fruits of the parties’ bargain.”[44] In another case, the court said, “The implied covenant of good faith and fair dealing requires a party in a contractual relationship to refrain from arbitrary or unreasonable conduct which has the effect of preventing the other party to the contract from receiving the fruits of the bargain.”[45]

The Colorado LLC Act does permit the parties to use the operating agreement to “prescribe standards by which the performance of the obligation [of good faith and fair dealing] is to be measured, if such standards are not unreasonable.”[46] As noted, this duty applies whether the LLC is member-managed or manager-managed, and applies both to members and managers. As an example of the parties eliminating a reasonableness requirement in an operating agreement, see *Related Westpac LLC v. JER Snowmass LLC*. There, the Delaware Court of Chancery ruled that LLC members had the freedom to contract away an obligation by the members to act “reasonably” and, as a result, the failure by one party to act reasonably did not violate the contractual obligation of good faith and fair dealing.[47]

There is a significant difference between the default rules with respect to transferability of interests in an LLC under the Colorado LLC Act and those applicable to corporations under the CBCA. Under the default rules under the Colorado LLC Act, the transfer of an “interest” in the entity does not vest the transferee with any right other than economic right—no management right, no right to inspect books and records, and no right to interfere in management.[48]

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44 In *Bakerman v. Grey Goose,* 2006 WL 2987020 (Del.Ch. Oct. 10, 2006), *quoting from Chamison v. Healthtrust*.

45 *Chrin v. Ibrix Inc.,* Civ. A20587, 2005 WL 2810599 at *7 (Del. Ch. Oct. 19, 2005), *citing Dunlap v. State Farm Fire & Cas. Co.*, 878 A.2d 434, 442 (Del. 2005).

46 C.R.S. § 7-80-108(2)(d).

47 C.A. No. 5001-VCS, 2010 WL 2929708, (Del. Ch., Jul. 23, 2010). In *Related Westpac*, Related, JER, and a third (passive) investor formed two LLCs for a redevelopment project in Snowmass, Colorado. Under the operating agreements, Related was to act as manager and JER was to provide funding. The operating agreement required the manager to obtain JER’s consent for 23 different category of “Major Decisions” and JER’s ability to withhold its consent in most of those cases was subject to a reasonableness standard. “Major Decisions” that constituted a “Material Action” were expressly not subject to a reasonableness standard, and JER could withhold its approval in its sole discretion. When JER did so, Related brought suit for damages. The Chancery Court reviewed the operating agreement and refused to “imply a reasonableness condition as part of the Operating Agreements’ implied covenant of good faith and fair dealing” since the Operating Agreement expressed the agreement of the parties over the subject matter of the action and the Court “cannot imply an obligation inconsistent with the parties’ express agreement.”

48 C.R.S. § 7-80-407.

A membership interest in an LLC is personal property,[49] and therefore should be treated as personal property under the Uniform Commercial Code, and may be assigned.[50] Unless otherwise stated in the operating agreement, however, the LLC has no obligation to admit the assignee as a member, and unless admitted as a member, the assignee only has the economic rights attributable to the membership interest assigned – the assignee does not have voting or other rights that a member may have. The admission of the assignee as a member "terminates the assignor's . . . rights and powers as a member with respect to the portion of the membership interest assigned . . . and releases the assignor . . . from liability to the [LLC] other than for liabilities under § 7-80-502 [liability for contributions] or 7-80-606 [liability for distributions]."[51] Section 7-80-701 requires a unanimous vote of the other members for the admission of new members, but this can be reduced in the operating agreement.[52]

In contrast, the transfer of stock in a corporation transfers economic rights as well as the voting rights of the shares—generally one vote per share. This critical distinction between an "interest" in an unincorporated entity and "stock" in a corporation is one often overlooked and greatly misunderstood.

Corporate law has long permitted creditors to disregard the liability protection of a corporation or other limited liability entity where evidences of fraud or equity render it appropriate to disregard the organizational veil and hold the owners personally liable for the obligations of the organization. Generally, when organizational formalities are observed, financing is adequate, and the organization is not formed or used to defraud creditors or other third parties, the liability protection of the organizational form is respected and owners are be liable for the organization's debts and liabilities.

On the other hand, the organization may be disregarded and owners may be held personally liable for some or all of the obligations of the organization if the owner disregards the separateness of the organization, commingles assets, undercapitalizes the organization, forms or uses the organization for personal use or to perpetrate a fraud on

[49] C.R.S. §7-80-702(1).

[50] Taking an LLC interest as collateral for repayment of a debt is complicated and is discussed in more detail below in Lidstone, *Limited Liability Companies in Colorado,* § 5.4.1, "Taking Interests in LLPs and LLCs as Security for Debt Repayment."

[51] C.R.S. §7-80-702(2).

[52] As discussed, the operating agreement can provide for admission of new members by less than a unanimous vote of the members, or even by the managers. *See* Section 11.5 of Exhibit 1. This offers two possibilities – either admission by Three-Quarters Vote of the Members, or by the Managers. Care should be taken in determining whether the persons organizing the business want to make it more or less difficult to add new Members.

creditors, or fails to observe the organizational formalities associated with the organization. Statistics indicate that veil piercing is most likely to occur in the case of organizations with fewer than 10 owners and by creditors with contractual claims. As the ownership of the entity decreases, the likelihood of veil piercing increases.

Because veil piercing is a common law doctrine, the circumstances under which "piercing" will occur is fact specific and determined on an *ad hoc* basis.[53] As a common law theory applicable to corporations, whether piercing should ever apply to unincorporated organizations is a source of great uncertainty. For example, two of the most common reasons for piercing the veil of a corporation are the failure to follow corporate formalities and undercapitalization of the enterprise. In unincorporated entities, formalities do not exist and the capitalization structure of a corporation is also nonexistent in unincorporated statutes. Nevertheless, the Colorado LLC Act specifically provides that the liability shield of an LLC can be pierced by applying the corporate case law, but that, for piercing purposes, failure to observe formalities will not be considered a negative piercing concept.[54] The DLLCA does not expressly address the question of piercing.

"Reverse piercing" is a common law doctrine pursuant to which a court may disregard the separate existence of an organization or otherwise make the assets of the organization available to satisfy the obligations of an owner. Reverse piercing also occurs where owners of a corporation seek to disregard the corporation's existence in order to take advantage of other law, *e.g.,* homestead exemptions or state unemployment benefits where stockholders take turns laying each other off during down times of the corporation. While "reverse piercing" often relies on the same disregard of organizational existence as piercing, it is a fact intensive test that often trades in equity in order to allow either creditors or

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[53] *See,* Robert B. Thompson, *Piercing The Corporate Veil: An Empirical Study*, 76 Cornell L. Rev. 1036 Cornell Law Review (July, 1991) (analyzing the characterization of the grounds on which piercing was sought into the following characteristics: Instrumentality (pierced successfully in 97.33% of the cases), Alter Ego (95.58%), Misrepresentation (94.08%), Agency (92.31), Dummy (89.74%), Lack of Substantive Separation (85.11%), Intertwining (85.71%), Undercapitalization (73.33%), Informalities (66.89%), Domination & Control (56.99%), Overlap in officers (50.00%), Overlap in directors (43.42%), Overlap in owners (48.51%); Overlap in office (58.82%), Overlap in business activity (81.40%), Overlap in employees (69.23%), Overlap in management (65.12%, Other overlap (69.82%), Total overlap (56.53%)), and Robert B. Thompson, *The Limits of Liability in the New Limited Liability Entities*, 32 Wake Forest L. Rev. 1, 7 (1997) (noting that while piercing may be supported for a variety of reasons, it is always applied in the context of closely held corporations).

[54] C.R.S. § 7-80-107(1) which provides: "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. (2) For purposes of this section, the failure of a limited liability company to observe the formalities or requirements relating to the management of its business and affairs is not in itself a ground for imposing personal liability on the members for liabilities of the limited liability company."

owners to succeed to and enforce the rights of owners or owners to equitably enjoy rights under other law.

The Process of Incorporation Versus LLC Formation

Another significant point that must be considered is selecting the state in which to form your entity. For a Colorado business planning to do business in Colorado, the choices are two: Colorado or Delaware. Ultimately the correct answer to that question will likely be Colorado. Most lawyers do not know Delaware corporate or limited liability company law; to incorporate in Delaware you will need a professional service company to make the filings for you and to serve as registered agent in a state in which you are not otherwise doing business, and the franchise fee for Delaware corporations is many times the cost in Colorado. Even the annual cost to maintain an LLC in Delaware ($50 plus service company fees) is greater than Colorado ($10).

There is little lost by organizing your new business in Colorado. The Colorado statutes are flexible and up to date. The filing costs are nominal, and the cost of the annual reports are small ($10.00). To the extent there is a downside to incorporating a corporation or organizing an LLC in Colorado, it has to do with dispute resolution. Delaware Chancery Courts are experienced in business litigation and issue consistent decisions. Colorado does not have a business court, and the courts have issued inconsistent decisions, some of which are demonstrably wrong. Where venture capitalists are expected to be involved in financing the entity, or where financing may be expected from countries outside the United States, the financing parties may insist on Delaware law since they may be more familiar with the requirements and benefits of Delaware law.

Under Colorado law, the process of forming an LLC or incorporating a corporation is not difficult, although both have the potential for bad decisions and error.

An LLC is formed by filing the articles of organization with the Colorado Secretary of State in a form provided by the Colorado Secretary of State. There is little room for error except in determining whether to form a manager-managed LLC or a member-managed LLC. The correct answer to that is a manager-managed LLC, with a member-managed LLC being the correct answer in very few cases. If the articles of organization are silent, the management will be vested in the members of the LLC.[55] Limitations on the authority of managers or members that are contained in the articles of organization are ineffective except against those with actual notice of the limitations.[56]

Incorporation of a corporation under the CBCA is equally simple since the Secretary of State has provided an appropriate form, but merely completing the form is never a good

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[55] C.R.S. § 7-80-204.

[56] C.R.S. § 7-80-208.

idea. The CBCA provides for a number of provisions that are effective only if set forth in the articles of incorporation. These can be set forth in an attachment to the articles of incorporation and, unlike the LLC, these additional provisions do constitute constructive notice.

Drafting an operating agreement for any limited liability company can be extremely intimidating. We have discussed the default provisions above, which are seldom acceptable to the parties should they take the time to think about it. It is important to note that the operating agreement has much more flexibility in its drafting than does any other entity agreement. The warning stated by Vice Chancellor Strine of the Delaware Court of Chancery has real meaning, however: "With the contractual freedom granted by the LLC Act comes the duty to "scriven with precision."[57]

There is less freedom of contract in the corporation's bylaws, although once again there are choices that can be made.

The third part of the corporate scheme is generally the buy-sell agreement. The corporate buy-sell agreement is generally a separate agreement, not a part of either the articles of incorporation or the bylaws.[58] The buy-sell agreement for an LLC generally appears in an LLC operating agreement.

Walking the Ethical Line

In considering ethical issues, it is important to note Paragraph [20] of the scope of the Colorado Rules of Professional Conduct which states:

> "Violation of a Rule should not give rise to a cause of action against a lawyer nor should it create any presumption in such a case that a legal duty has been breached."

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[57] *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 With For – Freedom of Contract and the Necessity of Careful Scrivening*" XXIV Pubogram 19 (October 2006), available at http://ssrn.com/abstract=939009.

[58] For a form of corporate buy-sell agreement, *see* Lidstone "*Form of Stock Redemption and Cross Purchase Agreement*" found in chapter 23 of Rozansky and Reichert, PRACTITIONER'S GUIDE TO COLORADO BUSINESS ORGANIZATIONS (Colorado Bar Assn. 2006-2010).

Rule 1.0(e) – Informed Consent

Many of the Rules of Professional Conduct require the client's "informed consent" before the lawyer can take any action.[59] In some cases the rules require the client's "informed consent confirmed in writing." Rule 1.0(e) defines "informed consent" as follows:

> "'Informed consent' denotes the agreement by a person to a proposed course of conduct after the lawyer has communicated adequate information and explanation about the material risks of and reasonably available alternatives to the proposed course of conduct."

Comment [6] to Rule 1.0 explains "informed consent" further by saying: "[o]rdinarily, this will require communication that includes a disclosure of the facts and circumstances giving rise to the situation, any explanation reasonably necessary to inform the client or other person of the material advantages and disadvantages of the proposed course of conduct and a discussion of the client's or other person's options and alternatives. In some circumstances it may be appropriate for a lawyer to advise a client or other person to seek the advice of other counsel." Comment [7] goes on to say that a lawyer may not assume consent by the client's silence: "[o]btaining informed consent will usually require an affirmative response by the client or other person."

Where the informed consent must be "confirmed in writing," Rule 1.0(b) provides that the writing may be signed by the client or may be a letter from the lawyer to the client confirming an oral informed consent given by the client. In some situations, the rules require the informed consent to be signed by the client, *e.g.* when engaging in a business transaction with a current client under Rule 1.8.

Rule 1.4 (Communication) requires that the lawyer, as a part of his or her duty to communicate with the client, fully inform the client about matters requiring the client's "informed consent." A failure to communicate is one of the leading causes for clients filing grievances against their attorney. The Colorado Supreme Court Attorney Regulation Counsel reports that out of 4,119 complaints filed against attorneys in 2008, approximately 8% (more than 320) involved claims of failure to communicate. Sanctions against attorneys for a failure to communicate can be severe.[60]

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[59] *See, specifically,* Rules 1.2(c) (limitation of the scope of representation), 1.6(a) (maintaining the confidentiality of information), 1.7(b) (conflicts of interest), 1.8(a) (business transactions with a client), 1.9 (duties to former clients), 1.18(c) (duties to prospective clients after receiving disqualifying information) and 2.3 (evaluations for the use of third parties).

[60] *See* Wald, *Attorney-Client Communications in Colorado*, 38 THE COLO. L. (CBA) No. 4 at 59 (Apr. 2009). The statistics were derived from note 4 to that article.

The Attorney/Client Relationship

Whether an attorney-client relationship exists is a question of fact, and the attorney-client relationship, itself, has a number of issues that must be considered. The client must be identified, and the identification of the client has certain complexities when an attorney is dealing with an organization, or individuals who want to form an entity. There are times when a person other than the client will be paying fees on behalf of the client, and those issues must be addressed. All attorneys owe their clients a specific fiduciary duty of care, and this duty even includes prospective clients in certain circumstances. Finally, attorneys must be aware of the proper procedure for declining or terminating representation. These topics are addressed individually below.

The Attorney-Client Relationship, In General.

First, it is important to note that no formal engagement letter or writing is necessary to create an attorney-client relationship.[61] A putative client's reasonable, subjective belief that he is being represented by an attorney may be sufficient to give rise to the attorney-client relationship and the duties imposed by the Rules of Professional Conduct on the lawyer in such a relationship. In *People v. Bennett*,[62] The Colorado Supreme Court held:

> "An attorney-client relationship is 'established when it is shown that the client seeks and receives the advice of the lawyer on the legal consequences of the client's past or contemplated actions.' The relationship may be inferred from the conduct of the parties. The proper test is a subjective one, and an important factor is whether the client believes that the relationship existed. Further, '[t]he attorney-client relationship is an ongoing relationship giving rise to a continuing duty to the client unless and until the client clearly understands, or reasonably should understand, that the relationship is no longer to be depended on.'" [Citations omitted]

As stated in § 14 of The Restatement of the Law Governing Lawyers, when a putative client manifests to a lawyer the person's interest that the lawyer provide legal services to the person and the lawyer fails to manifest lack of consent to do so, the lawyer-client relationship may arise.

Potential Liability to Non-Clients. This goes even further in the opinion of one panel of the Colorado court of appeals, applying the tort of negligent misrepresentation in a

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[61] If the attorney expects to be paid for his or her services, Rule 1.5(b) requires that the basis for compensation be communicated to the client in writing, when the attorney has not previously regularly represented the prospective client.

[62] 810 P.2d 661 (Colo. 1991).

case where there was admittedly no attorney-client relationship. In *Steele v. Allen*,[63] an injured motorist consulted an attorney regarding legal options against the other driver. During the initial consultation, plaintiff claimed that the attorney advised him of an erroneous statute of limitations. The plaintiff (Steele) never retained the attorney and did not allege that an attorney-client relationship was ever established. When Steele sought advice from another attorney, the statute of limitations had expired and he lost his claim. He then sued the attorney for professional negligence and negligent misrepresentation. The district court dismissed the case on motion, but the Court of Appeals reversed, relying in part on *Mehaffy, Rider Windholz & Wilson v. Central Bank of Denver, N.A.*,[64] affirming a Court of Appeals ruling finding that attorneys could be liable to non-clients for negligent misrepresentation.[65] The Court of Appeals went on to say:

> We note that the specter of potential liability to an unlimited number of third parties, which concerned the court in *Mehaffy* is alleviated by the requirement in a claim for negligent misrepresentation that the plaintiff show that the defendant supplied false information in the context of a business transaction regarding the representation of a potential client. However, informal statements by an attorney in a social setting would generally not result in a viable claim against the attorney.[66]

In a 2009 case, a law firm sought a motion to dismiss a suit brought against it in a case where there allegedly existed conflicts of interest in its representation of both a lender and a borrower.[67] As alleged in the complaint, Dury loaned funds to a group of businesses (the "Trinity Entities") which then failed to repay Dury the monies borrowed. After Dury

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[63] 2009 WL 399992 (Colo. App. 2009), *cert granted* Mar. 22, 2010 (09SC263, 2010 WL 1011037) on the following issues:

* Whether the court of appeals erred in imposing liability on attorneys to non-clients for negligent misrepresentation in light of Mehaffy, Rider, Windholz & Wilson v. Cent. Bank Denver, 892 P.2d 230 (Colo.1995).
* Whether the court of appeals erred in relying on Restatement (Third) of the Law Governing Lawyers section 15 (2000) as a basis for establishing a duty of care on a lawyer to a non-client.

[64] 892 P.2d 230 (Colo. 1995); the Court of Appeals decision is at 865 P.2d 862 (Colo. App. 1993).

[65] 865 P.2d at 865. The Court of Appeals also cited Section 15 of the Restatement (Third) of the Law Governing Lawyers and Colo. R.P.C. 1.18 which impose certain obligations on lawyers deal with prospective clients. As stated in a commentary by Anthony Davis, the court could have reached a similar conclusion if it had reviewed the facts and concluded that the lawyer had established an attorney-client relationship and gave the client (allegedly) bad advice knowing that the client would rely on it. Compensation to the lawyer is not material to the establishment of the attorney-client relationship. Davis, *Duties to Prospective and Pro Bono Clients*, 242 N.Y. Law J. (Jul. 6, 2009) at col. 1 (© The New York Law Pub. Co.).

[66] The Court of Appeals went on to cite Restatement (Second) of Torts §552 cmt. d, and concluded, "Thus, whether statements are made during an initial consultation for legal services or in a casual manner in a social setting may ultimately be determinative of whether a lawyer is liable for negligent misrepresentation."

[67] *Dury v. Ireland, Stapleton, Pryor & Pascoe, P.C.*, 2009 WL 2139856 (D. Colo., 7-14-2009).

filed an action against the Trinity Entities, they filed for bankruptcy protection. At the time of the initial transaction, Dury retained the law firm and attorney Miller (a partner of the firm) to draft the promissory notes and other documents. At the time, the firm was also representing the Trinity Entities and two of their founders. During the course of representing Dury, the complaint alleges that the defendant firm and attorney took positions contrary to Dury's interests and disclosed privileged information to at least one of the founders of the Trinity Entities. Dury alleged that the attorney and the firm failed to disclose the conflicts of interest to him and that, if the attorney and the firm were not acting as counsel to Dury (because they were acting as counsel to their other clients instead), they had "tortiously failed to disclose this fact to [Dury]." In denying the attorneys' motion for dismissal the District Court said (in part):

> "[A]n attorney can be liable for negligent nondisclosure when he fails to exercise reasonable care or competence in communicating materially incomplete information to a non-client regarding a matter in which the attorney should reasonably foresee the non-client will rely on the incomplete information."[68]

Declining and Terminating Representation; Prospective Clients.

As indicated in the *Bennett* case, once the attorney-client relationship has commenced, the question of whether the attorney-client relationship has concluded can be difficult. As quoted above, *Bennett* says clearly:

> 'The attorney-client relationship is an ongoing relationship giving rise to a continuing duty to the client unless and until the client clearly understands, or reasonably should understand, that the relationship is no longer to be depended on.'

Rule 1.16 – Declining or Terminating Representation. Rule 1.16 discusses when and how a lawyer may decline or terminate a representation, and what obligations flow from the termination. Generally the 2008 rule is similar to the former rule. Rule 1.16(b)(1) is a significant, positive, change for lawyers, and is equivalent to a "no fault divorce" between the lawyer and client. Former Rule 1.16 did not permit a lawyer to withdraw solely on the grounds that "withdrawal can be accomplished without material adverse effect on the interests of the client." Under new Rule 1.16, no other reason is necessary. The right to withdraw may be limited if the attorney's withdrawal may materially adversely affect the client.

Rule 1.16(d) requires that, upon termination of representation, the lawyer must take steps "to the extent reasonably practicable" to protect a client's interests. These steps may include "allowing time for employment of other counsel, surrendering papers and property

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[68] *Citing Smith v. Boyett*, 908 P.2d 508, 513-14 (Colo. 1995) and *Mehaffy, Rider, Windholz & Wilson v. Central Bank Denver, N.A.,* 892 P.2d 230, 236-37 (Colo. 1995).

to which the client is entitled and refunding any advance payment of fee or expense that has not been earned or incurred." The Colorado Bar Association Ethics Committee issued letter opinion 2007-2[69] which addressed the obligation of an attorney surrendering paper and property to the client. An estate planning attorney asked whether the obligation included an obligation to surrender digital files "in accessible electronic format, if so maintained," so that the client could "save . . . money during the revision process" by new counsel. The Ethics Committee concluded that delivering electronic files "is a reasonably practical step that [the attorney] should take to enable the continued protection of your former client's interests within the meaning of C.R.P.C. 1.16(d)."

The letter opinion leaves a number of questions unaddressed. For example, the letter opinion does not address whether an attorney can claim a lien on the client's digital files as the attorney can on paper files. To the extent that an attorney has the right to retain paper files pursuant to an attorney's lien for unpaid fees, the attorney should have the same right to retain digital files.[70]

The letter opinion also does not address whether any portion of the digital files may be considered to be "work product" which, under Formal Opinion 104, attorneys are not obligated to turn over to clients.[71] Formal Opinion 104 does not address whether (for example) special formatting of a document for printing that may have been accomplished by the attorney or his or her staff is "work product" or client's property.[72] Can an attorney deliver a text-readable version of the document in Adobe Acrobat format to meet the Rule 1.16(d) requirement? While all of the words are generally available in such a format, transforming the document into a word processing accessible document loses all formatting codes and requires a significant amount of "clean up" work by the successor attorney or his or her staff.

Formal Opinion 104 provides that, to the extent the attorney retains drafts in the client file, the client is entitled to receive those drafts. The same should apply to digital drafts of documents.

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[69] Abstract available at 36 THE COLO. L. (CBA) No. 11 at 17 (Nov. 2007).

[70] *See* Formal Opinion 82, CBA Ethics Committee, April 15, 1989, addendum issued 1995, available at http://www.cobar.org/index.cfm/ID/386/CETH/Formal-Ethics-Opinions-Index/.

[71] *See* Formal Opinion 104, CBA Ethics Committee, April 17, 1999, available at http://www.cobar.org/index.cfm/ID/386/CETH/Formal-Ethics-Opinions-Index/.

[72] Formal Opinion 104 provides the following as an example of attorney work product which may be withheld from a client when turning over records: "Certain documents may be withheld: for example, internal memoranda concerning the client file, conflicts checks, personnel assignments, and lawyer notes reflecting personal impressions and comments relating to the business of representing the client. This information is personal attorney-work product that is not needed to protect the client's interests, and does not constitute papers and property to which the client is entitled." The Formal Opinion concludes with the statement that "The lawyer should err on the side of production."

Another question for which answers are yet to be given is the ability of an attorney, before turning over documents, to scrub metadata from the documents. This would include things like revision schedules, authors working on the document, redline-strikeout codes, and other hidden information. Metadata[73] is a known feature of MS Word, and can only be removed by special metadata scrubbers or by converting the document to a read-only format such as Adobe. In an article addressing metadata, the author concluded that when sending documents to third parties on behalf of the client, metadata scrubbing is consistent with the attorney's duty of confidentiality under C.R.P.C. Rule 1.6(a).[74] What if the client specifically requests the attorney to leave metadata in the document? This question is not addressed by letter opinion 2007-2 or by Formal Opinion 104.

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[73] The Southern District of New York engaged in an in depth discussion of metadata in the context of litigation in *Aguilar v. Immigration and Customs Enforcement*, 255 F.R.D. 350 (SDNY 2008). It identified three types of metadata: substantive, system and embedded:

> Substantive metadata was identified as data "created as a function of the application software used to create the document or file," such as prior edits or editorial comments.
>
> System metadata was defined as data that "reflects information created by the user or by the organization's information management system," such as data concerning author, date and time of creation and modification.
>
> Embedded metadata was defined as consisting of "text, numbers, content, data or other information that is directly or indirectly inputted into a [n]ative [f]ile by a user and which is not typically visible to the user viewing the output display," such as spreadsheet formulae.

In *Dahl v. Bain Capital Partners, LLC*, 2009 WL 1748526 (D.Mass., 2009), the court denied plaintiffs' motion requesting the production of all metadata associated with emails and MS Word documents produced by the defendants. The court advised the plaintiffs that, instead of making "sweeping requests for metadata," such requests should be tailored to specific documents which would in turn reduce the costs and burdens associated with electronic discovery. The court denied the defendant's request to shift the costs of discovery to the plaintiffs, but said that if the plaintiffs wanted to change the data into a format other than the form maintained by the defendants, the plaintiffs would have to bear the burden of that cost.

[74] Luce, "*What's the Matter With Metadata*," 36 THE COLO. L. (CBA) No. 11 at 113 (Nov. 2007). Mr. Luce also concluded that metadata mining (adverse counsel retrieving and using metadata from sent documents) is permissible under the pre-2008 Colorado Rules of Professional Conduct. The District of Columbia Bar Association Legal Ethics Committee addressed this issue in its Ethics Opinion 341. The Committee noted that lawyers who send electronic documents outside of discovery or subpoena have a duty under Rule 1.6 to take reasonable steps to maintain the confidentiality of the documents, including removing potentially harmful metadata before sending the documents. This requires that the lawyers understand the software they use or they have employees who can safeguard against unintended disclosures. However, there is also a duty upon receiving lawyers who actually know that a sender has inadvertently included metadata along with a document. The opinion held that lawyer should not review the metadata without contacting the sending lawyer and abiding by the sender's instruction. This gives the sender the opportunity to determine if the metadata includes work product or confidential information of the sender's client. In all other circumstances, however, the receiving lawyer is free to review the metadata contained in electronic files provided by an adversary. *See, also,* Colorado Ethics Committee Formal Opinion 119 (May 17, 2008) published at 37 THE COLO. L. (CBA) No. 8 at 59 (Aug. 2008).

Colorado Rule 1.16(d) requires that, when terminating the representation of a client, a lawyer take steps necessary to protect the client's interests including (without limitation) "giving reasonable notice to the client" of the termination. Comment [1] to Rule 1.16 provides that "[o]rdinarily, representation in a matter is completed when the agreed-upon assistance has been concluded." Even then, notification under Rule 1.16(d) is required unless the termination of the representation upon conclusion of the matter at hand was clearly set forth in the engagement letter. As stated in a 1994 article[75] which is still good guidance:

> "Due to the discrepancies and different standards being applied by the courts today in the determination of when the attorney-client relationship terminates, attorneys should take extra precautions to make sure that there is a clear, unambiguous end to the attorney-client relationship. Attorneys should make sure that the relationship's termination is evidenced in writing and in such a manner that neither the client nor a tribunal can question the relationship's termination."

Rule 1.18 – Prospective Clients. Rule 1.18 has no counterpart in the pre-2008 rules. This new rule prohibits an attorney using information gained from dealing with a prospective client against that person's interests – whether or not the prospective client becomes an actual client. The new rule provides an exception to the prohibition when, during the course of the interview, "the lawyer who received the information took reasonable steps to avoid disclosure to more disqualifying information." This protects the situation where the lawyer, in a client intake interview, realizes that there may be conflicts with existing clients or other interests of the attorney or the law firm. The rule goes on to require that, for the exception to be applicable, the lawyer receiving the information from the prospective client must be "screened from further participation in the matter and is apportioned no part of the fee therefrom."[76] Additionally, written notice must be given to the prospective client.

Most requirements of this rule are achievable. However, given the compensation structure of most law firms, it is likely not possible to avoid apportioning a portion of the fee from any specific representation to any specific attorney.[77] Thus the effect of this new rule

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[75] Sutton, *How Long Does an Attorney-Client Relationship Last?*, Journal of the Legal Profession (1994) 277, at 287.

[76] Similarly, under Rule 1.10(e), when an attorney moves laterally to a new firm, circumstances exist where the firm can represent a client adverse to a client of the former firm even where the new lawyer had minimal involvement in the representation. This requires that the new firm take appropriate screening measures and again ensures that the new lawyer "is apportioned no part of the fee therefrom."

[77] One ethics opinion has been found under Rule 1.10 that discusses this "no apportionment requirement. State of Washington Informal Opinion 1498 (1992) distinguishes between a partner and an associate moving laterally and dealing with the 1.10 consequences:

is that a prospective client can effectively disqualify an unsuspecting law firm should the prospective client desire to do so. Attorneys must be alert to potential conflicts of interest very early in the intake process. Otherwise, this may give less reputable plaintiffs or defendants the opportunity to go "attorney shopping," provide disqualifying information during the initial interview, and thereby prevent an attorney or firm from representing even a long-term client in adverse litigation.

Who Is the Client?

When an attorney represents a legal entity such as a corporation, limited liability company, or other entity, the attorney must identify the client at the inception of the representation. It is frequently important to reconsider the issue from time-to-time during the representation because, as noted above in *Bennett*, the attorney-client relationship can evolve and take different forms.

An entity is a legal fiction – it is a 'person' for legal purposes, but it cannot take any action except through the efforts of its managers, officers, members, directors, or other human beings. Frequently representation of an entity over time results in a close relationship between the attorney and certain of these human beings. The attorney must always remember that, when representing the organization these individuals are not the attorney's client – the client is the organization.

Colo. RPC Rule 1.13 makes it clear that that the attorney for an entity "owes allegiance to the organization itself and not [to] its individual stockholders, directors, officers, employees, representatives or other persons connected with the entity." Rule 1.13 of the ABA's Model Rules of Professional Conduct is identical.

While Rule 1.13 makes it clear that the attorney must recognize the entity as his or her client, Rule 1.13 does not prevent the attorney-client relationship from evolving to include constituents, as well. This can happen when the attorney is not careful, or it may occur intentionally. During the representation, the relationship may evolve and the entity's constituent (officer, director, or other) may "seek[] and receive[] the advice of the lawyer on

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> "The Committee was of the opinion that a personally disqualified associate may be paid a regular salary, but may not share in any bonus or any other additional payment based upon the fee received in the case from which he or she is screened."
>
> "The Committee was of the opinion that in the case of a personally disqualified partner, the law firm must put into place an accounting practice to ensure that the gross income received from the case is handled in such a way that the personally disqualified partner does not share in it in any way. The Committee was further of the opinion that the law firm must document that accounting because the rule places the burden of proof of compliance upon the law firm."

Surprisingly, this point and the mechanics of accomplishing this "non-apportionment" requirement are not discussed in the comments to Rule 1.10 or Rule 1.18.

the legal consequences of the client's past or contemplated actions." As the court in *Bennett* said, this is a subjective analysis and depends in large part upon the belief of the putative client.

The client may intentionally evolve. For example, during a merger or acquisition transaction, an attorney for the target may also be representing the officers in negotiating employment contracts. Conflicts of interest rules under Colo. RPC 1.7 must be considered, but this may be a waivable conflict. Of course, the tougher the attorney is in negotiating the employment contract (or other economic terms outside of the target's interest), the less value may remain for the target and its equity holders. Thus, depending on the facts and circumstances, the conflict may not be waivable.

Thus, the attorney must make clear to all relevant parties, not only at the commencement of the representation but during the progress of the representation, where the attorney-client relationship lies.

When a dispute develops that involves the entity and certain of its constituents, the attorney for the entity must be on a heightened awareness. Formal Opinion 120[78] reiterates Rule 1.13 that the attorney representing the organization owes his or her duties to the organization. The Formal Opinion goes on to provide that representing the organization does not necessarily mean that the attorney is also representing any of the constituents (stockholders, members, officer, directors, or managers). Consequently, the attorney representing the organization cannot assert that he or she is also representing any constituent unless the attorney reasonably believes that he or she has been retained to represent the constituent. "Knowingly making such an assertion without having [such] a reasonable belief . . . would violate Rule 4.1 on truthfulness in statements to others."

Formal Opinion 120 goes on to discuss the situation where the interests of the organization are potentially adverse to the interests of its constituents. In that case, the attorney must clarify his or her role and advise the constituents that the attorney-client relationship flows to the organization and that the constituent may want to obtain independent representation. The other consequence is that there would not be confidentiality or attorney-client privilege in communications between the attorney and the constituent.

Finally, Formal Opinion 120 reminds attorneys that, under Rule 3.4(f), an attorney is prohibited from requesting that a person (other than a client) refrain from providing non-privileged information to another party except where both: (1) the person is a relative or employee or other agent of the client and the lawyer is not prohibited by other law from making the request **and** (2) the lawyer reasonably believes the person's interest will not be adversely affected by refraining from giving such information.

[78] Colorado Bar Association Ethics Committee, adopted May 17, 2008 (published at 37 THE COLO. L. (CBA) No 8 at 62 (Aug. 2008)).

Forming an Entity – Who Is the Client?

During the pre-formation period, the attorney is working with individuals to form an entity. If the entity will be the ultimate client, the lawyer must recognize that the entity does not yet exist. But the lawyer must make it clear to the individuals that none of them is individually, his client. The Colorado rules do contemplate this representation, but the attorney must recognize, and must advise his or her clients, that there are significant potential conflicts of interest in almost any entity formation. As only a single example, when the clients are valuing their respective contributions to the entity, each time a share or percentage is issued to one person, that share or percentage is not available to another. There are many more subtle decisions that must be made in the formation of an entity, the drafting of a buy-sell or other agreement among the equity holders, and in the continuing representation where one decision may favor one of the constituents and disadvantage another. Thus the issues discussed below surrounding 1.7 (conflicts of interest) and 4.3 (dealing with unrepresented persons) must be considered (among others). In considering these issues, note Comments [8] and [28] to Rule 1.7:

> "[8] . . . For example, a lawyer asked to represent several individuals seeking to form a joint venture is likely to be materially limited in the lawyer's ability to recommend or advocate all possible positions that each might take because of the lawyer's duty of loyalty to the others. The conflict in effect forecloses alternatives that would otherwise be available to the client. The mere possibility of subsequent harm does not itself require disclosure and consent. The critical questions are the likelihood that a difference in interests will eventuate and, if it does, whether it will materially interfere with the lawyer's independent professional judgment in considering alternatives or foreclose courses of action that reasonably should be pursued on behalf of [one of the clients]."

> "[28] Whether a conflict is consentable depends on the circumstances. For example, a lawyer may not represent multiple parties to a negotiation whose interests are fundamentally antagonistic to each other, but common representation is permissible where the clients are generally aligned in interest even though there is some difference in interest among them. Thus a lawyer may seek to establish or adjust a relationship between clients on an amicable and mutually advantageous basis; for example, in helping to organize a business in which two or more clients are entrepreneurs, working out the financial reorganization of an enterprise in which two or more clients have an interest or arranging a property distribution in settlement of an estate. The lawyer seeks to resolve potentially adverse interests by developing the parties' mutual interests. Otherwise each party might have to obtain separate representation, with the possibility of incurring additional cost, complication, or even litigation. Given these and other relevant factors, the clients may prefer that the lawyer act for all of them."

While it may be the clients' preference that the lawyer acts for all of them, the lawyer would frequently be better served by identifying and acting for a single client, even if it may be the entity that does not yet exist. In any event, the attorney must advise the individuals involved as to the attorney-client relationship with the recommendation (in writing) that each of the individuals consult with their own attorney if they determine it to be necessary or appropriate in the circumstances.[79]

The Arizona State Bar has expressed the opinion that it is permissible for a lawyer to represent an entity that does not yet exist:

> As long as the incorporators understand that they are retaining counsel on behalf of the yet-to-be-formed entity and will need to ratify this corporate action, *nunc pro tunc*, once the entity is formed.[80]

The Arizona Opinion goes on to say that it is the lawyer's duty to clarify at the outset whom the lawyer represents.

Colo. RPC 4.3 (effective January 1, 2008) permits a lawyer to give legal advice to an unrepresented person so long as the lawyer does not know (and has no reason to know) of a conflict between the interests of the lawyer's client and the unrepresented person. Paragraph [2] of the Comment explains the reasons for this expansion of the lawyer's permissible communications with unrepresented persons:

> [2] The Rule distinguishes between situations involving unrepresented persons whose interests may be adverse to those of the lawyer's client and those in which the person's interests are not in conflict with the client's. In the former situation, the possibility that the lawyer will compromise the unrepresented person's interests is so great that the Rule prohibits the giving of any advice, apart from the advice to obtain counsel.

This protects a lawyer when, for example, the lawyer is meeting with several individuals about the formation of a new business. Depending on the identification of the lawyer's client in such a circumstance, all of the other parties at the meeting are technically unrepresented. However, where the parties are all pursuing the same goal on an amicable basis, little purpose can be served by advising everyone else at the table to "obtain your own counsel." This is a beneficial clarification under the 2008 rules. Other states have reached a

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[79] See Colo. RPC 4.3, Dealing with Unrepresented Persons.

[80] Ariz. Opinion No. 02-06 at 3 (Sept. 2003).

similar conclusion, although in some cases using a retroactive application of the entity rule[81] to do so.

The engagement letter for the representation is usually the first time the attorney has to clarification the focus of the representation and to identify the client. When drafting any further agreement that defines the relationship among the unrepresented persons and the represented entity it is important to be clear that each unrepresented person should consult with his or her own legal advisors if they determine it to be necessary. It is not the attorney's choice whether such consultation is necessary – it is a decision that should be made by the unrepresented person, whether a member or manager of the LLC, partner of a partnership, or an officer, shareholder, or director of a corporation.[82]

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[81] The entity rule, which derives from CRPC Rule 1.13, holds that the lawyer represents the entity, not the individual constituents. *See, for example, Jesse v. Danforth*, 485 N.W.2d 63 (Wis. 1992), which offered the following guideline:

> [W]here (1) a person retains a lawyer for the purpose of organizing an entity and (2) the lawyer's involvement with that person is directly related to that incorporation and (3) such entity is eventually incorporated, the entity rule applies retroactively such that the lawyer's pre-incorporation involvement with the person is deemed to be representation of the entity, not the person.

See also Manion v. Nagin, 394 F.3d 1062 (8th Cir. 2005). *See also McKinney v. McMeans*, 147 F.Supp.2d 898 (W.D. Tenn. 2001) (following *Jesse*, denying motion to disqualify plaintiff's attorney, who prepared shareholder agreement, represented the corporation, then filed suit on behalf of one shareholder against the other); *In re Ireland*, 706 P.2d 352 (Ariz. 1985) (disciplining lawyer for conflict of interest for failing to disclose to corporation one incorporator's improper use of funds, where evidence showed that lawyer represented corporation in formation and operation); B. Wunnicke, *Ethics Compliance for Business Lawyers* §§ 8.4 and 8.5 (1987) ("The appealing reality is that often the lawyer who is organizing a corporation is representing the group.") (*quoted with approval in Meyer v. Mulligan*, 889 P.2d 509, 514 (Wyo. 1995)); "An Expectations Approach to Client Identity," 106 *Harv. L. Rev.* 687, 691, 696 (Jan. 1993) (*Jesse* comports with the "reasonable constituent's expectation approach"; "Treating pre-incorporation individual representation, absent evidence to the contrary, as entity representation accords with an organizer's reasonably expectations during the incorporation phase of the company's existence."); T. Thompson, "What is an Entity? – Entity-in-Formation," 6 *Ariz. Prac. Corporate Practice* § 2.5 (2004 ed.) (*citing Jesse* for proposition that treatment of entity-in-formation as person capable of being a client has become "well settled").

[82] For example, see the following disclaimer published in Lidstone, "*Form of Stock Redemption and Cross Purchase Agreement*" (ch. 23) in Rozansky and Reichert, PRACTITIONER'S GUIDE TO COLORADO BUSINESS ORGANIZATIONS (Colorado Bar Assn. 2007)

> **Section 15.6. Professional Advisors.** The Parties understand, acknowledge, and agree that the law firm of ______________________, P.C. represents only the Company with respect to this Agreement and has offered no legal, tax, or other advice to any Stockholder. The Stockholders further acknowledge and agree that: They have 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; They have been given reasonable time and opportunity to obtain such advice; and They have obtained such independent advice as they have deemed necessary and appropriate in the circumstances.

Who Is Paying the Fees?

In some cases, a person other than the named client may be paying the client's fees – such as when a promoter is paying the legal fees of a corporation or when the acquirer is paying the fees of the target who may not otherwise be able to afford the necessary legal representation. In any case where a person other than the client is paying legal fees, the attorney must consider the requirements of Rule 1.8(f) of the Colorado and Model Rules of Professional Conduct:

> A lawyer shall not accept compensation for representing a client from one other than the client unless: (1) the client consents after consultation; (2) there is no interference with the lawyer's independence of professional judgment or with the client-lawyer relationship; and (3) information relating to representation of a client is protected as required by Rule 1.6.

Once again, it is advisable for the attorney to make all necessary disclosures in writing and obtain the client's informed consent.[83]

Duty of Care.

An attorney owes a duty of care to each client,[84] and (under cases like *Steele v. Allen* and *Dury* discussed above[85]), potentially to non-clients as well. The duty of care requires that an attorney act with reasonable diligence and promptness in attending to the client's needs notwithstanding "opposition, obstruction, or personal inconvenience to the lawyer, and take whatever lawful and ethical measures are required to vindicate a client's cause or endeavor."[86] An attorney must employ that degree of knowledge, skill, and judgment

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83 Colo. RPC 1.0(e) defines informed consent to be the person's "agreement by a person to a proposed course of conduct after the lawyer has communicated adequate information and explanation about the material risks of and reasonably available alternatives to the proposed course of conduct." The attorney may confirm the consent in a letter to the person, or may obtain the person's signature on a communication, such as an engagement letter. Rule 1.4 (Communication) requires that the lawyer, as a part of his or her duty to communicate with the client, fully inform the client about matters requiring the client's "informed consent."

84 Restatement of the Law Governing Lawyers § 483, cmt. e. *Miller v. Byrne*, 916 P,2d 566, 579 (Colo. Ct.App. 1995). Generally, a fiduciary duty arises between individuals through a relationship where one party is empowered with a high level of control, trust, confidence or reliance. *Bailey v. Allstate Ins. Co.,* 844 P.2d 1336, 1339 (Colo. Ct.App. 1992). Certain relationships give rise to fiduciary duties as a matter of law. *Id.* Due to the high degree of control, level of trust and level of confidence empowered to an attorney, the attorney-client relationship gives rise to fiduciary obligations as a matter of law. *See Id.*; Restatement of the Law Governing Lawyers § 49. Legal malpractice actions based on breach of fiduciary duty involve violations of standards of conduct. *Smith v. Mehaffy*, 30 P.3d 727 (Colo. Ct.App. 2000). In order to establish a breach of a fiduciary duty, the plaintiff must demonstrate "that [1] the plaintiff incurred damages, and [2] that the [attorney's] breach of fiduciary duty was the cause of the damages sustained." *Miller*, 916 P.2d at 575.

85 *See* Section 8.3.1.

86 Colo. RPC 1.3, comment [1].

ordinarily possessed by members of the legal profession at the time the task is undertaken.[87] Although required to act with "commitment and dedication to the interests of the client and with zeal in advocacy," the "lawyer is not bound to press for every advantage that might be realized for a client."[88] If a dispute arises, the trier of fact determines whether the attorney has breached any duty.[89]

The duty of care requires an attorney to "protect a client in every possible way."[90] In *O'Melveny*, the court denied summary judgment in favor of a law firm because a triable issue of fact existed as to why the law firm failed to provide accurate opinion letters for two private offerings. The court explained that within the context of the private offerings, the law firm had a duty to make a "reasonable, independent investigation." The court also noted an expert witness' testimony arguing that the law firm's failure to contact their client's former counsel and accountants was a breach of the duty of due care. The plaintiff, the Federal Deposit Insurance Corporation, did not allege that the law firm had been aware of the fraud nor did the court's conclusion rest on the law firm's awareness of the fraud. The court in *O'Melveny* set forth that an attorney fulfills the duty of due care by performing with "such skill, prudence, and diligence as attorneys of ordinary skill and capacity commonly possess."[91]

An important aspect of the Rules of Professional Conduct is their availability to private litigants. The Rules of Professional Conduct are primarily directed toward attorney conduct and disciplinary matters before the state organization (Supreme Court or other appropriate body) that regulates discipline of lawyers.[92] The Colorado commentary states

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[87] *McCafferty v. Musat*, 817 P.2d 1039, 1043-44 (Colo. App. 1990) (finding professional negligence where an attorney recommended settling a case before performing any discovery); *See also* Restatement of the Law Governing Lawyers § 52.

[88] Colo. RPC 1.3, comment [1]. The comment provides, as an example, that the lawyer may have authority to exercise professional discretion in determining the means by which a matter should be pursued." Also, the "lawyer's duty to act with reasonable diligence does not require the use of offensive tactics or preclude the treating of all persons involved in the legal process with courtesy and respect."

[89] *McCafferty*, 817 P.2d at 1044.

[90] *FDIC v. O'Melveny & Meyers*, 969 F.2d 744, 748 (9th Cir. 1992), rev'd on other grounds *O'Melveny & Myers v. FDIC*, 114 S.Ct. 2048 (1994) (quoting *Day v. Rosenthal*, 170 Cal App. 3d 1125, 1143 (1985)).

[91] *Id.* at 748 (quoting *Lucas v. Harem*, 15 Cal.2d 583, 591 (1961)). *Temple Hoyne Buell Foundation v. Holland & Hart*, 851 P.2d 192, 198 (Colo. Ct. App. 1992).

[92] *See Astarte, Inc. v. Pac. Indus. Sys., Inc.*, 865 F. Supp. 693 (D. Colo. 1994) stating that under Colorado law, ethics codes for lawyers neither prescribe civil liability standards nor create private causes of action. *See* other cases cited in the *Annotated Model Rules of Professional Conduct* (Fifth Ed.) (Center for Professional Responsibility, American Bar Association, at pages 6-7).

that "[v]iolation of a Rule should not itself give rise to a cause of action against a lawyer nor should it create any presumption in such a case that a legal duty has been breached."[93] However, most courts permit the use of the applicable rules of professional conduct as evidence of the lawyer's standard of care in cases involving malpractice and breach of fiduciary duty.[94] The Colorado commentary goes on to say that, "since the Rules do establish standards of conduct by lawyers, in appropriate cases a lawyer's violation of a Rule may be evidence of breach of the applicable standard of conduct."[95]

What If You Have More Than One Client? The advice above clearly recommends that the attorney, in forming an entity or taking on other legal representation, clearly identify a single client so that the focus of the attorney's duties is clearly identified. Notwithstanding that advice, there is no prohibition against an attorney representing multiple clients in the same transaction providing the rules are met. In fact, Formal Opinion 68[96] specifically contemplates that in some cases an attorney's representation of more than a single party may be appropriate. The syllabus to the Opinion clearly lays out the issues [*emphasis supplied*]:

> While attorneys are frequently requested to act as the attorney for multiple parties in drafting an agreement, *the Committee does not recommend multiple representation* because this situation places an attorney in the clearest of conflicts regarding client confidentiality and the ability to exercise professional judgment free of compromising influences. In those situations in which an attorney agrees to accept such a role, the attorney may do so only after fully disclosing the risks of multiple representation and obtaining the consent of each party. Furthermore, prior to accepting employment, the attorney must determine if it is obvious whether the attorney can adequately represent the interests of each party to the transaction. The nature of the disclosure required and the ability adequately to represent each party will depend on the agreement in question. However, regardless of the agreement in question, representing both parties requires adherence to the full range of duties

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[93] Preamble and Scope to the Colorado Rules of Professional Conduct, Comment [20], first sentence.

[94] *See* cases cited in the *Annotated Model Rules of Professional Conduct* (Fifth Ed.) (Center for Professional Responsibility, American Bar Association, at pages 7-8).

[95] Preamble and Scope to the Colorado Rules of Professional Conduct, Comment [20], last sentence. Some courts take a more cautious approach, permitting ethics rules to be considered in cases to the extent an expert witness has used them in reaching a conclusion in the case regarding legal malpractice, and a small number of courts do not permit the use of the rules to show evidence of malpractice. *See Annotated Model Rules of Professional Conduct* (Fifth Ed.) (Center for Professional Responsibility, American Bar Association, and cases cited therein at page 8-9).

[96] *Conflicts Of Interest: Propriety Of Multiple Representation*, Adopted April 20, 1985.

accompanying the attorney-client relationship and *under no circumstances is multiple representation to be considered a "scrivener's" role*.

The Formal Opinion goes on to describe certain disclosure that must be made to the clients, including that there is no attorney-client privilege as between the clients – information conveyed by one of the multiple clients can (and perhaps should) be conveyed to all of the clients involved in that representation. If subsequent litigation between the multiple clients develop, "the privilege will not protect any communications between the attorney and each party."

Formal Opinion 68 goes on to provide that, in the event a dispute among or between the clients does develop, the attorney will have to withdraw from representing any of the parties absent knowing consent of both sides and the attorney's determination that he or she can continue the representation of one party against the other party without violating any of the Rules. The attorney must disclose to the client that the net effect of such a withdrawal is that each party will likely incur higher legal costs than if separate counsel had been secured at the outset of the transaction.

In all but the most unusual cases, it is preferable for the attorney to have a single client.

Rule 1.1 Competence

As should be obvious to all practicing lawyers, competence in the practice of law flows through all of the other rules.

Rule 1.1 is specifically mentioned in Formal Opinion 119, *Disclosure, Review, and Use of Metadata*,[97] which addresses the ethical obligations of the "sending lawyer" who transmits electronic documents containing metadata to a third party, including the lawyer for an adverse party. According to Opinion 119, any lawyer (or staff person) who transmits electronic documents or files has a duty to use reasonable care to guard against the disclosure of metadata containing confidential information. The definition of reasonable care will depend on the facts and circumstances of each case. Opinion 119 makes it clear that the duty under Rule 1.1 to provide competent representation requires each lawyer sending electronic information "to ensure that he or she is reasonably informed about the types of metadata that may be included in an electronic document or file and the steps that can be taken to remove metadata if necessary."

Rule 2.3 permits a lawyer for a client to provide an evaluation for the use of a third party. As discussed below, this is usually the situation with legal opinions. In order to

[97] Ethics Committee, Colorado Bar Association, Formal Opinion 120 (May 17, 2008) available at http://www.cobar.org/index.cfm/ID/386/subID/23920/CETH//.

competently render a legal opinion for the benefit of a client, the opining lawyer must be familiar with customary practice as defined in the literature and elsewhere.[98]

Rules 1.2(d), Rule 4.1 and 8.4(c) – Truthfulness in Statements to Others

Rule 4.1 requires that lawyers be truthful in their statements to others. Under Rule l.2(d), a lawyer is prohibited from counseling or assisting a client in conduct that the lawyer knows is criminal or fraudulent. Rule 8.4(c) provides that it is professional misconduct to engage in conduct involving dishonesty, fraud, deceit or misrepresentation. While Rules 4.1 and 1.2(d) involve client representation, Rule 8.4(c) expands the lawyer's obligation for truthfulness to all aspects of the attorney's practice and life, including social networking sites.

Rule 4.1(b) addresses the situation where a client's crime or fraud takes the form of a lie or misrepresentation. These rules have significant potential applicability to lawyers practicing transactional law.

According to the commentary to Rule 4.1, a lawyer can ordinarily avoid assisting a client's crime or fraud by withdrawing from the representation. Sometimes it may be necessary for the lawyer to give notice of the fact of withdrawal and to disaffirm an opinion, document, affirmation or the like. In extreme cases, substantive law may require a lawyer to disclose information relating to the representation to avoid being deemed to have assisted the client's crime or fraud. If the lawyer can avoid assisting a client's crime or fraud only by disclosing this information, then under Rule 4.1(b) the lawyer is required to do so, unless the disclosure is prohibited by Rule 1.6.

Even apart from ethical obligations, assisting client's misdeeds may lead to civil, criminal, or administrative liability to attorneys. In *Thompson v. Paul*,[99] the Ninth Circuit surveyed case law from the Third, Fifth, Sixth, and Seventh Circuits seeking to hold attorneys liable for actions of their client in the context of securities representation. The Ninth Circuit found that a clear rule emerges:

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[98] This literature is easily available and much of it can be found in the ABA's legal opinion resource center. http://www.abanet.org/buslaw/tribar/home.shtml. The website of the American College of Real Estate Lawyers (www.acrel.org) includes valuable information for persons writing legal opinions in real estate transactions. Of these, the ABA's "Guidelines for the Preparation of Legal Opinions," 57 The Bus. L. (ABA) 875 (2002) and "Legal Opinion Principles," 53 The Bus. L. (ABA) 831 (1998), are among the most significant, as are the reports prepared by the TriBar Opinion Committee. There are also numerous treatises available, including contributions from a number of Colorado lawyers in Holderness and Wunnicke, *Legal Opinion Letters Form Book* (Aspen Law Business, 2nd Ed. 2003). Chapter 1B of the 2008 Supplement is a primer for lawyers not experienced in opinion practice. *Glazer and Fitzgibbon on Legal Opinions: Drafting, Interpreting, and Supporting Closing Opinions in business Transactions* (Aspen Law & Business, 3rd Ed.) is another valuable resource for legal opinion preparers.

[99] 547 F.3d 1005 (9th Cir. 2008).

> An attorney who undertakes to make representations to prospective purchasers of securities is under an obligation, imposed by Section 10(b), to tell the truth about those securities. That he or she may have an attorney-client relationship with the seller of the securities is irrelevant under Section 10(b).[100]

The *Thompson v. Paul* case posits liability for the attorneys as a primary participant in the fraud, as required by the U.S. Supreme Court in its *Stoneridge* decision.[101] According to the pleadings in *Stoneridge*, in 2000 Charter Communications, Inc., was facing a significant revenue and cash flow shortfall as compared to Wall Street expectations. Charter allegedly agreed to overpay Scientific-Atlanta, Inc. and Motorola, Inc. by a total of $17 million for set-top boxes that Charter had already agreed to purchase from them at lower prices. Allegedly, *quid-pro-quo* for the overpayment, Scientific-Atlanta and Motorola agreed to use those additional funds to purchase unwanted advertising from Charter. To create an appearance that these transactions were legitimate, Scientific-Atlanta and Motorola each allegedly: (i) issued documentation stating that they demanded the price increases because of higher costs; (ii) backdated contracts; and (iii) agreed to "purchase" advertising at four to five times regular rates using Charter's overpayment. The factual allegations in *Credit Suisse* and *Simpson* were equally egregious. Documents were presented in each of the cases that indicated that the secondary actors (Scientific Atlanta and Motorola in the *Stoneridge* case) knew that their transactions would be used by the primary actor (Charter in the *Stoneridge* case) to inflate their financial statements. Thus, in none of these cases were the secondary actors innocent dupes.

However, in no case did the secondary actors make any public disclosures or representations that were then included in public disclosures. In no case were the secondary actors involved in the offer, purchase, or sale of securities as required in *Blue Chip Stamps v. Manor Drug Stores*.[102] And in no case did the secondary actors have a legal duty to speak.

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[100] Notably it is also irrelevant under the Rules of Professional Conduct that governs lawyers in all 50 states. Rule 2.3 of the ABA's Model Rules (adopted in most states) is entitled "*Truthfulness in Statements to Others*." An attorney assisting a client in a crime or fraud, including a violation of SEC Rule 10b-5, is also breaching his or her ethical obligations. When the attorney speaks to third parties, the attorney has a duty to speak truthfully. It is preferable not to speak at all when there is any doubt.

[101] During 2007, there were three similar cases pending before the Supreme Court which again rose the question of potential liability for secondary actors under Rule 10b-5. This was initially resolved in 1994 in *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164 (1994), but resuscitated in the early 21st century in the cases of *Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc.*, 443 F.3d 987 (8th Cir. 2006), *cert granted*; *Regents of the University of California, et al. v. Credit Suisse First Boston (USA), Inc.*, 482 F.3d 372 (5th Cir. 2007), *cert. granted* and *Simpson v. AOL Time Warner Inc.*, 452 F.3d 1040, 1048 (9th Cir. 2006), *cert. granted.* In each of those three cases, third parties assisted public companies in inflating revenue and profits by engaging in the "round-trip transactions" similar to the *Stoneridge* transaction described in the text.

[102] 421 U.S. 723 (1975). *See* Lidstone, *Securities Law Deskbook* (www.bradfordpublishing.com) at § 16.4.1.

As the Supreme Court said in *Chiarella v. United States*,[103] "When an allegation of fraud is based upon nondisclosure, there can be no fraud absent a duty to speak." The Supreme Court issued its *Stoneridge* decision on January 15, 2008,[104] holding:

> Here respondents were acting in concert with Charter in the ordinary course as suppliers and, as matters then evolved in the not so ordinary course, as customers. Unconventional as the arrangement was, it took place in the marketplace for goods and services, not in the investment sphere. Charter was free to do as it chose in preparing its books, conferring with its auditor, and preparing and then issuing its financial statements. In these circumstances the investors cannot be said to have relied upon any of respondents' deceptive acts in the decision to purchase or sell securities; and as the requisite reliance cannot be shown, respondents have no liability to petitioner under the implied right of action. This conclusion is consistent with the narrow dimensions we must give to a right of action Congress did not authorize when it first enacted the statute and did not expand when it revisited the law.

The Supreme Court went on to say that, in the *Stoneridge* case, "any deceptive statement or act respondents made was not actionable because it did not have the requisite proximate relation to the investors' harm. That conclusion is consistent with our own determination that respondents' acts or statements were not relied upon by the investors and that, as a result, liability cannot be imposed upon respondents." Falsifying documents and other actions can be deceptive. In the future and similar to the cases (such as *Thompson v. Paul*[105]) holding attorneys civilly liable for their client's misrepresentations, cases will instead turn on whether the deceptive act was somehow communicated to the investing public and whether proximate cause exists.[106]

Importantly, the limitations imposed by *Central Bank* and *Stoneridge* on liability for aiding and abetting securities fraud do not apply to enforcement actions brought by the SEC or actions for criminal violations brought by the United States Attorneys under § 17(a) of the Securities Act of 1933 or under Rule 10b-5 adopted under the Securities Exchange Act of 1934. As the U.S. Supreme Court stated in the *Stoneridge* case: [107]

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[103] 445 U.S. 222, 234 (1980).

[104] Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc., 552 U.S. 148, 128 S.Ct. 761 (2008).

[105] 547 F.3d 1055, (9th Cir. 2008).

[106] For a more detailed discussion, see Lidstone, *The Securities Law Deskbook* (www.bradfordpublishing.com) at § 16.11.

[107] Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc., 552 U.S. 148 (2008) at Part IV, 128 S.Ct. at 773-4.

> Secondary actors are subject to criminal penalties, see, *e.g.,* 15 U. S. C. §78ff, and civil enforcement by the SEC, see, *e.g.,* §78t(e). The enforcement power is not toothless. Since September 30, 2002, SEC enforcement actions have collected over $10 billion in disgorgement and penalties, much of it for distribution to injured investors. …. And in this case both parties agree that criminal penalties are a strong deterrent. …. In addition some state securities laws permit state authorities to seek fines and restitution from aiders and abettors. …. All secondary actors, furthermore, are not necessarily immune from private suit. The securities statutes provide an express private right of action against accountants and underwriters in certain circumstances, see 15 U. S. C. §77k, and the implied right of action in §10(b) continues to cover secondary actors who commit primary violations.

The conclusion must be that lawyers may be liable to third parties as a result of their client's actions. This liability may be civil, to third parties, where the third parties can show that the lawyer's actions rose to that of a primary participant in the matter. The lawyer may be liable for aiding and abetting a client's actions in enforcement or criminal actions brought to enforce the securities laws. A lawyer who follows his or her obligations under the Rules of Professional Conduct not only acts ethically, but is most likely to avoid additional liability as well.

Rule 1.5 – Fees and Fee Agreements Can an Attorney Take Equity as an Investment or for Fees

Fees and Fee Agreements. Colorado Rule 1.5 governs fees and retainer agreements. Fees must be reasonable (Rule 1.5(a)) and, except where the attorney has regularly represented the client, the fees must be communicated to the client in writing (Rule 1.5(b)). "Attorney fees are always subject to refund if they are excessive or unearned."[108]

Referral fees (Rule 1.5(e)) are prohibited; a division of fees among or between lawyers is permitted only to the extent permitted in Rule 1.5(d) that:

(i) the lawyers among whom the fees are to be divided actually performed work or each of the lawyers assume the obligations of joint representation,

(ii) the client agrees to the arrangement, including the basis on which fees are to be divided,

(iii) the overall fee is reasonable.

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[108] *In the Matter of Larry D. Sather,* 3 P.3d 403 at 413 (Colo. 2000).

The division of fees among lawyers is another case where the rules specifically require the client's consent to be in writing.

Rule 1.5(f) is extremely important – fees are not earned until the work has been performed. By the same token, non-refundable fees are prohibited in Rule 1.5(g). After the completion of the work, a lawyer is required to return any unearned fee to the client. (Rule 1.16(d).)[109] All unearned fees must be maintained in a COLTAF account meeting the requirements of Rule 1.15, or in a separate account where the interest on funds deposited accrues for the benefit of the client. Note that Rule 1.15 makes it clear that COLTAF accounts are intended for funds that will not generate significant income. COLTAF accounts are "pooled interest-bearing insured depository account[s] for funds of clients or third persons *that are nominal in amount or are expected to be held for a short period of time . . .*."[110]

While the rules only mandate a written fee agreement in certain circumstances (such as with a new client (Rule 1.5(b)), a contingent fee arrangement (Rule 1.5(c)), and where there will be a division of fees (Rule 1.5(d)), the commentary states the following:

> "In a new client-lawyer relationship, the basis or rate of the fee must be promptly communicated in writing to the client. When the lawyer has regularly represented a client, they ordinarily will have reached an understanding concerning the basis or rate of the fee; but, when there has been a change from their previous understanding, the basis or rate of the fee should be promptly communicated in writing. All contingent fee arrangements must be in writing, regardless of whether the client-lawyer relationship is new or established. See C.R.C.P., Ch. 23.3, Rule 1. A written communication must disclose the basis or rate of the lawyer's fees, but it need not take the form of a formal engagement letter or agreement, and it need not be signed by the client. Moreover, it is not necessary to recite all the factors that underlie the basis of the fee, but only those that are directly involved in its computation. It is sufficient, for example, to state that the basic rate is an hourly charge or a fixed amount or an estimated amount, to identify the factors that may be take into account in finally fixing the fee, or to furnish the client with a simple memorandum or the lawyer's customary fee schedule. When developments occur during the representation that render an earlier disclosure substantially inaccurate, a revised written disclosure should be provided to the client.
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> "A written statement concerning the fee reduces the possibility of misunderstanding. Lawyers are well-advised to use written disclosures even when they are not required. Moreover, it is preferable, although not mandatory, to obtain the client's signature acknowledging the basis or rate of the fee."

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[109] *See In the Matter of Larry D. Sather,* 3 P.3d 403 at 413 (Colo. 2000).

[110] CRPC, Rule 1.15(h)(2). Emphasis supplied.

Interest on amounts that are past-due can only be assessed if the client has agreed to interest in writing. The failure to have a fee agreement in place to define the relationship between the attorney and his or her client has resulted in disciplinary actions against the attorney. In *People v. Ungar*,[111] the presiding disciplinary judge described the matter that led to a conditional admission of misconduct and a 90-day suspension as follows:

> "Respondent performed securities work on behalf of his client, an investment company, in connection with the acquisition of controlling interests in shell companies that were to become the subject of reverse mergers. However, Respondent failed to communicate the basis of his fee in writing to his client and never explicitly agreed on the contingencies of the fee agreement. A dispute as to the funds held by the Respondent in escrow later arose when he failed to keep all of the funds subject to this transaction in trust [as required by C.R.P.C. Rule 1.15]."

A carefully-worded fee agreement would have resolved that issue and many other similar disputes that arise with clients.

Can an Attorney Take Equity in a Client as an Investment or as Payment of Fees? Under the Rule 1.5(a) of the Colorado Rules of Professional Conduct, attorney's fees must be reasonable. Where the fees are negotiated between sophisticated business people and their counsel in a normal business representation, the fees are generally presumed to be reasonable.

In many cases, clients ask attorneys to invest in a corporate or partnership entity. This is specifically contemplated and permitted in the comment to Rule 1.5, as follows:

> "A lawyer may accept property in payment for services, such as an ownership interest in an enterprise, providing this does not involve acquisition of a proprietary interest in the cause of action or subject matter of the litigation contrary to Rule 1.8(j). However, a fee paid in property instead of money may be subject to special scrutiny because it involves questions concerning both the value of the services and the lawyer's special knowledge of the value of the property."

There are many reasons a client may request the attorney to accept payment of fees, at least in part by accepting an ownership interest –

- perhaps as a method of reducing fees payable to the attorney, or

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111 05PDJ076 (Colo. PDJ, Jun. 8, 2006) available at http://www.coloradosupremecourt.com/PDJ/ConditionalAdmissions/Ungar,Conditional%20Admission,05PDJ076,%2006-08-06.pdf.

- perhaps as a method of having the attorney show confidence in the client and his or her business.

Many attorneys have accepted investment opportunities in clients. One of the principal limitations is found in malpractice insurance policies maintained by attorneys. Generally these policies contain limitations on the percentage investment an attorney can make, or at least require disclosure of instances where the covered attorney has invested in a client. The 1998 report of the ABA's Business Law Section's Committee on Business Ethics warns that:

> "even when precautions are taken, lawyers still risk accusations of self-dealing. The lawyer who goes into business with a client faces a heavy burden of establishing both informed consent and transactional fairness."

A commentator suggests that attorneys who invest in clients "not only have the opportunity to become a multi-millionaire, you have the opportunity to get sued." [112] The ethical rules do not prohibit an attorney from investing in a client or from taking an equity interest in the client in lieu of, or in addition to, fees. For example, ABA Formal Opinion 00-418 states in pertinent part:

> "The Model Rules of Professional Conduct do not prohibit a lawyer from acquiring an ownership interest in a client, (i) either in lieu of a cash fee for providing legal services or (ii) as an investment opportunity in connection with such services, as long as the lawyer complies with Rule 1.8(a) governing business transactions with clients."[113]

Colorado has issued a formal opinion on the subject – Formal Opinion 109.[114] The Formal Opinion warns (with citations included):

> "The circumstances of each case should be judged under an objective standard of reasonableness. *See* Colo. RPC 1.5(a); *Feiger, Collison & Killmer v. Jones*, 926 P.2d 1244, 1252 (Colo. 1996) (client's sophistication a factor); *Beeson v. Industrial Claim Appeals Office of the State of Colorado*, 942 P.2d 1314, 1316 (Colo. App. 1997) (various factors should be employed to measure the reasonableness of the attorney fee, and the weight given to any factor depends on the circumstances of each case.) A lawyer taking equity in lieu of fees would be well advised to obtain, if possible, an objective valuation of the equity interest at the time it is received to demonstrate that

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[112] Debra Baker, *Who Wants to be a Millionaire?*, 86 A.B.A.J. 36, 38 (Feb. 2000).

[113] *Accord* Association of the Bar of the City of New York Committee on Professional and Judicial Ethics, Formal Opinion 2000-3.

[114] "Acquiring an Ownership Interest in a Client," May 19, 2001.

the fee is reasonable in light of the benefit conferred or services rendered or to be rendered to the client in return."

The Formal Opinion goes on to note that the receipt of an ownership interest in a client in lieu of fees is (when paid at the commencement of the representation) equivalent to an advance against fees. The requirements of Rule 1.15 (for holding advance fees in a COLTAF account) and 1.16(d) (for the returning of fees) must be considered when accepting an ownership interest in lieu of cash payment of fees.

Issues arise under the rules even where an attorney invests in a client rather than accepting an ownership interest in lieu of cash payment of fees. In either case, it is considered to be a "business transaction with a client," and must comply with the requirements of Rule 1.8(a) discussed below. In considering taking equity for fees or investing in a client, it is important to note that, "although it has been said that 'there are no transactions that courts will scrutinize with more jealousy than dealings between and attorney and his client,'[115] neither the common law nor rules of professional ethics prohibit such transactions outright."[116] Where the attorney is receiving equity as a portion of the fee being charged for the legal services in question, the attorney must evaluate whether the fee is excessive. This must be evaluated as of the time the transaction is negotiated.

In providing legal services to the client's business while owning its stock, an attorney must be cognizant of the limitations under various other Rules of Professional Conduct:

- Rule 1.7(b) provides that a lawyer may not represent a client if the representation of that client may be materially limited by, among other things, "the lawyer's own interests";[117] and

- Rule 2.1 requires that, in representing a client, a lawyer shall exercise "independent professional judgment and render candid advice."[118]

It is always possible that an exchange of securities for fees reasonably may affect an attorney's professional judgment on behalf of a client. In order to avoid impacting his or her professional judgment, the amount involved should be nominal from both the attorney's perspective and the perspective of the client organization, and the attorney should place any

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115 *Quoting Spilker v. Hankin*, 88 F.2d 35 (D.C. Cir. 1951) and *citing Stockton v. Ford*, 52 U.S. (11 How.) 232 (1850) and *Cupeiro v. Baron*, 555 So.2d 370 (Fla. Dist. Ct. App. 1989).

116 *The Law of Lawyering*, §12.4 at page 12-11. Section 126 of the *Restatement* addresses business transactions with clients in a manner that is consistent with the requirements of Colo. RPC 1.8(a).

117 Colo. RPC, Rule 1.7(b) (1997).

118 Colo. RPC, Rule 2.1 (1997).

stock certificates in the office safe and forget that they are there for as long as the representation is ongoing. This is difficult, to say the least.

Thus, while there is no prohibition against an attorney accepting stock for fees, or in making an investment in a client, the attorney would be well advised to include the disclosures required under Rule 1.8(a) in an appropriate engagement letter or other writing – as required by Rule 1.8(a)(3).

Rule 1.13 and Rule 1.6 – Representation of Organizations and Confidentiality

Colorado substantially revised its rules regarding confidentiality (Rule 1.6) and representation of entities (Rule 1.13) effective January 1, 2008. These rules are similar to the rules proposed by the Kutak Commission in 1982 which were rejected by the ABA's House of Delegates when considering revisions to the Model Rules of Professional Conduct. Similar proposals were rejected by the House in 1991 and again when proposed by ABA's Ethics 2000 Commission in August 2001.[119] Thereafter significant events in the corporate governance landscape occurred. These events were named Enron, Worldcom, HealthSouth, Tyco CEO Dennis Kozlowski, and too many others. Senators and the public were shouting "where were the lawyers?"[120] As a result a committee of the ABA reconsidered the proposals received a year previously from the Ethics 2000 Commission, proposed them again to the ABA's House of Delegates, which adopted them in August 2002.

Rule 1.13 makes it clear that where the client is an entity, the attorney must always be aware that the entity is a collection of individuals. As stated in Rule 1.13 (both before and after amendment), where the entity is the client, the attorney for an entity "owes allegiance to the organization itself and not [to] its individual stockholders, directors, officers, employees, representatives or other persons connected with the entity." During the entity's operations over a period of time, the attorney will unquestionably develop close relationships with the individuals associated with the entity with whom the attorney is working. That relationship, no matter how friendly, cannot affect the attorney's representation of the entity or further corporate scandals are likely to occur.

As discussed above, one of the provisions of the Sarbanes-Oxley Act was § 307 which required the SEC to "issue rules, in the public interest and for the protection of investors, setting forth minimum standards of professional conduct for attorneys appearing

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[119] *See* Stephen Gillers and Roy D. Simon, *Regulation of Lawyers: Statutes and Standards* 69-71 (2005 ed.) cited in *Report of the Task Force on the Lawyer's Role in Corporate Governance* at 77 (November 2006) by the Association of the Bar of the City of New York.

[120] *See, e.g.,* Remarks of Senator John Edwards, 148 Cong. Rec. S6552 (daily ed. July 10, 2002) and Remarks of Senator Michael Enzi, 148 Cong. Rec. S6576 (daily ed. July 10, 2002). These remarks were made during the debate surrounding the adoption of the Sarbanes-Oxley Act of 2002, and specifically § 307 thereof. *See* text at notes 8-9, above.

and practicing before the Commission in any way in the representation of issuers."[121] The SEC adopted its attorney conduct rules effective in August 2003.[122] Most financing and merger and acquisition transactions involve the offer, purchase, or sale of securities and, consequently, the SEC's attorney conduct rules will likely apply. Even where the SEC's attorney conduct rules do not apply, Rule 1.13 imposes obligations on attorneys representing entities.

Under Colorado Rule 1.13, where counsel to an entity knows that a person associated with that entity:

1. is engaged, intends to act or refuses to act in a manner;
2. related to the representation;
3. that is a violation of a legal obligation to the entity or a violation of law which might reasonably be imputed to the entity; and
4. is likely to result in substantial injury to the entity,

the attorney must proceed as reasonably necessary in the best interests of the entity, giving consideration to:

a) the seriousness of the violation and its consequences;

b) the scope and nature of the lawyer's representation;

c) the responsibility and the motivation of the person involved; and

d) other relevant considerations.

Where the attorney has concerns in this regard, there are many actions the attorney can take to fulfill his or her legal duties. These include:

- Asking for reconsideration of the matter;
- Seeking a separate legal opinion;

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[121] 15 U.S.C. § 7245.

[122] 17 C.F.R. § 205.1. Note that the term "appearing and practicing before the SEC" is interpreted very broadly and includes attorneys representing private issuers in transactions involving the issuance or transfer of securities. *See* Lidstone, THE SECURITIES LAW DESKBOOK (Bradford Publishing Co. 2007) at § 13.6 and § 13.7; Lidstone, "Sarbanes-Oxley Act of 2002: Impact on Private Companies and their Attorneys," 33 THE COLO. L. (CBA), no. 7 at 73 (July 2004).

- Referring the matter to a higher authority at the entity; or

Where the entity continues to act in the objectionable manner which the lawyer determines is a violation of law and is likely to result in substantial injury to the entity, the lawyer may resign.[123] Under 2008 changes, attorney's duty to report within the organization continues:

– If the lawyer reasonably believes that he was discharged by the client because of his compliance with Rule 1.13, or

– If the lawyer withdrew under circumstances that required the lawyer to report corporate wrongdoing.

Colorado Rule 1.13(c) permits the lawyer to reveal information related to the representation of the entity to third parties irrespective of whether such disclosure would violate Rule 1.6. Disclosure under Rule 1.13(c) is only permitted when, in the lawyer's judgment, disclosure is necessary to prevent substantial injury to the organization. Note that Rule 1.13 focuses the emphasis of the disclosure on injury to the organization.

Rule 1.6(b) permits (but does not require) disclosure by an attorney of the confidences of a client, when the attorney believes it necessary:

- To prevent reasonably certain death or substantial bodily harm;

- To prevent the client from committing a crime or fraud that is reasonably certain to result in substantial injury to the financial interests or property of another **and** in furtherance of which the client used or is using the lawyer's services; or

- To prevent, mitigate or rectify substantial injury to the financial interests or property of another" resulting from a crime or fraud "in furtherance of which the client has used the lawyer's services"

The focus of Rule 1.6(b) is not the attorney's client. The focus of Rule 1.6(b) is to protect third parties. Notably the rules do not require attorney disclosure in the circumstances outlined in the rule disclosure is instead permissible. Where the attorney becomes aware of one of the matters that may be subject to disclosure under Rule 1.6(b), the attorney's interests may diverge from the client as the attorney considers how to address the issues to his or her client and whether to make disclosure under Rule 1.6. One of the

[123] The duties of attorneys representing entities that file reports under the Securities Exchange Act of 1934 or which have filed registration statements under the Securities Act of 1933 have enhanced duties imposed by §307 of the Sarbanes-Oxley Act of 2002 and the rules the SEC has adopted thereunder. *See* Lidstone, *Am I My Brother's Keeper? Redefining the Attorney-Client Relationship*, 32 THE COLO. L. (CBA) No. 4, 11 (Apr. 2003).

concerns an attorney in such a position may have is potential aiding and abetting liability if the attorney is publicly silent in the face of such knowledge.[124] Even though the rules state that violation "should not itself give rise to a cause of action against a lawyer nor should it create any presumption in such a case that a legal duty has been breached,"[125] it is likely that plaintiffs will argue that the rules reflect the standard of care in the community. Recently the Colorado Court of Appeals determined that attorneys could be held liable for aiding and abetting the breach of fiduciary duties. The Colorado Supreme Court overturned the appellate court's decision on other grounds, but specifically left open the issue of whether an attorney can be held liable for an aiding and abetting the breach of fiduciary duties.[126] Regardless of civil liability, however, there is clear precedent that a lawyer may be disciplined for aiding and abetting a client's financial crimes.[127]

The 2008 amendments to Rules 1.13 and 1.6 make representation of organizations more difficult. When the impact of these new rules is fully understood, individuals associated with organizations may be less forthcoming with their legal counsel, concerned about the attorney's duties to make disclosure, even when voluntary.

In 2003 the SEC proposed a requirement that attorneys, in circumstances similar to new Rule 1.6(b), make a 'noisy withdrawal' when the situation is such that the attorney can no longer represent the client.[128] As described above,[129] following the disclosure of the

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[124] Consider the case where an attorney finds out about events in which a client participated which ultimately prove to have been fraudulent (although the attorney and the client may disagree with that characterization at the time). The attorney considers his or her Rule 1.6 obligations and determines not to make the permissive disclosure but simply resigns. Even though that failure to make permissive disclosure cannot be subject to a disciplinary proceeding, might it be sufficient for the attorney to be held responsible for aiding and abetting the client's fraud?

[125] Colo. RPC Preamble and Scope, Comment [20].

[126] *Alexander v. Anstine*, 152 P.3d 497 (Colo. 2007).

[127] *In re DeRose*, 55 P.3d 126 (Colo. 2002) (Attorney was convicted of a felony charge of aiding and abetting when, on behalf of his clients, he engaged in eleven separate financial transactions structured to avoid federal financial reporting requirements. Through his criminal conduct, the attorney violated C.R.C.P. 251.1(b) and Rule 8.4(b), and was therefore disbarred.)

[128] The Commission proposed rules under § 307 of the Sarbanes-Oxley Act of 2002 on November 6, 2002. SEC Rel. 33-8150, 34-46868, IC-25829, and adopted final rules on January 29, 2003 (effective August 5, 2003). SEC Rel. 33-8185, 34-47276, IC-25929. Although the rules as proposed included the provision for a "noisy withdrawal," the Commission deferred consideration of those rules. SEC Rel. 33-8186, 34-47282, IC-25920 In that release, the Commission itself acknowledges that the "noisy withdrawal" proposal went beyond the requirements of Sarbanes-Oxley. Both Senators Edwards and Enzi made it clear in their remarks that § 307 "would not require the attorneys to report violations to the [Commission], only to corporate legal counsel or the CEO, and ultimately to the board of directors." 148 Cong. Rec. S6555 (Daily ed., July 10, 2002). Nevertheless, the proposed rules have not been withdrawn. *See* Lidstone, "*Am I My Brother's Keeper? Redefining the Attorney-Client Relationship*," 32 THE COLO. L. (CBA), no. 4 at 11 (April 2003).

[129] See text at notes 23-26.

Ponzi scheme operated by Allen Stanford, his former attorneys effected a noisy withdrawal, advising the SEC in writing that:

> "I disaffirm all prior oral and written representations made by me and my associates to the SEC staff regarding Stanford Financial Group and its affiliates."

The Department of Justice revised its guidelines for deciding when to seek an indictment of a corporation following the corporate scandals of the early 2000's, culminating in the McNulty Memorandum,[130] which became effective in 2006. The McNulty Memorandum provided that waivers of attorney-client privilege would be viewed favorably by prosecutors, and a failure to waive corporate attorney-client privilege would be viewed negatively in making decisions whether to charge a corporation or in determining the terms of a settlement.

In 2008 (before the economic crisis that hit in September 2008), the pendulum swung back toward the protection of attorney-client privilege for corporations. After significant Congressional pressure, the Justice Department determined it may have gone too far in essentially forcing corporations to waive attorney-client privilege or work-product as a condition to cooperation credit. In a speech by Deputy Attorney General Mark R. Filip,[131] the Department announced significant changes in its policies defining cooperation in the Department's corporate charging policy:

- Credit for cooperation will not depend on whether a corporation has waived attorney-client privilege or work product. Prosecutors will provide credit based on the corporation's disclosure of relevant facts.

- Prosecutors are forbidden from asking for non-factual attorney-client privileged communications and work-product, such as legal advice.

- In assessing credit for cooperation, prosecutors may not consider whether the corporation advanced or paid attorneys' fees for employees, officers, or directors unless the payment "would rise to the level of criminal obstruction of justice" which would not generally be the case.

- In assessing credit for cooperation, prosecutors may not consider whether the corporation disciplined or terminated employees considered to be at fault for the alleged violations.

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[130] Memorandum dated December 12, 2006, from Paul J. McNulty, Deputy Attorney General, U.S. Department of Justice, available at www.usdoj.gov/dag/speech/2006/mcnulty_memo.pdf.

[131] Aug. 28, 2008, avail. at www.usdoj.gov/dag/speeches/2008/dag-speech-0808284.html.

Deputy Attorney General Filip added that, "[n]o corporation is obligated to cooperate or to seek cooperation credit by disclosing information to the government. Refusal by a corporation to cooperate, just like refusal by an individual to cooperate, is not evidence of guilt… It simply means that the corporation will not be entitled to mitigating credit for cooperation…." These principles are now included in the United States Attorneys' Manual at Chapter 9-28.000. In step with the Justice Department, the SEC revised its Enforcement Manual in October 2008. The new SEC guidance directs staff to consider that "[a] party's decision to assert a legitimate privilege will not negatively affect their claim to credit for cooperation."[132] These moves by federal enforcement agencies may eventually lead to further changes in the Rules of Professional Conduct to strengthen the attorney-client privilege which was weakened by the 2008 version of the Rules.

Rule 1.8 – Conflicts of Interest: Current Clients

Rule 1.8 sets forth specific prohibitions for situations that can commonly arise during the attorney-client relationship. Of most interest to transactional attorneys is Rule 1.8(a) regarding entering into a business transaction with a client. To comply with Rule 1.8(a), the transaction by which the lawyer acquires the interest and its terms must be:

- fair and reasonable to the client; and

- fully disclosed and transmitted in writing in a manner that can be reasonably understood by the client.

Rule 1.8(a) also requires the lawyer advise the client that he or she should seek independent counsel to review the transaction and give the client reasonable time to do so. Finally, Rule 1.8(a) requires the lawyer to obtain, in a writing signed by the client, informed consent to the essential terms of the agreement.[133]

The Rule 1.8(a) requirements apply not only to direct attorney-client transactions, but also indirect transactions in which the attorney may have an interest. For example, in 2009, the Presiding Disciplinary Judge publicly censured an attorney who failed to withdraw from representing a client when he learned that his wife was in a business transaction with the client.[134] The PDJ attributed her actions to the attorney. In issuing the censure, the PDJ also found that the attorney failed to make appropriate disclosures to the client and failed to ensure that his wife's conduct was compatible with his ethical obligations.

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[132] SEC Enforcement Manual, §4.3, revised October 6, 2008.

[133] In *People v. Sanford*, 2009 WL 1397226 (Colo. OPDJ, Apr. 22, 2009), the attorney was suspended from the practice of law for 60 days for entering into "numerous business transactions with his client" and failing to comply with the obligations of Rule 1.8(a).

[134] *People v. Montoya*, 2009 WL 1037714 (Colo. OPDJ Apr. 17, 2009).

Rule 2.3 – Evaluation for Use by Third Parties (e.g., Legal Opinions)[135]

Colorado Rule 2.3 has generally been interpreted to allow attorneys for clients to issue legal opinions to third parties in connection with the closing of a transaction or in other circumstances. A legal opinion places the lawyer in the odd position of issuing legal advice to a person not his or her client and generally disclosing confidences about the client. The principal change between the current Colorado rule and the new rule is that, under new Rule 2.3(b), the client's "informed consent" is required only when the lawyer knows or reasonably should know that the evaluation is likely to affect the client's interests materially and adversely. As described in Paragraph [5] of the Comment to this rule:

> When a client requests a lawyer to provide an opinion for the benefit of third parties and the opinion is consistent with the client's interests, there is no good reason to require the client's consent.

Rendering a legal opinion to third parties also invokes other Rules of Professional Conduct:

- The lawyer must be competent to render the opinion (Rule 1.1), which includes an understanding of customary practice as defined by the literature and elsewhere;[136]
- The lawyer must preserve the confidentiality of client information (Rule 1.6);
- The lawyer's conduct must conform to the requirements of the law and must be characterized by independent judgment and truthfulness (Rules 1.2, 2.1 and 4.1); and
- The lawyer must avoid conflicts of interest (Rules 1.7 and 1.9).

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[135] For a discussion of Colorado legal opinion practice within the national scope, see Lidstone and Belak, *Danger Ahead! Legal Opinions for Colorado Lawyers*, 38 THE COLO. L. (CBA) No. 4 at 25 (Apr. 2009).

[136] This literature is easily available and much of it can be found in the ABA's legal opinion resource center. http://www.abanet.org/buslaw/tribar/home.shtml. The website of the American College of Real Estate Lawyers (www.acrel.org) includes valuable information for persons writing legal opinions in real estate transactions. Of these, the ABA's "Guidelines for the Preparation of Legal Opinions," 57 The Bus. L. (ABA) 875 (2002) and "Legal Opinion Principles," 53 The Bus. L. (ABA) 831 (1998), are among the most significant, as are the reports prepared by the TriBar Opinion Committee. There are also numerous treatises available, including contributions from a number of Colorado lawyers in Holderness and Wunnicke, *Legal Opinion Letters Form Book* (Aspen Law Business, 2nd Ed. 2003). Chapter 1B of the 2008 Supplement is a primer for lawyers not experienced in opinion practice. *Glazer and Fitzgibbon on Legal Opinions: Drafting, Interpreting, and Supporting Closing Opinions in business Transactions* (Aspen Law & Business, 3rd Ed.) is another valuable resource for legal opinion preparers.

Formal Opinion 113 – Ethical Duties to Disclose Errors to the Client

Ethics Opinion 113 issued on November 19, 2005 by the Ethics Committee of the Colorado Bar Association reminds lawyers that it is their duty under Rule 1.4 to inform clients about material developments in the subject matter of the representation.[137] Opinion 113 states that this includes "material adverse developments . . . resulting from the lawyer's own errors." The lawyer is not obligated to disclose all errors – only errors that clearly prejudice a client's claim or rights must be disclosed under Opinion 113. Where the lawyer is in doubt about the obligation to disclose, it would be prudent for the lawyer to seek outside counsel. Consulting with lawyers in the same firm may not be appropriate because they each have the same problem vicariously.

Where the lawyer can fix the error without (or prior to) disclosure, then the Opinion provides that disclosure is not necessary. The cure, however, cannot lead to any further prejudice to the client.

After the lawyer has disclosed the error, the lawyer "may continue to represent the client in . . . compliance with Colo. RPC 1.7(b)." The opinion goes on to acknowledge that "in many if not most circumstances, the interest of the attorney in avoiding liability will be consistent with the interest of the client in a successful representation." There are potentially cases where the lawyer's interest in avoiding liability might influence his or her willingness to pursue a strategy that would avoid the attorney's liability at the expense of the success of the representation – in that case, continued representation by the lawyer would be improper under Rule 1.7(b).

Ethics opinion 113 goes on to state that, when admitting an error to a client, the attorney should also give consideration to notifying the attorney's malpractice insurance carrier. Finally, the opinion notes that it does not consider whether an attorney's failure to notify a client of an error gives rise to a cause of action against the lawyer, separate and apart from any cause of action arising from the error itself. Paragraph [20] of the scope of the Rules of Professional Conduct does state:

> "Violation of a Rule should not give rise to a cause of action against a lawyer nor should it create any presumption in such a case that a legal duty has been breached."

In attempting to rectify the results of the error, an attorney may not obtain a release of liability from the client except in compliance with Rule 1.8(h).

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[137] *See* Houghtaling, *Disclosing Mistakes in Light of Ethics Opinion 113*, 35 THE COLO. L. No. 4 at 89 (Apr. 2006) for a good discussion of Opinion 113.

Illustrative Form of a Multi-Member Operating Agreement

THE FOLLOWING DOCUMENT IS A FORM PREPARED BY HERRICK K. LIDSTONE, JR. OF BURNS, FIGA & WILL, P.C. FOR USE IN A CONTINUING LEGAL EDUCATION SEMINAR. THIS FORM IS INTENDED TO BE INSTRUCTIVE AND ILLUSTRATIVE ONLY, INDICATING CERTAIN TYPES OF PROVISIONS THAT MAY BE APPROPRIATE IN CERTAIN COLORADO LIMITED LIABILITY COMPANIES. THIS FORM IS NOT INTENDED FOR ANY SPECIFIC TRANSACTION, AND SHOULD ONLY BE USED AS AN AID BY A LAWYER FAMILIAR WITH THE STRUCTURE OF LIMITED LIABILITY COMPANIES.

PURSUANT TO INTERNAL REVENUE SERVICE RULES OF PRACTICE, ANY TAX ADVICE SET FORTH IN THIS FORM IS NOT INTENDED OR WRITTEN TO BE USED, AND CANNOT BE USED, FOR THE PURPOSE OF (A) AVOIDING PENALTIES THAT MAY BE IMPOSED UNDER THE INTERNAL REVENUE CODE OR (B) PROMOTING, MARKETING OR RECOMMENDING TO ANOTHER PARTY ANY TAX-RELATED MATTER ADDRESSED HEREIN.

OPERATING AGREEMENT
OF
NEWCO, LLC
A COLORADO LIMITED LIABILITY COMPANY

___________, 2011

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.

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OPERATING AGREEMENT[1]

This Agreement is effective as of the _____ day of _____ 2011, 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.

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[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 draftsperson 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 With 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.

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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

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[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 Treas. Reg. § 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 Treas. Reg. § 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.**

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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

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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, 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 Section 1.704-1(b)(2)(ii)(c) of the Treasury Regulations, as well as any additions thereto pursuant to the next to last sentence of Section 1.704-2(g)(1) of the Treasury Regulations or the next to last sentence of Section 1.704-2(i)(5) of the Treasury Regulations, 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 Treasury Regulation Section 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 Treasury Regulation Section 1.752-2).

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

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.

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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.

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 Interests[4] 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 him, her, it, itself, or other like references shall also, where the context so requires, be deemed to

[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 . . .."

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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]

[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

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(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.

(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 Section 703 of the Code 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)[6] 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 Section 705(a)(2)(B) of the Code 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 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.

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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] This section is entitled "*Guaranteed Payments and Regulatory Allocations*."

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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.[7] 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).

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.

[7] 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.

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1.36 "Three-Fourths Interest" shall mean Members holding more than 75% of the *aggregate Percentage Membership Interests*[8] 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.[9] 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.[10] 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 expressly granted by the Managers in the resolutions by which a matter is submitted to the Members for consideration.

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[8] 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 . . .."

[9] 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.

[10] 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."

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(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

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(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?][11]

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.[12] 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.[13]

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[11] 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.

[12] 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."

[13] 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 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;

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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.[14]

(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.

(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.

[14] 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. Grauberger*, 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).

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(c) No Manager has the authority to act on behalf of the Company unless authorized to do so by a resolution of the Managers.[15] 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.[16]

(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:

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[15] 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."

[16] 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.

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(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.[17]

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[17] 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:

> (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.

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5.4 Limitations on Authority.[18] Notwithstanding any other provision of this Operating Agreement, the Managers may not cause or commit the Company to do any of the following 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);[19] 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 .

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.[20] 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

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18 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."

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

20 This duty of Managers to act as an ordinarily prudent person in the best interests of the Company is inconsistent with elimination of fiduciary duties set forth below in Section 5.7(a) which 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.

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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 Elimination of Fiduciary Duties.[21]

(a) 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 or Manager other than the

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21 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.

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contractual obligation of good faith and fair dealing,[22] and to the extent that, under the Colorado Act, the law of agency, or common law or any other law or at equity,[23] a Member, Manager, or Officer of the Company has duties or obligations to the Company or to a Member, Manager or other Person who is a party to this Agreement, that Member, Manager or officer of the Company shall not be liable to the Company or to any such other Member, 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,[24] is

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[22] 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."

[23] 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.

[24] 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:

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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,[25] 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.[26]

5.8 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.[27]

(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.

> 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.

[25] *See* §7-80-404(1)(b). This is probably not appropriate in most situations.

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

[27] 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.

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(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.

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.[28]

5.9 Removal.

(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.[29]

(b) 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.

5.10 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.

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28 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.

29 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".

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5.11 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.[30] No Person shall be prevented from receiving such compensation by reason of the fact that he or she is also a Member of the Company.[31]

(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.

6.2 Company Debt Liability. Except as otherwise required by law or contract,[32] a Member or Assignee will not be personally liable for any debts or losses of the Company beyond his respective Capital Contributions and any obligation of the Member or Assignee under Section 8.1 or 8.2 to make Capital Contributions.

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

[31] 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.

[32] 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).

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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.[33] 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. Units representing Membership Interests and Economic Interests are securities as contemplated in, and are therefore governed by, article 8 of the Uniform Commercial Code as adopted in Colorado, C.R.S. §§ 4-8-101 *et seq*.[34] Units will not be represented by a certificate.[35] The foregoing is not intended to admit that a Unit is subject

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

34 *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.

35 As a result, the interests will be "uncertificated securities" for the purposes of Articles 8 and 9 of the UCC. Any interest 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

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to the applicability of federal or state laws regulating the offer or sale of securities as that term is defined in such laws.[36]

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 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.[37]

ARTICLE 7)

MEETINGS OF MEMBERS[38]

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.

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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").

[36] This self-serving statement likely will not be effective if the interests otherwise are "securities" within the applicability of such laws.

[37] 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.

[38] 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.

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(b) The Managers shall call[39] 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.

(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.

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

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(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.[40] 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.

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.[41]

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[40] 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).

[41] 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:

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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.

(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;[42]

(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);

- 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*.

[42] Where Units are issued for services and are subject to vesting, the recipient and the LLC should consider the potential applicability of Internal Revenue 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 Treas. Regs. § 1.83-2.

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(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;[43] 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.

(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 Treasury Reg. §1.704-1(b) and §1.704-2. In addition, the Managers, in their discretion and in accordance with the Code and

[43] 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.

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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.[44] 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.

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.[45]

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.

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

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[44] §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."

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

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allocated between each Member or Assignee in accordance with the Percentage Economic Interest of such holder.[46]

(b) Guaranteed Payments and Regulatory Allocations

(i) *Guaranteed Payments.* To the extent the Company pays guaranteed payments or compensation (as described in Section 5.11 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

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[46] 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.

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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***.**[47] 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 adjustment to the adjusted tax basis of any Company asset pursuant to Code §734(b) or

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[47] 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 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).

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Code §743(b) is required (pursuant to Regulations §1.704-1(b)) 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).

(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 Section 1.704-2 of the Treasury Regulations 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 Treasury Regulation Section 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 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.

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(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 §1.704-2(h)(3) of the Regulations, 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.

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(ix) *Tax Allocations: Code §704(c).*[48]

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

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48 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.

49 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.

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(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 Section 1.704-1(b)(2)(iv)(*f*) of the Treasury Regulations.

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 § 704(c), using any method described in Section 1.704-3 of the Treasury Regulations 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.[50]

[50] 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 §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.

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(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.[51] 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.

(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.[52]

(d) The Company will not make any distribution if such distribution would violate the Colorado Act.[53]

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.

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

[52] §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."

[53] 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 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).

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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.[54]

(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.

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

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

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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;[55] and

(d) as otherwise required by law.[56]

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.

(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),[57] the net Fair Market Value of such assets as of the date of dissolution

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[55] 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."

[56] 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.

[57] § 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.

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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.[58]

(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 §1.704-1(b) of the Regulations, 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 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.

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[58] 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.

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(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.[59]

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 ("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."[60]

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[59] 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.

[60] Transferability restrictions are usually important in small businesses where the proprietors want to choose their partners. Reasonable transfer restrictions are enforceable. A trial court granted summary judgment to an LLC 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. In *Condo v. Conners*, No. 09CA1130 (Colo. App. 2010), the Court of Appeals affirmed the trial court's grant of summary judgment holding:

- "Our conclusion is also supported by cases addressing the assignment of contractual rights in other contexts. Such assignments, although generally permitted, may be prohibited by contract."

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(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 the entity Member or Assignee to remain substantially as at the time such entity became a Member or acquired its interest as an Assignee.[61]

(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:[62]

- ". . . the assignment here was void because (1) under paragraph 10.6, the provisions of the operating agreement governed the assignment; (2) it was not approved under paragraphs 10.1 and 10.2; and (3) under paragraph 10.7(c), the attempted transfer of the assignor's interest in the LLC was ineffective "for any purpose whatsoever" because the provisions of the operating agreement were not satisfied."

[61] 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.

[62] 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).

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(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

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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.[63] 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 purchaser[64] 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.[65] 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).[66]

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63 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.

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

65 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.

66 It is important that the purchaser purchase the "come-along" members for cash value, since the Selling Owner may have negotiated other arrangements which should be monetized. It is also important that the purchaser

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(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).[67]

(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*.

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:

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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.

67 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.

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(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;[68]

(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.[69] Furthermore, the Appraiser will give no value to goodwill,[70] trade names, or other intangible assets.

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[68] 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).

[69] 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.

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

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(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,

(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

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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.

[70] 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.

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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.[71]

(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,[72] 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

(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

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

[72] 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.

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Member and may not exercise any such right or power directly or indirectly on behalf of the Assignee.[73]

(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:

(i) Constitute such Assignee as a Member;

(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) Prevent a termination of the Company for tax purposes under Section 708(b)(1)(B) of the Code (and in such case any such transfer is void);

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73 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.

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(v) Maintain the status of the Company as a partnership for federal tax purposes; and

(vi) Assure compliance with any applicable state and federal laws, including Securities Laws and regulations.

(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 month[74] 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.[75]

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

[74] 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.

[75] Consider whether these estate planning provisions are appropriate.

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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 automatically upon the beneficiary accepting this Agreement in writing, without any further action of the Manager.[76]

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.[77] 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.78

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:[79]

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[76] 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.

[77] 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.

[78] 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.

[79] For a further discussion of drafting arbitration provisions in an operating agreement, see Dominick T.

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

Gattuso, "*Drafting Arbitration Provisions for LLC Agreements*," 2009 *Business Law Today (ABA)* (March-April 2009) at 53.

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(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 Members[80] 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.[81]

(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.

(f) (i) Each Member and Assignee hereby makes, constitutes, and appoints each Manager, with full power of substitution and resubstitution, its true and lawful

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[80] 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.

[81] 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.

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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.[82]

(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, 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

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82 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.

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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.[83]

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,

(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,

[83] 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.

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(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.

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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.

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(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.

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.

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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:

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(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. 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.

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.

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

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MEMBERS:[84]

______________________________	______________________________
ABC Company, Member By its president	XYZ, Inc., Member By its president

[84] 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.

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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.[85] The parties agree that at the time of the Person's admission as a Member, the Fair Market Value of the Company was $__________.[86]

(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.[87] The parties agree that at the time of the Person's acceptance as an Assignee, the Fair Market Value of the Company was $__________.[88]

MEMBER or ASSIGNEE:

_________________________________ _________________________________

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[85] 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.

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

[87] 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).

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

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Name: Co-owner (if any)
Address: SSN/EIN: ______________________

All co-owners will be treated as joint tenants with rights of survivorship unless not permitted under applicable law or another form of ownership is designated: ___________________

State of)
) ss.
County of)

Subscribed to, sworn, and acknowledged before me, a notary public in and for said county and state, by the Member(s) named above.

Witness my hand and official seal this ____ day of ____, 200x.

____
Notary Public

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Exhibit A
Capital Contributions
As of _________________, 200X[89]

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:

[89] 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.

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CBCA, §7-102-101 – one or more persons, 18 or older, may act as incorporators

§7-102-102 defines what must (and may) be in the articles – all of which is in the form provided on the Secretary of State's website.

§7-102-103 states that a corporation is incorporated and its existence begins when the articles are filed with the Secretary of State unless there is a delayed effective date.

§7-102-102(4) states that the articles of incorporation need not state any of the corporate powers enumerated in articles 101 to 117 of Title 7. Our articles frequently do.

§7-102-105 provides that after incorporation, the corporation must be organized.

§7-102-106 provides that the incorporator, the board of directors, or the shareholders may adopt the initial bylaws of the corporation (required to be adopted by §7-102-105(1)(a)).

The purpose of the Addendum is to address other provisions of the CBCA which the CBCA provides may be included in the articles.

ADDITIONAL PROVISIONS TO THE ARTICLES OF INCORPORATION OF _____________, INC.

I. NAME

The name of this Corporation is _____________, Inc. *[§7-90-601 and §7-102-102(1)(a)]*

II. PURPOSE

The purpose of the Corporation is to engage in any lawful act or activity for which a corporation may be organized under the Colorado Business Corporation Act. *[§7-103-102 and §7-102-102(2)(b)(I)]*

III. CAPITAL

A. The aggregate number of shares of all classes of capital stock which this Corporation shall have authority to issue is 1,100,000 shares, of which 100,000 shares shall be shares of preferred stock, par value of $.01 per share ("Preferred Stock"), and 1,000,000 shares shall be shares of common stock, par value of $.01 per share ("Common Stock"). *[§7-106-101]*

(1) Preferred Stock. The designations, preferences, limitations, restrictions, and relative rights of the Preferred Stock, and variations in the relative rights and preferences as between different series shall be established in accordance with the Colorado Business Corporation Act by the board of directors of the Corporation ("Board of Directors"). Except for such voting powers

with respect to the election of directors or other matters as may be stated in the resolutions of the Board of Directors creating any series of Preferred Stock, the holders of any such series shall have no voting power. *[§7-106-101(3) and §7-106-102]*

(2) Common Stock. The holders of Common Stock shall have and possess all rights as shareholders of the Corporation, including such rights as may be granted elsewhere by these Articles of Incorporation, except as such rights may be limited by the preferences, privileges and voting powers, and the restrictions and limitations of the Preferred Stock. *[§7-106-101(2)]*

B. Subject to preferential dividend rights, if any, of the holders of Preferred Stock, dividends on the Common Stock may be declared by the Board of Directors and paid out of any funds legally available therefor at such times and in such amounts as the Board of Directors shall determine. *[§7-106-204 (share dividends) and §7-106-401 (other distributions)]*

C. The capital stock, after the amount of the subscription price has been paid in, shall not be subject to assessment to pay the debts of the Corporation. *[§7-106-203]*

D. Any stock of the Corporation may be issued for money, property, services rendered, labor done, cash advances for the Corporation, or for any other assets of value in accordance with the action of the Board of Directors, whose judgment as to value received in return therefor shall be conclusive and said stock when issued shall be fully paid and nonassessable. *[§7-106-202]*

E. The holders of the Common Stock or Preferred Stock shall not have any preemptive or preferential right to purchase or subscribe for: (a) any shares of the Corporation that the Board of Directors may determine to issue, whether now or hereafter authorized, or (b) any bonds, debentures, notes or others securities convertible into or carrying options, warrants or privileges to purchase any shares of the Corporation, whether now or hereafter authorized, in all cases including any such shares, bonds, debentures, notes, or other securities held in the treasury of the Corporation. *[§7-106-301]*

F. The Board of Directors shall have the authority to impose restrictions upon the transfer of the capital stock of the Corporation as it deems necessary in the best interests of the corporation or as required by law. *[§7-106-208]*

IV. PERPETUAL EXISTENCE

The Corporation shall have perpetual existence.

V. BOARD OF DIRECTORS

The governing board of this corporation shall be known as the Board of Directors, and the number of directors may from time to time be increased or decreased in such manner as shall be provided by the Bylaws of this corporation. There shall not be fewer than one member of the Board of Directors. *[§7-108-101 and §7-108-103]*

Cumulative voting in the election of directors shall not be permitted. *[§7-102-102(3), §7-107-209, and §7-107-104(1.5)]*

VI. INDEMNIFICATION

A. The Corporation shall indemnify, to the fullest extent permitted by applicable law, any person, and the estate and personal representative of any such person, against all liability and expense (including attorneys' fees) incurred by reason of the fact that he is or was a director or officer of the Corporation or, while serving at the request of the Corporation as a director, officer, partner, trustee, employee, fiduciary, or agent of, or in any similar managerial or fiduciary position of, another domestic or foreign corporation or other individual or entity or of an employee benefit plan. The Corporation also shall indemnify any person who is serving or has served the Corporation as director, officer, employee, fiduciary, or agent, and that person's estate and personal representative, to the extent and in the manner provided in any bylaw, resolution of the shareholders or directors, contract, or otherwise, so long as such provision is legally permissible. *[§7-109-102 (directors) and §7-109-107 (employees and officers)]*

B. The Corporation shall advance expenses in advance of the final disposition of the case to or for the benefit of a director, officer, employee, fiduciary, or agent, who is party to a proceeding such as described in the preceding paragraph A to the maximum extent permitted by applicable law. *[§7-109-104]*

C. Any repeal or modification of the foregoing paragraph by the shareholders of the Corporation shall not adversely affect any right or protection of a director or officer of the Corporation or other person entitled to indemnification existing at the time of such repeal or modification.

VII. LIMITATION OF DIRECTOR LIABILITY

A. A director of the Corporation shall not be personally liable to the Corporation or its shareholders for monetary damages for breach of fiduciary duty as a director, except for liability (i) for any breach of the director’s duty of loyalty to the Corporation or to its shareholders, (ii) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law, (iii) for acts specified under Section 7-108-403 of the Colorado Business Corporation Act or any amended or successor provision thereof, or (iv) for any transaction from which the director derived an improper personal benefit. If the Colorado Business Corporation Act is amended after this Article is adopted to authorize corporate action further eliminating or limiting the personal liability of directors, then the liability of a director of the Corporation shall be eliminated or limited to the fullest extent permitted by the Colorado Business Corporation Act, as so amended. *[§7-108-402]*

B. Any repeal or modification of the foregoing paragraph by the shareholders of the Corporation shall not adversely affect any right or protection of a director of the Corporation existing at the time of such repeal or modification.

VIII. ACTIONS OF SHAREHOLDERS

A. Meetings of shareholders shall be held at such time and place as provided in the bylaws of the Corporation or by resolution of the board of directors. *[§7-107-101 (annual meeting) and §7-107-102 (special meeting)]*

B. At all meetings of the shareholders, one-third of all votes entitled to be cast at the meeting shall constitute a quorum or, if there is more than one voting group, one-third of all shares entitled to vote within each voting group entitled to vote. *[§7-107-206]*

C. Any action for which the Colorado Business Corporation Act requires the approval of two-thirds of the shares or any class or series or voting group entitled to vote with respect thereto, unless otherwise provided in the Articles of Incorporation, shall require for approval, the affirmative vote of a majority of the shares or any class or series or voting group outstanding and entitled to vote thereon. *[Amendment of articles requires more votes for than against (§7-110-103), merger, conversion and share exchange require a majority of all votes entitled to be cast (§7-111-103(5)), sale of property not in the ordinary course of business requires a majority of all votes entitled to be cast (§7-112-102(6)), and dissolution requires a majority of all votes entitled to be cast (§7-114-101(5)). Thus this provision is left over from prior law which did require two-thirds from time to time, and is no longer necessary.]*

D. Any vote of the shareholders of the Corporation may be taken either:

(1) at a meeting called for such purpose or,

(2) by the written consent of the shareholders in lieu of a meeting provided that shareholders holding shares having not less than the minimum number of votes that would be necessary to authorize or take such action at a meeting at which all shares entitled to vote thereon were present and voted consent to such action in writing. *[§7-107-104(1)(b)]*

IX. CONFLICTING INTEREST TRANSACTIONS

No act, contract, or other transaction between the Corporation and one or more of its directors, officers, or employees, or between the Corporation and any corporation or association of which one or more of this Corporation's officers, directors, or employees are in any way interested, shall be affected or invalidated in any way because of such fact; provided, that such fact shall have been known to or disclosed to the Board of Directors of the Corporation prior to its authorization of such act, contract or other transaction. Any director or directors of the Corporation so interested may be present and may be counted in determining the existence of a quorum at any meeting of the Board of Directors which authorized or ratified such act, contract,

or other transaction, and such director or directors may vote thereat with like force and effect as if they were not interested. *[§7-108-501]*

BYLAWS
OF
__________________, INC.
(the "Corporation")
As Adopted _______, 2010

ARTICLE I
OFFICES

Section 1.1 Principal Office. The principal office of the Corporation shall be located as designated by the Board of Directors, either within or without the State of Colorado. The Corporation may have such other offices, either within or without the State of Colorado, as the Board of Directors may designate or as the business of the Corporation may require from time to time. *[§7-102-102(1)(d)]*

Section 1.2 Registered Office. The registered office of the Corporation, required by the Colorado Business Corporation Act to be maintained in the State of Colorado, may be, but need not be, identical with the principal office if located in the State of Colorado, and the address of the registered office may be changed from time to time by the Board of Directors. *[§7-102-102(1)(c) and §7-105-101]*

ARTICLE II
SHAREHOLDERS

Section 2.1 Annual Meeting. The annual meeting of the shareholders shall be held at such time on such day as shall be fixed by the Board of Directors, for the purpose of electing directors and for the transacting of such other business as may come before the meeting. If the election of directors shall not be held on the date designated herein for any annual meeting of the shareholders, or at any adjournment thereof, the Board of Directors shall cause the election to be held at a special meeting of the shareholders as soon thereafter as may be convenient. *[§7-107-101]*

Section 2.2 Special Meetings. Special meetings of the shareholders, for any purpose or purposes, unless otherwise prescribed by statute, may be called by the President or by the Board of Directors, and shall be called by the President at the request of the holders of not less than one-tenth of all votes entitled to be cast at the meeting; provided, however, that the requesting holders must have held their ownership in the Corporation for at least twelve consecutive months. *[§7-107-102]*

Section 2.3 Place of Meetings. The Board of Directors may designate any place, either within or without the State of Colorado, as the place of meeting for any annual meeting or for any special meeting called by the Board of Directors. If no designation is made, or if a special meeting be otherwise called, the place of meeting shall be the principal office of the Corporation. *[§7-107-101(2) and §7-107-102(3)]*

Section 2.4 Notice of Meeting. Written notice stating the place, day and hour of the meeting of shareholders and, in case of a special meeting, the purpose or purposes for which the meeting is called, shall, unless otherwise prescribed by statute, be delivered not less than ten nor more than 60 days before the date of the meeting,

either personally or by mail, by or at the direction of the President, or the Secretary, or the officer or other persons calling the meeting, to each shareholder of record entitled to vote at such meeting; provided, however, that if the authorized shares of the Corporation are to be increased, at least 30 days notice shall be given. If mailed, such notice shall be deemed to be delivered when deposited in the United States mail, addressed to the shareholder at his address as it appears on the stock transfer books of the Corporation, with postage thereon prepaid. *[§7-107-105]*

Section 2.5 Fixing of Record Date. (a) The Board of Directors may fix in advance a date as the record date for any such determination of shareholders, such date in any case to be not more than 70 days and, in case of a meeting of shareholders, not less than ten days prior to the date on which the particular action, requiring such determination of shareholders, is to be taken.

(b) If no record date is fixed for the determination of shareholders entitled to notice of or to vote at a meeting of shareholders, or shareholders entitled to receive payment of a dividend, the date on which notice of the meeting is mailed or the date on which the resolution of the Board of Directors declaring such dividend is adopted, as the case may be, shall be the record date for such determination of shareholders.

(c) When a determination of shareholders entitled to vote at any meeting of shareholders has been made as provided in this section, such determination shall apply to any adjournment thereof so long as the meeting is not adjourned to a date and time more than 120 days after the date of such meeting of shareholders. *[§7-107-107]*

Section 2.6 Adjournment of Meeting. A meeting of shareholders may be adjourned to another time or place as determined by the chair of the meeting. Unless the Board of Directors fixes a new record date, or if a new record date is required to be fixed pursuant to section 7-107-107(2) of the Colorado Business Corporation Act, shareholders of record for an adjourned meeting shall be as originally determined for the meeting from which the adjournment was taken. If the adjournment is for more than 120 days, or if after the adjournment a new record date is fixed for the adjourned meeting, a notice of the adjourned meeting shall be given to each shareholder of record entitled to vote. At the adjourned meeting any business may be transacted that might have been transacted at the meeting as originally called.

Section 2.7 Voting Record. (a) The officer or agent having charge of the stock transfer books for shares of the Corporation shall make a complete record of the shareholders entitled to be given notice of the meeting, arranged in alphabetical order, with the address of and the number of shares held by each. The record shall be kept on file at the principal office of the Corporation, whether within or without the State of Colorado, and shall be subject to inspection by any shareholder for any purpose germane to the meeting at any time during usual business hours. Such record shall be produced and kept open beginning at the earlier of ten days before the meeting for which the list was prepared or two business days after notice of the meeting is given, and continuing through the meeting and any adjournment thereof. Such record shall also be available at the time and place of the meeting and shall be subject to the inspection of any shareholder during the whole time of the meeting for the purposes thereof. *[§7-107-201]*

(b) The original stock transfer books shall be the prima facie evidence as to the identity of the shareholders entitled to examine the record or transfer books or to vote at any meeting of shareholders.

Section 2.8 Quorum. Shares representing one-third of the votes entitled to be cast, represented in person or by proxy, shall constitute a quorum at any meeting of shareholders, except as otherwise provided by the Colorado Business Corporation Act and the Articles of Incorporation. In the absence of a quorum at any such meeting, a majority of the shares so represented may adjourn the meeting from time to time for a period not to exceed 60 days. At such adjourned meeting at which a quorum shall be present or represented, any business may be transacted which might have been transacted at the original meeting as originally noticed. The shareholders present at a duly organized meeting may continue to transact business until adjournment, notwithstanding the withdrawal of enough shareholders to leave less than a quorum. *[§7-107-206(1)]*

Section 2.9 Manner of Acting. If a quorum is present, action on a matter is approved if the votes cast favoring the action exceed the votes cast opposing such action, unless the vote of a greater proportion or number or voting by classes is otherwise required by statute or by the Articles of Incorporation or these Bylaws. *[§7-107-206(3)]*

Section 2.10 Proxies. At all meetings of shareholders a shareholder may vote in person or by proxy executed in writing by the shareholder or by his duly authorized attorney-in-fact. Such proxy shall be filed with the Secretary of the Corporation 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. Proxies shall be in such form as shall be required by the Board and as set forth in the notice of meeting and/or proxy or information statement concerning such meeting. *[§7-107-203]*

Section 2.11 Voting of Shares. Unless otherwise provided by these Bylaws or the Articles of Incorporation, each outstanding share entitled to vote shall be entitled to one vote upon each matter submitted to a vote at a meeting of shareholders, and each fractional share shall be entitled to a corresponding fractional vote on each such matter. *[§7-107-202]*

Section 2.12 Voting of Shares by Certain Shareholders. (a) Shares standing in the name of another corporation may be voted by such officer, agent or proxy as the bylaws of such corporation may prescribe, or, in the absence of such provision, as the Board of Directors of such other corporation may determine.

(b) Shares standing in the name of a deceased person, a minor ward or an incompetent person, may be voted by his administrator, executor, court appointed guardian or conservator, either in person or by proxy without a transfer of such shares into the name of such administrator, executor, court appointed guardian or conservator. Shares standing in the name of a trustee may be voted by him, either in person or by proxy, but no trustee shall be entitled to vote shares held by him without a transfer of such shares into his name.

(c) Shares standing in the name of a receiver may be voted by such receiver and shares held by or under the control of a receiver may be voted by such receiver without the transfer thereof into his name if authority so to do is contained in an appropriate order of the court by which the receiver was appointed.

(d) A shareholder whose shares are pledged shall be entitled to vote such shares until the shares have been transferred into the name of the pledgee, and thereafter the pledgee shall be entitled to vote the shares so transferred.

(e) Neither treasury shares of its own stock belonging to this corporation, nor shares of its own stock held by it in a fiduciary capacity, nor shares of its own stock held by another corporation if the majority of the shares entitled to vote for the election of directors of such other corporation is held by the Corporation, may be voted, directly or indirectly, at any meeting and shall not be counted in determining the total number of outstanding shares at any given time.

(f) Redeemable shares which have been called for redemption shall not be entitled to vote on any matter and shall not be deemed outstanding shares on and after the date on which written notice of redemption has been mailed to shareholders and a sum sufficient to redeem such shares has been deposited with a bank or trust company with irrevocable instruction and authority to pay the redemption price to the holders of the shares upon surrender of certificates therefor. *[§7-107-205]*

(g) Shares held of record by a shareholder but which are held for the account of a specified person or persons may be voted by such person or persons, provided the shareholder has certified to the Corporation in writing that all or a portion of the shares registered in the name of the shareholder are held for the account of such person or persons, as provided in Article VI, Section 6.6 of these Bylaws. *[§7-107-204]*

Section 2.13 Informal Action by Shareholders. (a) Any action required or permitted to be taken at a meeting of the shareholders may be taken without a meeting if a consent in writing, setting forth the action so taken, shall be signed by shareholders holding shares having not less than the minimum number of votes that would be necessary to authorize or take such action at a meeting at which all shares entitled to vote thereon were present and voted consent to such action in writing. *[§7-107-104; Articles, Art. VIII]*

(b) All required consents must be received by the Corporation within sixty days after the date the Corporation first receives a writing describing and consenting to the action and signed by a sufficient number of shareholders who have not previously revoked their signature. Any such consent will be effective upon the Corporation's receipt of the last writing necessary to effect the action unless all of the writings necessary to effect the action state another date as the effective date of the action, in which case such stated date shall be the effective date of the action.

(c) Any written consent may be provided by facsimile or other form of wire or wireless communication providing the Corporation with a complete copy thereof, including a copy of the signature thereto.

(d) If action is taken pursuant to this Section 2.13 by less than unanimous consent, the Corporation shall give notice of the action to all shareholders who were entitled to vote upon the action but who did not consent thereto as required by Section 7-107-104(5.5) of the Colorado Business Corporation Act. *[§7-107-104(5.5)]*

Section 2.14 Voting by Ballot. Voting on any question or in any election may be by voice vote unless the presiding officer shall order or any shareholder shall demand that voting be by ballot.

Section 2.15 No Cumulative Voting. No shareholder shall be permitted to cumulate his votes by giving one candidate as many votes as the number of such directors multiplied by the number of his shares shall equal, or by distributing such votes on the same principle among any number of candidates. *[§7-107-209; Articles, Art. V]*

Section 2.16 Meetings by Telecommunication. If permitted by resolution of the Board of Directors,[1] any or all of the shareholders may participate in an annual or special meeting by, or the meeting may be conducted through the use of, any means of communication by which all persons participating in the meeting may hear each other during the meeting. A shareholder participating in a meeting by this means is deemed to be present in person at the meeting. *[§7-107-108]*

Section 2.17 Procedural Requirements for Nomination of Directors by Shareholders. *[1934 Act reporting companies only]*

(a) **Annual Meetings of Shareholders**.

(1) Nominations of persons for election to the Board of Directors of the Corporation and the proposal of other business to be considered by the shareholders may be made at an annual meeting of shareholders only (A) pursuant to the Corporation's notice of meeting (or any supplement thereto), (B) by or at the direction of the Board of Directors, or (C) by any shareholder of the Corporation who (i) was a shareholder of record of the Corporation at the time the notice provided for in this Section 2.17 is delivered to the Secretary of the Corporation and at the time of the annual meeting, (ii) is entitled to vote at the meeting, and (iii) complies with the notice procedures set forth in this Section 2.17 as to such business or nomination. Clause (C) of the preceding sentence shall be the exclusive means for a shareholder to make nominations or submit other business (other than matters properly brought under Rule 14a-8 under the Securities Exchange Act of 1934, as amended (the "Exchange Act") and included in the Corporation's notice of meeting) before an annual meeting of shareholders.

(2) Without qualification or limitation, for any nominations or any other business to be properly brought before an annual meeting by a shareholder pursuant to clause (C) of paragraph (a)(1) of this Section 2.17, the shareholder must have given timely notice thereof in writing to the Secretary of the Corporation and any such proposed

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[1] Unless stated to be subject to Board discretion, under C.R.S. § 7-107-108 shareholders "may participate" in meetings by electronic means, which means that the Corporation must arrange for such participation. *See* Section 3.9 for similar provisions for meetings of the Board of Directors.

business, other than the nominations of persons for election to the Board of Directors, must constitute a proper matter for shareholder action. To be timely, a shareholder's notice shall be delivered to the Secretary at the principal executive offices of the Corporation not later than the date announced by the Corporation as to the date by which Shareholder Proposals must be received as required by Item 5.08 of Form 8-K (or any other announcement made by the Corporation in any other report filed by the Corporation with the Securities Exchange Commission) (the "Shareholder Proposal Notice Date"). In no event shall the public announcement of an adjournment or postponement of an annual meeting commence a new time period (or extend any time period) for the giving of a shareholder's notice as described above.

(3) To be in proper form, a shareholder's notice delivered pursuant to this Section 2.17 must set forth:

(A) As to each person, if any, whom the shareholder proposes to nominate for election or reelection as a director (i) all information relating to such person that would be required to be disclosed in a proxy statement or other filings required to be made in connection with solicitations of proxies for election of directors in contested election, or is otherwise required, in each case pursuant to and in accordance with Regulation 14A under the Exchange Act, (ii) such person's written consent to being named in the proxy statement as a nominee and to serving as a director if elected and (iii) a description of all direct and indirect compensation and other material monetary agreements, arrangements and understandings during the past three years, and any other material relationships, between or among such shareholder and beneficial owner, if any, and their respective affiliates and associates, or others acting in concert therewith, on the one hand, and each proposed nominee, and his or her respective affiliates and associates, or others acting in concert therewith, on the other hand, including, without limitation all information that would be required to be disclosed pursuant to Rule 404 promulgated under Regulation S-K if the shareholder making the nomination and any beneficial owner on whose behalf the nomination is made, if any, or any affiliate or associate thereof or person acting in concert therewith, were the "registrant" for purposes of such rule and the nominee were a director or executive officer of such registrant;

(B) If the notice relates to any business other than a nomination of a director or directors that the shareholder proposes to bring before the meeting, a brief description of the business desired to be brought before the meeting, the text of the proposal or business (including the text of any resolutions proposed for consideration and in the event that such business includes a proposal to amend the By-laws of the Corporation, the language of the proposed amendment), the reasons for conducting such business at the meeting and any material interest in such business of such shareholder and the beneficial owner, if any, on whose behalf the proposal is made, and a description of all agreements, arrangements and understandings between such shareholder and beneficial owner, if any, and any other person or persons (including their names) in connection with the proposal of such business by such shareholder; and

(C) As to the shareholder giving the notice and the beneficial owner, if any, on whose behalf the nomination or proposal is made (i) the name and address of such shareholder, as they appear on the Corporation's books, and of such beneficial

owner, if any, (ii) (a) the class or series and number of shares of capital stock of the Corporation which are, directly or indirectly, owned beneficially and of record by such shareholder and such beneficial owner, (b) any option, warrant, convertible security, stock appreciation right, or similar right with an exercise or conversion privilege or a settlement payment or mechanism at a price related to any class or series of shares of the Corporation or with a value derived in whole or in part from the value of any class or series of shares of the Corporation, whether or not such instrument or right shall be subject to settlement in the underlying class or series of capital stock of the Corporation or otherwise (a "Derivative Instrument") directly or indirectly owned beneficially by such shareholder and any other direct or indirect opportunity to profit or share in any profit derived from any increase or decrease in the value of shares of the Corporation, (c) any proxy, contract, arrangement, understanding, or relationship pursuant to which such shareholder has a right to vote any shares of any security of the Company, (d) any short interest in any security of the Company (for purposes of this By-law a person shall be deemed to have a short interest in a security if such person directly or indirectly, through any contract, arrangement, understanding, relationship or otherwise, has the opportunity to profit or share in any profit derived from any decrease in the value of the subject security), (e) any rights to dividends on the shares of the Corporation owned beneficially by such shareholder that are separated or separable from the underlying shares of the Corporation, (f) any proportionate interest in shares of the Corporation or Derivative Instruments held, directly or indirectly, by a general or limited partnership in which such shareholder is a general partner or, directly or indirectly, beneficially owns an interest in a general partner and (g) any performance-related fees (other than an asset-based fee) that such shareholder is entitled to based on any increase or decrease in the value of shares of the Corporation or Derivative Instruments, if any, as of the date of such notice, including without limitation any such interests held by members of such shareholder's immediate family sharing the same household, (iii) a description of any agreement, arrangement or understanding with respect to the nomination or proposal between or among such shareholder and such beneficial owner, any of their respective affiliates or associates, and any others acting in concert with any of the foregoing, (iv) a representation that the shareholder is a holder of record of stock of the Corporation entitled to vote at such meeting and intends to appear in person or by proxy at the meeting to propose such business or nomination, (v) a representation whether the shareholder or the beneficial owner, if any, intends or is part of a group which intends (a) to deliver a proxy statement and/or form of proxy to holders of at least the percentage of the Corporation's outstanding capital stock required to approve or adopt the proposal or elect the nominee or (b) otherwise to solicit proxies from shareholders in support of such proposal or nomination, and (vi) any other information relating to such shareholder and beneficial owner, if any, that would be required to be disclosed in a proxy statement or other filings required to be made in connection with solicitations of proxies for, as applicable, the proposal and/or for the election of directors in a contested election pursuant to Section 14 of the Exchange Act and the rules and regulations promulgated thereunder.

In addition, the shareholder's notice with respect to the election of directors must include, with respect to each nominee for election or reelection to the Board of Directors, the completed and signed questionnaire, representation and agreement required by Section 3.2(d). The Corporation may require any proposed nominee to furnish such other information as it may reasonably require to determine the

eligibility of such proposed nominee to serve as an independent director of the Corporation or that could be material to a reasonable shareholder's understanding of the independence, or lack thereof, of such nominee.

Notwithstanding the foregoing, the information required by clauses (a)(3)(C)(ii) and (a)(3)(C)(iii) of this Section 2.17 shall be updated by such shareholder and beneficial owner, if any, not later than 10 days after the record date for the meeting to disclose such information as of the record date.

(4) Notwithstanding anything in the second sentence of paragraph (a)(2) of this Section 2.17 to the contrary, in the event that the number of directors to be elected to the Board of Directors of the Corporation at an annual meeting is increased and there is no public announcement by the Corporation naming all of the nominees for director or specifying the size of the increased Board of Directors by the Shareholder Proposal Notice Date, a shareholder's notice required by this Section 2.17 shall also be considered timely, but only with respect to nominees for any new positions created by such increase, if it shall be delivered to the Secretary at the principal executive offices of the Corporation not later than the close of business on the 10th day following the day on which such public announcement is first made by the Corporation.

(b) **Special Meetings of Shareholders**. Only such business shall be conducted at a special meeting of shareholders as shall have been brought before the meeting pursuant to the Corporation's notice of meeting. Nominations of persons for election to the Board of Directors may be made at a special meeting of shareholders at which directors are to be elected pursuant to the Corporation's notice of meeting

(1) By or at the direction of the Board of Directors, or

(2) Provided that the Board of Directors has determined that directors shall be elected at such meeting, by any shareholder of the Corporation who (i) is a shareholder of record of the Corporation at the time the notice provided for in this Section 2.17 is delivered to the Secretary of the Corporation and at the time of the special meeting, (ii) is entitled to vote at the meeting and upon such election, and (iii) complies with the notice procedures set forth in this Section 2.17 as to such nomination.

In the event the Corporation calls a special meeting of shareholders for the purpose of electing one or more directors to the Board of Directors, any such shareholder may nominate a person or persons (as the case may be) for election to such position(s) as specified in the Corporation's notice of meeting, if the shareholder's notice required by paragraph (a)(3) hereof with respect to any nomination (including the completed and signed questionnaire, representation and agreement required by this By-law) shall be delivered to the Secretary at the principal executive offices of the Corporation not earlier than the close of business on the Shareholder Proposal Notice Date. In no event shall the public announcement of an adjournment or postponement of a special meeting commence a new time period (or extend any time period) for the giving of a shareholder's notice as described above.

(c) **General**.

(1) Only such persons who are nominated in accordance with the procedures set

forth in this Section 2.17 or the Articles of Incorporation shall be eligible to be elected at an annual or special meeting of shareholders of the Corporation to serve as directors and only such other business shall be conducted at a meeting of shareholders as shall have been brought before the meeting in accordance with the procedures set forth in this Section 2.17. Except as otherwise provided by law, the Articles of Incorporation or these By-laws, the person presiding at the meeting of shareholders shall have the power and duty (A) to determine whether a nomination or any other business proposed to be brought before the meeting was made or proposed, as the case may be, in accordance with the procedures set forth in this Section 2.17 (including whether the shareholder or beneficial owner, if any, on whose behalf the nomination or proposal is made solicited (or is part of a group which solicited) or did not so solicit, as the case may be, proxies in support of such shareholder's nominee or proposal in compliance with such shareholder's representation as required by clause (a)(3)(C)(v) of this Section 2.17) and (B) if any proposed nomination or other business was not made or proposed in compliance with this Section 2.17, to declare that such nomination shall be disregarded or that such proposed other business shall not be transacted. Notwithstanding the foregoing provisions of this Section 2.17, if the shareholder (or a qualified representative of the shareholder) does not appear at the annual or special meeting of shareholders of the Corporation to present a nomination or other business, such nomination shall be disregarded and such proposed other business shall not be transacted, notwithstanding that proxies in respect of such vote may have been received by the Corporation. For purposes of this Section 2.17, to be considered a qualified representative of the shareholder, a person must be a duly authorized officer, manager or partner of such shareholder or must be authorized by a writing executed by such shareholder or an electronic transmission delivered by such shareholder to act for such shareholder as proxy at the meeting of shareholders and such person must produce such writing or electronic transmission, or a reliable reproduction of the writing or electronic transmission, at the meeting of shareholders.

(2) For purposes of this Section 2.17, "public announcement" shall mean disclosure in a press release reported by a national news service or in a document publicly filed by the Corporation with the Securities and Exchange Commission (the "SEC") pursuant to Section 13, 14 or 15(d) of the Exchange Act and the rules and regulations promulgated thereunder.

(3) Notwithstanding the foregoing provisions of this Section 2.17, a shareholder shall also comply with all applicable requirements of the Exchange Act and the rules and regulations thereunder with respect to the matters set forth in this Section 2.17; provided however, that any references in these By-laws to the Exchange Act or the rules promulgated thereunder are not intended to and shall not limit any requirements applicable to nominations or proposals as to any other business to be considered pursuant to this Section 2.17 (including clause (a)(1)(C) and paragraph (b) hereof), and compliance with clause (a)(1)(C) and paragraph (b) of this Section 2.17 shall be the exclusive means for a shareholder to make nominations or submit other business, as applicable (other than matters brought properly under and in compliance with Rule 14a-8 of the Exchange Act, as may be amended from time to time). Nothing in this Section 2.17 shall be deemed to affect any rights (A) of shareholders to request inclusion of proposals in the Corporation's proxy statement pursuant to Rule 14a-8 of the Exchange Act or (B) of the holders of any class or series of stock having a preference over the common stock of the Corporation as to dividends or upon

liquidation ("Preferred Stock") to elect directors pursuant to any applicable provisions of the Articles of Incorporation.

(4) Notwithstanding any shareholder's compliance with the foregoing procedure, the shareholder does not have the right to have its nominee included in the Corporation's proxy statement for such meeting of shareholders at which directors will be elected unless the Corporation is subject to, and the shareholder has complied with, the requirements of SEC Rule 14a-11.

ARTICLE III
BOARD OF DIRECTORS

Section 3.1 General Powers. The business and affairs of the Corporation shall be managed by its Board of Directors. *[§7-108-101(2)]*

Section 3.2 Number, Tenure and Qualifications. The initial number of directors shall be not fewer than one. The number of directors fixed by these bylaws may be increased or decreased from time to time by resolution of the board of directors. *[§7-108-103]*

(a) Each director shall hold office until the next annual meeting of shareholders and until his successor shall have been elected and qualified. *[§7-108-105(2)]*

(b) The tenure of a director shall not be affected by any decrease or increase in the number of directors so made by the board. *[§7-108-105(3)]*

(c) In addition to the qualifications for directors established in section 7-108-102 of the Colorado Business Corporation Act and subject to Section 3.10 with respect to the Board's power to fill vacancies, a person shall not be eligible for election or re-election as a director at an annual or special meeting unless:

(i) The person is nominated by a Record Shareholder in accordance with Section 2.17, or

(ii) The person is nominated by or at the direction of the Board of Directors. *[§7-108-102]*

(d) In addition to the qualifications set forth in established in section 7-108-102 of the Colorado Business Corporation Act and Section 3.2(c), to be eligible for election or reelection as a director at an annual or special meeting of shareholders, each person shall:

(i) Deliver (in accordance with the time periods prescribed for delivery of notice under Section 2.17 of these By-laws) to the Secretary at the principal executive offices of the Corporation a written questionnaire with respect to the background and qualification of such person and the background of any other person or entity on whose behalf the nomination is being made (which questionnaire shall be provided by the Secretary upon written request) and a written representation and agreement (in the

form provided by the Secretary upon written request) that such person (a) is not and will not become a party to (1) any agreement, arrangement or understanding with, and has not given any commitment or assurance to, any person or entity as to how such person, if elected as a director of the Corporation, will act or vote on any issue or question (a 'Voting Commitment') that has not been disclosed to the Corporation or (2) any Voting Commitment that could limit or interfere with such person's ability to comply, if elected as a director of the Corporation, with such person's fiduciary duties under applicable law as it presently exists or may hereafter be amended, (b) is not and will not become a party to any agreement, arrangement or understanding with any person or entity other than the Corporation with respect to any direct or indirect compensation, reimbursement or indemnification in connection with service or action as a director that has not been disclosed therein, and (c) in such person's individual capacity and on behalf of any person or entity on whose behalf the nomination is being made, would be in compliance, if elected as a director of the Corporation, and will comply with all applicable publicly disclosed corporate governance, conflict of interest, confidentiality and stock ownership and trading policies and guidelines of the Corporation.

(ii) Be ________________.
[§7-108-102]

(e) The chairman of the meeting shall have the power and the duty to determine whether a nomination or any business proposed to be brought before the meeting has been made in accordance with the procedures set forth in these Bylaws and, if any proposed nomination or business is not in compliance with these Bylaws, to declare that such defectively proposed business or nomination shall not be presented for shareholder action at the meeting and shall be disregarded.

Section 3.3 Regular Meetings. A regular meeting of the Board of Directors shall be held without other notice than this bylaw immediately after, and at the same place as, the annual meeting of shareholders. The Board of Directors may provide, by resolution, the time and place, either within or without the State of Colorado, for the holding of additional regular meetings, without other notice than such resolution. *[§7-108-203(1)]*

Section 3.4 Special Meetings. Special meetings of the Board of Directors may be called by or at the request of the Chairman, if there be one, the President, any of the directors, or by such persons as are authorized to call special meetings under the Colorado Business Corporation Act. The person or persons authorized to call special meetings of the Board of Directors may fix any place, either within or without the State of Colorado, as the place for holding any special meeting of the Board of Directors called by them.

Section 3.5 Notice. (a) Written notice of any special meeting of directors shall be given by mail to each director at his business address at least two business days prior to the meeting or by personal delivery, fax, electronic mail, or telegram at least 24 hours prior to the meeting to the business address of each director, or in the event such notice is given on a Saturday, Sunday or holiday, to the residence address of each director, or on such shorter notice as the person or persons calling the meeting, acting in good faith, may deem necessary or appropriate in the

circumstances. If mailed, such notice shall be deemed to be delivered when deposited in the United States mail, so addressed, with postage thereon prepaid. If notice is given by fax or electronic mail, such notice shall be deemed to be delivered when confirmation (either by electronic means or by the person receiving the fax or electronic mail) of such fax is received by the sender. If notice be given by telegram, such notice shall be deemed to be delivered when the telegram is delivered to the telegraph company. *[§7-108-203(2)]*

(b) Any director may waive notice of any meeting. The attendance of a director at any meeting shall constitute a waiver of notice of such meeting, except where a director attends a meeting for the express purpose of objecting to the transaction of any business because the meeting is not lawfully called or convened. *[§7-108-204]*

(c) Neither the business to be transacted at, nor the purpose of, any regular or special meeting of the Board of Directors need be specified in the notice or waiver of notice of such meeting. *[§7-108-203(2)]*

Section 3.6 Quorum. A majority of the directors shall constitute a quorum for the transaction of business at any meeting of the Board of Directors. *[§7-108-205(1)]*

Section 3.7 Manner of Acting. Except as otherwise required by law or by the Articles of Incorporation, the act of the majority of the directors present at a meeting at which a quorum is present shall be an act of the Board of Directors. *[§7-108-205(3)]*

Section 3.8 Action by Directors Without a Meeting. Any action required or permitted to be taken by the Board or Directors or by a committee thereof at a meeting may be taken without a meeting if a consent in writing, setting forth the action so taken, shall be signed by all of the directors or all or the committee members entitled to vote with respect to the subject matter thereof. Signatures may be original signatures or by fax. Signatures on such consent may be made in counterparts. *[§7-108-202]*

Section 3.9 Meetings by Telecommunication. Any members of the Board of Directors or any committee designated by such Board may participate in a meeting of the Board of Directors or committee by means of telephone conference or similar communications equipment by which all persons participating in the meeting can hear each other at the same time. Such participation shall constitute presence in person at the meeting[2]. *[§7-108-201(2)]*

Section 3.10 Vacancies. Any vacancy occurring in the Board of Directors may be filled by the affirmative vote of a majority of the remaining directors, though less than a quorum of the Board of Directors. A director elected to fill a vacancy shall be elected for the unexpired term of his predecessor in office. Any directorship to be

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[2] *See* Section 2.16 for similar provisions regarding shareholders' meetings. C.R.S. § 7-108-201(2) provides that "unless otherwise provided by the bylaws," the board of directors may permit any director to participate in a regular or special board meeting telephonically. If directors want to permit participation in the board meetings by telephonic meetings only in certain circumstances this should be so stated.

filled by reason of an increase in the number of directors may be filled by election by the Board of Directors for a term of office continuing only until the next election of directors by the shareholders. *[§7-108-110]*

Section 3.11 Resignation. Any director of the Corporation may resign at any time by giving written notice to the President or the Secretary of the Corporation. The resignation of any director shall take effect upon receipt of notice thereof or at any such later time as shall be specified in such notice; and, unless otherwise specified therein, the acceptance of such resignation shall not be necessary to make it effective. When one or more directors shall resign from the Board, effective at a future date, a majority of the directors then in office, including those who have so resigned, shall have power to fill such vacancy or vacancies, the vote thereon to take effect when such resignation or resignations shall become effective. *[§7-108-107]*

Section 3.12 Removal. Any director or directors of the Corporation may be removed at any time by the shareholders, with or without cause, in the manner provided in the Colorado Business Corporation Act. *[§7-108-108 and §7-108-109]*

Section 3.13 Committees. By resolution adopted by a majority of the Board of Directors, the directors may designate two or more directors to constitute a committee, any of which shall have such authority in the management of the Corporation as the Board of Directors shall designate and as shall not be proscribed by the Colorado Business Corporation Act. *[§7-108-206]*

Section 3.14 Compensation. By resolution of the Board of Directors and irrespective of any personal interest of any of the members, each director may be paid his expenses, if any, of attendance at each meeting of the Board of Directors, and may be paid a stated salary as director or a fixed sum for attendance at each meeting of the Board of Directors, or both. No such payment shall preclude any director from serving the Corporation in any other capacity and receiving compensation therefor.

Section 3.15 Presumption of Assent. A director of the Corporation who is present at a meeting of the Board of Directors at which action on any corporate matter is taken shall be presumed to have assented to the action taken unless the dissent shall be entered in the minutes of the meeting or unless he shall file his written dissent to such action with the person acting as the Secretary of the meeting before the adjournment thereof or shall forward such dissent by registered mail to the Secretary of the Corporation immediately after the adjournment of the meeting. Such right to dissent shall not apply to a director who voted in favor of such action. *[§7-108-205(4)]*

ARTICLE IV
OFFICERS

Section 4.1 Number. The officers of the Corporation shall be a President, who shall be elected by the Board of Directors. Such other officers and assistant officers as may be deemed necessary may be elected or appointed by the Board of Directors. Any two or more offices may be held by the same person. *[§7-108-301(1) and §7-108-301(4)]*

Section 4.2 Election and Term of Office. The officers of the Corporation to be elected by the Board of Directors shall be elected annually by the Board of Directors at the first meeting of the Board of Directors held after the annual meeting of the shareholders. If the election of officers shall not be held at such meeting, such election shall be held as soon thereafter as practicable. Each officer shall hold office until his successor shall have been duly elected and shall have qualified or until his death or until he shall resign or shall have been removed in the manner hereinafter provided. *[§7-108-301(2)]*

Section 4.3 Removal. Any officer or agent may be removed by the Board of Directors whenever in its judgment the best interests of the Corporation will be served thereby, but such removal shall be without prejudice to the contract rights, if any, of the person so removed. Election or appointment of an officer or agent shall not of itself create contract rights. *[§7-108-303]*

Section 4.4 Vacancies. A vacancy in any office because of death, resignation, removal, disqualification or otherwise, may be filled by the Board of Directors for the unexpired portion of the term. *[§7-108-301(2)]*

Section 4.5 Chairman of the Board. If the directors so desire, they may elect a Chairman of the Board from among themselves. The chairman of the board shall preside at all meetings of the shareholders and of the Board of Directors. He shall have such other powers and duties as may be prescribed by the Board of Directors. *[§7-108-301(1) and §7-108-302]*

Section 4.6 President. The President shall be the chief executive officer of the Corporation and, subject to the control of the Board of Directors, shall in general supervise and control all of the business and affairs of the Corporation. He shall, if no Chairman be elected, be the chief executive officer of the Corporation and shall preside at all meetings of the shareholders and of the Board of Directors. He may sign, with the Secretary or any other proper officer of the Corporation thereunto authorized by the Board of Directors, certificates for shares of the Corporation and deeds, mortgages, bonds, contracts or equipment leases entered into in the ordinary course of business, and other contracts or instruments which the Board of Directors has authorized to be executed, except in cases where the signing and execution thereof shall be expressly delegated by the Board of Directors or by these Bylaws to some other officer or agent of the Corporation, or shall be required by law to be otherwise signed or executed; and in general shall perform all duties incident to the office of President and such other duties as may be prescribed by the Board of Directors from time to time. *[§7-108-301(1) and §7-108-302]*

Section 4.7 The Vice Presidents. If elected or appointed by the Board of Directors, the Vice President (or in the event there be more than one vice president, the vice presidents in the order designated at the time of their election, or in the absence of any designation, then in the order of their election) shall, in the absence of the President or in the event of his death or inability to act, perform all duties of the President, and when so acting, shall have all the powers of and be subject to all the restrictions upon the President. Any Vice President may sign, with the Secretary or an Assistant Secretary, certificates for shares of the Corporation, and contracts or equipment leases entered into in the ordinary course of business; and shall perform

such other duties as from time to time may be assigned to him by the President or by the Board of Directors. *[§7-108-301(1) and §7-108-302]*

Section 4.8 The Secretary. If elected or appointed by the Board of Directors, the Secretary shall: (a) keep the minutes of the proceedings of the shareholders and of the Board of Directors in one or more books provided for that purpose; (b) see that all notices are duly given in accordance with the provisions of these Bylaws or as required by law; (c) be custodian of the corporate records and of the seal of the Corporation and see that the seal of the Corporation is affixed to all documents the execution of which on behalf of the corporation under its seal is duly authorized; (d) keep a register of the post office address of each shareholder which shall be furnished to the Secretary by such shareholder; (e) sign with the President, or a Vice President, certificates for shares of the Corporation, the issuance of which shall have been authorized by resolution of the Board of Directors; (f) have general charge of the stock transfer books of the Corporation; (g) in general perform all duties incident to the office of Secretary and such other duties as from time to time may be assigned to him by the President or by the Board of Directors. *[§7-108-301(1), §7-108-301(3) and §7-108-302]*

Section 4.9 The Treasurer. If elected or appointed by the Board of Directors, the Treasurer shall: (a) have charge and custody of and be responsible for all funds and securities of the Corporation; (b) receive and give receipts for monies due and payable to the Corporation from any source whatsoever, and deposit all such monies in the name of the Corporation in such banks, trust companies or other depositories as shall be selected in accordance with the provisions of Article V of these Bylaws; and (c) in general perform all of the duties incident to the office of Treasurer and such other duties as from time to time may be assigned to him by the President or by the Board of Directors. *[§7-108-301(1) and §7-108-302]*

Section 4.10 Assistant Officers, Assistant Secretaries and Assistant Treasurers.
(a) A duly appointed officer may appoint one or more assistant officers. *[§7-108-301(2)]*

(b) The Assistant Secretaries, when authorized by the Board of Directors, may sign with the President or a Vice President certificates for shares of the corporation the issuance of which shall have been authorized by a resolution of the Board of Directors. Other assistant officers shall perform such duties as shall be assigned to them by the Secretary or the Treasurer, respectively, or by the President or the Board of Directors. No officer may appoint an assistant officer with greater authority to act than the officer appointing such assistant officer. The Board of Directors may limit the authority of any officer to appoint any assistant officer, and the Board of Directors may limit the authority of any officer or assistant officer in any respect. *[§7-108-302]*

Section 4.11 Bonds. If the Board of Directors by resolution shall so require, any officer or agent of the corporation shall give bond to the Corporation in such amount and with such surety as the Board of Directors may deem sufficient, conditioned upon the faithful performance of their respective duties and offices.

Section 4.12 Salaries. The salaries of the officers shall be fixed from time to time by the Board of Directors and no officer shall be prevented from receiving such salary by reason of the fact that he is also a director of the Corporation.

ARTICLE V
CONTRACTS, LOANS, CHECKS AND DEPOSITS

Section 5.1 Contracts. The Board of Directors may authorize any officer or officers, agent or agents, to enter into any contract or execute and deliver any instrument in the name of and on behalf of the Corporation, and such authority may be general or confined to specific instances. The President or any Vice-President may enter into contracts or equipment leases entered into in the ordinary course of business. *[§7-108-304]*

Section 5.2 Loans. No loans shall be contracted on behalf of the Corporation and no evidences of indebtedness shall be issued in its name unless authorized by a resolution of the Board of Directors. Such authority may be general or confined to specific instances.

Section 5.3 Checks, Drafts, Etc. All checks, drafts or other orders for the payment of money, notes or other evidence of indebtedness issued in the name of the Corporation shall be signed by such officer or officers, agent or agents of the Corporation and in such manner as shall from time to time be determined by resolution of the Board of Directors. *[§7-108-302]*

Section 5.4 Deposits. All funds of the Corporation not otherwise employed shall be deposited from time to time to the credit of the Corporation in such banks, trust companies or other depositories as the Board of Directors may select.

ARTICLE VI
SHARES, CERTIFICATES FOR SHARES AND TRANSFER OF SHARES

Section 6.1 Regulations. The Board of Directors may make such rules and regulations as it may deem appropriate concerning the issuance, transfer and registration of certificates for shares of the Corporation, including the appointment of transfer agents and registrars.

Section 6.2 Certificates for Shares.[3] (a) Subject to the provisions of the Colorado Business Corporation Act, the shares of the Corporation shall be evidenced by certificates;

[3] Stock exchanges and (in some cases) the OTC market require that companies with shares listed for trading be DWAC and FAST-DRS eligible. DWAC (Deposit/Withdrawal at Custodian) is an automated system for deposits and withdrawals of securities from the Depository Trust Company (DTC). The Fast Automated Securities Transfer (FAST) system and Direct Registration System (DRS) are also requirements imposed by DTC for computerized stock trading in connection with exchange listings and in some cases the over-the-counter market. As stated in DTC's rule change request and the SEC approval thereof (Release No. 34-60196; June 30, 2009):

> Prior to the establishment of DTC's Fast Automated Securities Transfer program ("FAST"), transfers of securities to or from DTC on behalf of its participants occurred by sending securities certificates back and forth between DTC and transfer agents. In the case of securities being deposited with DTC,

provided, however, that the Board may provide by resolution or resolutions that some or all of any or all classes or series of stock of the Corporation shall be uncertificated shares.[4] Any such resolution shall not apply to shares evidenced by a certificate until such certificate is surrendered to the Corporation.

(b) Every holder of one or more shares of the Corporation is entitled, at the option of the holder, to a share certificate, or a non-transferable written certificate of acknowledgement of the right to obtain a share certificate, stating the number and the class of shares held as shown on the securities register. Any certificate shall be signed in accordance with these by-laws and need not be under corporate seal. Certificates may be manually countersigned by at least one director or officer of the Corporation or by or on behalf of a registrar or transfer agent of the Corporation. Subject to the provisions of the Act, the signature of any signing director, officer, transfer agent or registrar may be printed or mechanically reproduced on the certificate. Every printed or mechanically reproduced signature is deemed to be the signature of the person whose signature it reproduces and is binding on the Corporation. A certificate executed as set out in this section is valid even if a director or officer whose printed or mechanically reproduced signature appears on the certificate no longer holds office as of the date of the issue of the certificate.

(c) Where interest of a holder of stock of the Corporation is evidenced by a certificate or certificates, such certificate shall be in such form as the Board of Directors may from time to time prescribe. Each such certificate shall be signed by or in the name of the Corporation, by the Chairman of the Board of Directors or the President or a Vice President and by the Treasurer or an Assistant Treasurer or the Secretary or an Assistant Secretary. Any of, or all of, the signatures on the certificate may be a facsimile. If any officer, transfer agent

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DTC sent the certificates received by its participants to the transfer agent for registration into the name of DTC's nominee, Cede & Co., and the transfer agent returned the reregistered certificates to DTC. In the case of securities being withdrawn from DTC, DTC sent the certificates registered in the name of Cede & Co. to the transfer agent for re-registration into the name designated by the withdrawing participant, and the transfer agent returned a reregistered security certificate to DTC for delivery to the withdrawing participant or delivered the reregistered security certificate to another entity as directed and sent a security certificate to DTC representing the remainder of DTC's position. The process of physically transporting securities certificates between DTC and transfer agents exposed DTC, its participants, and the transfer agents to the risk of loss during transit and resulted in significant expenses.

DTC's FAST program was designed to eliminate some of the risks and costs related to this production and transportation of securities certificates. Under the FAST program, transfer agents hold FAST eligible securities in the name of Cede & Co. for the benefit of DTC. As additional securities are deposited or withdrawn from DTC, transfer agents adjust the size of DTC's position as appropriate and electronically confirm theses changes with DTC. Transfer agents acting as "FAST agents" are holding in custody for DTC those securities that would otherwise be held at DTC. As such, the FAST program reduces the movement of certificates between DTC and the transfer agents and therefore reduces the costs and risks associated with the creation, movement, and storing of certificates for issuers, transfer agents, broker-dealers, and DTC.

The FAST program has grown substantially since first being introduced in 1975. Recently all the major securities exchanges have made changes to the listing requirements to require companies to make their securities eligible to participate in the Direct Registration System ("DRS"). Because FAST eligibility is a prerequisite to an issue being eligible for DRS, DTC expects that the number of FAST eligible securities will continue to expand.

[4] Uncertificated shares are specifically permitted by C.R.S. § 7-106-207.

or registrar who has signed or whose facsimile signature has been placed upon a certificate shall have ceased to be such officer, transfer agent or registrar before such certificate is issued, it may be issued by the Corporation with the same effect as if he were such officer, transfer agent or registrar at the date of issue. *[§7-106-206]*[5]

Section 6.3 Cancellation of Certificates. All certificates surrendered to the Corporation for transfer shall be canceled and no new certificates shall be issued in lieu thereof until the former certificate for a like number of shares shall have been surrendered and canceled, except as herein provided with respect to lost, stolen or destroyed certificates.

Section 6.4 Lost, Stolen or Destroyed Certificates. Any shareholder claiming that his certificate for shares is lost, stolen or destroyed may make an affidavit or affirmation of that fact and lodge the same with the Secretary of the Corporation, accompanied by a signed application for a new certificate. Thereupon, and upon the giving of a satisfactory bond of indemnity to the Corporation not exceeding an amount double the value of the shares as represented by such certificate (the necessity for such bond and the amount required to be determined by the President and Treasurer of the Corporation), a new certificate may be issued of the same tenor and representing the same number, class and series of shares as were represented by the certificate alleged to be lost, stolen or destroyed.

Section 6.5 Transfer of Shares. (a) Subject to the terms of any shareholder agreement relating to the transfer of shares or other transfer restrictions contained in the Articles of Incorporation or authorized therein, shares of stock shall be transferable on the books of the Corporation pursuant to applicable law and such rules and regulations as the Board of Directors shall from time to time prescribe. *[§7-106-208]*

(b) Notwithstanding the foregoing, the transfer of a share may only be registered in the Corporation's securities register upon:

(i) Presentation and surrender of the certificate representing such share with an endorsement, which complies with the rules and regulations established with respect thereto by the Corporation or any transfer agent and registrar appointed by the Corporation, made on the certificate or delivered with the certificate, duly executed by an appropriate person as provided by such rules and regulations, together with reasonable assurance that the endorsement is genuine and effective, upon payment of all applicable taxes and in any reasonable fees prescribed by the Board; or

(ii) In the case of shares electronically issued without a certificate, upon receipt of proper transfer instructions from the registered holder of the shares, a duly authorized attorney of the registered owner of the shares or an individual presenting proper evidence of succession, assignment or authority to the transfer of the shares. *[Companies reporting under the 1934 Act only]*

(c) As against the Corporation, a transfer of shares can be made only on the books of the Corporation and in the manner hereinabove provided, and the

[5] Note that §7-106-207 provides for "shares without certificates." The foregoing contemplates electronic transfer of certificated securities.

Corporation shall be entitled to treat the holder of record of any shares as the owner thereof and shall not be bound to recognize any equitable or other claim to or interest in such shares on the part of any other person, whether or not it shall have express or other notice thereof, save as expressly provided by the statutes of the State of Colorado. *[§7-106-208]*

Section 6.6 Shares Held for the Account of a Specified Person or Persons. The Board of Directors may adopt by resolution a procedure whereby a shareholder of the Corporation may certify in writing to the Corporation that all or a portion of the shares registered in the name of such shareholder are held for the account of a specified person or persons. The resolution shall set forth:

(a) The classification of shareholder who may certify;

(b) The purpose or purposes for which the certification may be made;

(c) The form of certification and information to be contained therein;

(d) If the certification is with respect to a record date or closing of the stock transfer books, the time after the record date or closing of the stock transfer books within which the certification must be received by the Corporation; and

(e) Such other provisions with respect to the procedure as are deemed necessary or desirable.

Upon receipt by the Corporation of a certification complying with the procedure, the persons specified in the certification shall be deemed, for the purpose or purposes set forth in the certification, to be the holders of record of the number of shares specified in place of the shareholder making the certification. *[§7-107-204]*

ARTICLE VII
TAXABLE YEAR

The taxable year of the Corporation shall be determined by resolution of the Board of Directors.

ARTICLE VIII
DIVIDENDS

The Board of Directors may from time to time declare, and the Corporation may pay, dividends on its outstanding shares in the manner and upon the terms and conditions provided by law and its Articles of Incorporation. *[§7-106-401]*

ARTICLE IX
CORPORATE SEAL

The Board of Directors may provide a corporate seal which shall be circular in form and shall have inscribed thereon the name of the Corporation and the state of incorporation and the word "Seal."

ARTICLE X
WAIVER OF NOTICE

Whenever any notice is required to be given under the provisions of these Bylaws or under the provisions of the Articles of Incorporation or under the provisions of the Colorado Business Corporation Act, or otherwise, a waiver thereof in writing, signed by the person or persons entitled to such notice, whether before or after the event or other circumstance requiring such notice, shall be deemed equivalent to the giving of such notice. *[§7-107-106 and §7-108-204]*

ARTICLE XI
AMENDMENTS

These Bylaws may be altered, amended or repealed and new Bylaws may be adopted by a majority of the directors present at any meeting of the Board of Directors of the Corporation at which a quorum is present.

ARTICLE XII
EXECUTIVE COMMITTEE
[generally §7-108-206]

Section 12.1 Appointment. The Board of Directors by resolution adopted by a majority of the full Board, may designate two or more of its members to constitute an Executive Committee. The designation of such Committee and the delegation thereto of authority shall not operate to relieve the Board of Directors, or any member thereof, of any responsibility imposed by law.

Section 12.2 Authority. The Executive Committee, when the Board of Directors is not in session, shall have and may exercise all of the authority of the Board of Directors except to the extent, if any, that such authority shall be limited by the resolution appointing the Executive Committee and except also that the Executive Committee shall not have the authority of the Board of Directors in reference to amending the Articles of Incorporation, adopting a plan of merger or consolidation, recommending to the shareholders the sale, lease or other disposition of all or substantially all of the property and assets of the Corporation otherwise than in the usual and regular course of its business, recommending to the shareholders a voluntary dissolution of the Corporation or a revocation thereof, or amending the Bylaws of the Corporation.

Section 12.3 Tenure and Qualifications. Each member of the Executive Committee shall hold office until the next regular annual meeting of the Board of Directors following his designation and until his successor is designated as a member of the Executive Committee and is elected and qualified.

Section 12.4 Meetings. Regular meetings of the Executive Committee may be held without notice at such time and places as the Executive Committee may fix from time to time by resolution. Special meetings of the Executive Committee may be called by any member thereof upon not less than one days notice stating the place, date and hour of the meeting, which notice may be written or oral, and if mailed, shall be deemed to be delivered when deposited in the United States mail addressed to the

member of the Executive Committee at his business address. Any member of the Executive Committee may waive notice of any meeting and no notice of any meeting need be given to any member thereof who attends in person. The notice of a meeting of the Executive Committee need not state the business proposed to be transacted at the meeting.

Section 12.5 Quorum. A majority of the members of the Executive Committee shall constitute a quorum for the transaction of business at any meeting thereof, and action of the Executive Committee must be authorized by the affirmative vote of a majority of the members present at a meeting at which a quorum is present.

Section 12.6 Action by Executive Committee Without a Meeting. Any action required or permitted to be taken by the Executive Committee at a meeting may be taken without a meeting if a consent in writing, setting forth the action so taken, shall be signed by all of the members entitled to vote with respect to the subject matter thereof.

Section 12.7 Vacancies. Any vacancy in the Executive Committee may be filled by a resolution adopted by a majority of the full Board of Directors.

Section 12.8 Resignations and Removal. Any member of the Executive Committee may be removed at any time with or without cause by resolution adopted by a majority of the full Board of Directors. Any member of the Executive Committee may resign from the Executive Committee at any time by giving written notice to the President or Secretary of the Corporation, and unless otherwise specified therein, the acceptance of such resignation shall not be necessary to make it effective.

Section 12.9 Procedure. The Executive Committee shall elect a presiding officer from its members and may fix its own rules of procedure which shall not be inconsistent with these Bylaws. It shall keep regular minutes of its proceedings and report the same to the Board of Directors for its information at the meeting thereof held next after the proceedings shall have been taken.

ARTICLE XIII
EMERGENCY BYLAWS
[generally §7-103-103]

(a) The Emergency Bylaws provided in this Article XIII shall be operative during any emergency in the conduct of the business of the Corporation resulting from an attack on the United States or any nuclear or atomic disaster, notwithstanding any different provision in the preceding articles of the Bylaws or in the Articles of Incorporation of the Corporation or in the Colorado Business Corporation Act. To the extent not inconsistent with the provisions of this article, the Bylaws provided in the preceding articles shall remain in effect during such emergency and upon its termination the Emergency Bylaws shall cease to be operative.

(b) During any such emergency:

(i) A meeting of the Board of Directors may be called by any officer or director of the Corporation. Notice of the time and place of the meeting shall be given by the person calling the meeting to such of the directors as it may be feasible to reach by any available means of communication. Such notice shall be given at such time in advance of the meeting as circumstances permit in the judgment of the person calling the meetings.

(ii) At any such meeting of the Board of Directors, a quorum shall consist of the number of directors in attendance at such meeting.

(iii) The Board of Directors, either before or during any such emergency, may, effective in the emergency, change the principal office or designate several alternative principal offices or regional offices, or authorize the officers so to do.

(iv) The Board of Directors, either before or during any such emergency, may provide, and from time to time modify, lines of succession in the event that during such an emergency any or all officers or agents of the Corporation shall for any reason be rendered incapable of discharging their duties.

(v) No officer, director or employee acting in accordance these Emergency Bylaws shall be liable except for willful misconduct.

(vi) These Emergency Bylaws shall be subject to repeal or change by further action of the Board of Directors or by action of the shareholders, but no such repeal or change shall modify the provisions of the next preceding paragraph with regard to action taken prior to the time of such repeal or change. Any amendment of these Emergency Bylaws may make any further or different provision that may be practical and necessary for the circumstances of the emergency.