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TEACHING UNINCORPORATED BUSINESS ASSOCIATIONS THROUGH A SIMULATED START-UP

BRETT H. McDONNELL*

INTRODUCTION

For about five years I have been teaching a course called Unincorporated Business Associations. As I write this, I am preparing to start on the third year of teaching this course through a simulated start-up LLC, in which students represent the company's founders, and over a series of four essays, they negotiate, draft, and analyze the main sections of an agreement¹ governing the business. In this Article, I describe how I came to teach such a course this way, some of the details of the course, and my sense of how the course has succeeded or not succeeded in meeting its objectives.

For most of my first decade as a law professor, I taught Business Associations/Corporations (BA/Corps). Since well before I arrived, that was the gateway business law course at the University of Minnesota Law School. It was, and is, a fairly traditional variant of a course offered at most law schools, although there is variation around a common core.² The course starts with a few classes on agency law, then spends several weeks on unincorporated entities. The main focus of those weeks is general partnerships—after an overview of partnership law, it very quickly touches on limited partnerships and limited liability companies. That's it for the "Business Associations" part of the course—the rest of the semester covers corporations.

BA/Corps, as it is (affectionately?) known, remains the gateway business law course for most Minnesota students, and I still teach it some years. However, a while back, we decided to make some decently major changes in

* Professor, University of Minnesota Law School. I thank Paul Rubin for helpful comments.

1. At least until this year, that agreement has been called a "member control agreement." To those with a background in business associations (and who else would be reading this?), that must seem like an odd name for what should be called an operating agreement. Hold tight, and eventually I will explain. *See infra* note 22 and accompanying text.

2. *See, e.g.*, Joan MacLeod Heminway, *Teaching Business Associations Law in the Evolving New Market Economy*, 8 J. BUS. & TECH. L. 175, 176–77 (2013) (providing an overview of the content of her Business Associations course and the natural variation among professors); Charles R.T. O'Kelley, *Delaware Corporation Law and Transaction Cost Engineering*, 34 GA. L. REV. 929, 929 n.1 (2000) (describing the variation of the Business Associations course among law schools).

our first year curriculum.³ One of those changes was to introduce an elective course.⁴ We decided to offer four classes in versions tailored only for first year students.⁵ We wanted a business law course, preferably one with somewhat of a transactional focus, to be one of the available electives. BA/Corps was the obvious option, but there was a problem. BA/Corps is a four-credit course, and we only had three credits available for the elective slot.⁶ What to do?

We decided to take out the “BA” and just offer Corps in the first year. That was clearly the best way to make a sensible and coherent three-credit course. But, it left the 1L elective students without exposure to unincorporated entities (beyond maybe half of a class of lightning-quick overview). These entities are of great and growing importance to modern business lawyers, especially transactional lawyers.⁷ Presumably most of the students who would choose to take Corporations in their first year were precisely those most likely to pursue a business law career, and hence those who most needed exposure to the leading modern forms of business associations. Once again, what to do?

We decided to create a three-credit Unincorporated Business Associations course to act as a follow-up to the 1L Corporations class.⁸ Students would be encouraged to take the unincorporated class in their second or third year.⁹ With that, we would get a double benefit from having the 1L elective: students would be able to get an early start in their business law training with the 1L Corporations class, and the upper level Unincorporated Business Associations class would give those with a particular business law bent much more in-depth

3. I chaired the effort to design these changes. Those who have been through such efforts may be surprised to learn that I came through only moderately scarred by the experience. There are much worse things in life. I know; I have been an associate dean.

4. There is a good chance we may soon undo that change, which has implications for the course I describe in this Article. *See infra* note 32 and accompanying text.

5. Subsequently we have allowed upper-class students in some of them. The other three first-year electives are Civil Procedure II, International Law, and Perspectives. The last course is co-taught by three faculty members from various perspective areas (e.g., law and economics, legal history, law and society, and so on). They choose two doctrinal topics taught in the first year, and each teacher analyzes that topic from their particular perspective. It only appeals to a fairly narrow niche of students, but for that group it is quite an interesting course.

6. Even at that, the 1L reforms probably left the first year too crowded and busy. One more credit was out of the question.

7. I take this point as given and not necessary to advocate to readers of this Article. *See, e.g.,* LARRY E. RIBSTEIN, *THE RISE OF THE UNCORPORATION* 1 (2010); Robert W. Hamilton, *Entity Proliferation*, 37 *SUFFOLK U. L. REV.* 859, 863–64 (2004).

8. Students who have taken the upper level BA/Corps class are also allowed to take Unincorporated Business Associations, but few do.

9. Not as many students as we expected and hoped have taken the follow-up course, creating a problem. I discuss this below.

exposure to unincorporated entities than is possible in the extremely rushed environment of the BA/Corps class.¹⁰

Responsibility for designing and teaching the new Unincorporated Business Associations class fell to me. This was something of a challenge, as, in my brief two years in practice, I concentrated mostly on public corporations—as we shall see, I have ultimately dealt with that limitation by bringing in two adjuncts to co-teach with me. But, I am getting ahead of the story. In my first two years teaching the course, I taught it in a fairly traditional way. Following the structure of the casebook,¹¹ the first half or a bit more of the course covered general partnership law, and the back half then covered limited partnerships (LPs), limited liability companies (LLCs), and limited liability partnerships (LLPs). Most of the grade was based on a traditional final exam. However, I did have the students work in groups on two short negotiating and drafting exercises based on problems in the casebook.

I included those exercises, in part, because I wanted to help build practical skills, especially skills tied to transactional practice, which students do not get enough of in most law school courses. More fundamentally, though, unincorporated entities are quite intensely transactional in nature.¹² The statutes not only allow, but actively expect and encourage, detailed agreements which set the structure and rules for individual business. To understand the law, you need to understand those agreements and the business goals that give rise to them. Reading cases is one way of getting at this, but it is an imperfect way—cases are necessarily tied to highly particular language and circumstances and reflect drafting and planning gone wrong in some way. They also suffer from hindsight bias.¹³ To really understand what is going on with business association law, I figured it would help tremendously to actually require students to negotiate and draft some language. To do so well, they would have to understand the goals of the business and its founders and anticipate the kinds of situations that the agreement might be forced to help handle.

The exercises those first two years were frustrating for both my students and me. I did not leave much time in class to help prepare the students specifically for negotiating and drafting, nor was there much time to analyze the results in class. Even if I had left more time, my limited practical

10. On the difficulty of coverage in the general Business Associations class, see Heminway, *supra* note 2, at 177.

11. LARRY E. RIBSTEIN & JEFFREY M. LIPSHAW, UNINCORPORATED BUSINESS ENTITIES vii–xvii (4th ed. 2009).

12. See RIBSTEIN, *supra* note 7, at 6.

13. Neal J. Roese & Kathleen D. Vohs, *Hindsight Bias*, 7 PERSP. ON PSYCHOL. SCI. 411, 411 (2012); Jeffrey J. Rachlinski, *A Positive Psychological Theory of Judging in Hindsight*, 65 U. CHI. L. REV. 571, 571 (1998).

experience with this kind of agreement left me ill-equipped to give good guidance and feedback. Thus, I faced a crossroads. Should I write the exercises off as a failed experiment or try to re-design them and devote more time and effort to making them succeed?

I decided to go all in, and structure the whole course around a series of exercises. In each exercise, the students would negotiate and draft a portion of an LLC agreement, so that, by the end, they would be able to integrate the parts and pull together an entire agreement. I brought in two adjunct practitioners to help me guide and evaluate the students in negotiating and drafting.¹⁴ The class meets three days a week. The first two days are with me, as I work through the statutes and cases in the casebook, as well as provisions in sample agreements. On the third day of the week, the students meet in smaller groups with one of the adjuncts. I describe below what the students do on the adjunct class days. The following paragraphs are a basic guide to how the course now works.

The simulations are built around a fictional start-up company, Minnesota Nicebook, a social media company. It has four founders: Evelyn Entwistle, a twenty-seven-year-old computer programmer who had the idea for the site; Sam Townshend, a thirty-year-old salesperson; Morgan Moon, a fifty-five-year-old friend of Evelyn's father who has much money to invest from a successful garbage disposal business; and Cory Daltrey, a twenty-six-year-old who inherited several million dollars and wants to invest and learn about the world of business. The students are assigned to groups, and, within a group, each student is assigned to be counsel for one of the founders (the students may have to double up for some roles in some groups).

The first couple of weeks of the course are spent giving a quick overview of the different types of unincorporated entities, plus a class session on taxation. The first time we conducted the class this way, this introductory portion ended with a simulation in which half of the students played lawyers and the others played clients and the lawyers counseled the clients on choice of entity. I have since dropped that simulation for two reasons. First, in that first year, I had students alternating between lawyer and client roles, which caused confusion and coordination problems, so we have subsequently simply had all students acting as lawyers for one of the founders in each simulation. Second, students did not really understand the different entities in enough depth in the early weeks to do anything more than parrot a few points I had made in class. So, now, I instead have students write about choice of entity in their final essay, discussed below.

14. The two adjuncts are Chris Sandberg of Lockridge Grindal Nauen P.L.L.P and Jon Tynjala of DeWitt Mackall Crouse & Moore S.C. They have been wonderful, and I could not teach the course without them.

The next section of the course focuses on management and duty. With me, the students study statutes and cases concerning management and duty in partnerships, LPs, and LLCs; while, with the adjuncts, the students discuss what issues are likely to concern the founders, and they look at sample contract language which addresses those issues. At the end of this section, the students negotiate the management and duty provisions in one of the adjunct class sessions and then, as a group, turn in an agreement for those provisions. They also turn in individual essays analyzing the results from the point of view of both the business and their client and reflecting upon how using Minnesota's LLC statute may have affected the agreement as compared with using statutes for a different state or type of entity.

The next section of the course is on financial rights. It proceeds similarly to the previous section, except that in the adjunct sessions the students both prepare for the financial rights negotiation and also review the results of the previous negotiation and draft. This culminates in a second exercise where the students negotiate and draft financial rights provisions, along with individual essays analyzing those provisions. The following section proceeds similarly for the provisions on transfer and dissolution. At the end of the course, we review what we have done, discuss the miscellaneous provisions of an agreement, and then the students negotiate and draft an entire agreement which revises the earlier sections and adds in the miscellaneous provisions. The final individual essays are longer, acting as a take-home final examination, and review the entire negotiations and agreements and reflect upon the choice of entities, considering both the point of view of the Minnesota Nicebook founders as well as social policy.

The first time I ran the course this way it was far from a complete success, and in the subsequent paragraphs, I will discuss the main problems we faced and how I have addressed them. However, right away, the course did, at least partially, succeed in meeting some of the objectives. The students clearly appreciated having a chance to learn the practical skills of negotiating and drafting agreements, and they liked interacting with the adjuncts and hearing the perspectives of skilled practicing lawyers.¹⁵ They also learned something about working in teams, an important practical skill that we do not teach well in law school.¹⁶

15. The importance of an increased focus on skills training, preparation for practice, and interaction with legal practitioners in legal education has been receiving much attention in recent years. The most influential study is WILLIAM M. SULLIVAN ET AL., *EDUCATING LAWYERS: PREPARATION FOR THE PROFESSION OF LAW* (2007).

16. John Coates et al., *What Courses Should Law Students Take? Harvard's Largest Employers Weigh In*, 64 J. LEGAL EDUC. (forthcoming 2014) (manuscript at 1, 6, 7), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2397317.

So, right away, the course was clearly better at exposing students to important practical skills than the previous version of the course (or the average law school course) but that was not my primary reason for teaching the course this way. My primary reason was to help students understand how business association law works and what it is trying to achieve. Did the course succeed in doing that?

In many ways, I think the answer is yes. Indeed, I myself learned a good deal in the process. But, in the first year there were some obstacles that made it less successful than I had hoped. One problem was that students felt there was not a close enough tie between what I was doing in my sessions and what they were doing in the adjunct sessions and simulations. In that first year, I basically taught my sessions not too differently from how I had taught before, just moving more quickly and cutting some material because of time lost to the adjunct sessions, and in hindsight, it is clear that it was not the best way to proceed. I now try to spend more time talking about both the simulation and the sample agreements that we make available to the students, so that I am explicitly making connections between the statutes and the agreements. This means spending less time on cases each year I teach the course, which involves some loss, but I think much more is gained than lost.

Related to this problem, much of the casebook material focuses on partnership law. Indeed, in the older edition,¹⁷ about the first three-fifths of the book is on partnership law.¹⁸ The material on LLCs covers only about one-fifth of the book.¹⁹ However, the simulation is based on an LLC, and for the negotiation and drafting exercises, the students use Minnesota's LLC law. I have had to work at making students see the connection between the partnership and LP material and the LLC law they were actually using.

In part, I have done this by modifying the individual essays so that a significant portion of them are focused on comparing different types of entities and speculating upon how the agreement would or would not differ, depending upon the entity used. Additionally, I have drawn connections by noting that each type of entity law is aimed at similar problems and comparing and contrasting how the laws handle those problems. I try to help the students see each statutory provision and case as offering a somewhat different model for dealing with the organizational problems under consideration in that part of the course.

The reader is perhaps thinking that there is another obvious way in which I should be connecting the LLC material to the partnership material: since LLC

17. The older edition is the only one I have yet taught from as of this writing. The new edition of the casebook I use presents the material in the same functional order in which I teach it. LARRY E. RIBSTEIN ET AL., UNINCORPORATED BUSINESS ENTITIES (5th ed. 2013).

18. RIBSTEIN & LIPSHAW, *supra* note 11, at 67–308.

19. *Id.* at 411–513.

law draws so heavily on partnership law, much partnership law and the way in which it is used and interpreted is of clear and direct relevance to understanding LLC law. Ah, but the reader thinking this is presumably unfamiliar with Minnesota's old LLC statute. That statute²⁰ was quite unusual, in that it drew extremely heavily upon the Minnesota Business Corporation Act.²¹ For many provisions, one could simply change "shareholder" to "member," "director" to "governor," and "officer" to "manager," and voila, one would have the LLC statutory provision. Partnership law provisions were, thus, much less directly relevant to understanding the Minnesota LLC statute. Yet I felt compelled to use the Minnesota statute, both because most of my students will go on to practice in Minnesota and because my adjuncts practice there and are most familiar with that law (and their forms assume that law).²²

As I prepare to teach this fall, the situation has changed. Minnesota will be moving to the Revised Uniform LLC Act as of August 2015²³ and that is what I will teach starting immediately. Thus, I will now be able to draw a much closer tie between the LLC statute the students will use and the partnership acts they learn about in the course. There will be some transitional issues, as the adjuncts become familiar with the new statute and work to develop appropriate forms. Of course, lawyers across Minnesota will be facing those same issues in their practices, so my students will be ahead of the curve going forward.

One further point concerning the new Minnesota LLC Act is worth noting, both pedagogically and as a point about entity law. The new statute is essentially the Revised Uniform LLC Act, but there is one major deviation that mainly affects management structure.²⁴ Minnesota's LLC Act, like the Uniform Act, has two statutory management structures: member-managed and manager-managed.²⁵ However, Minnesota's Act adds a third alternative: board-managed,²⁶ obviously reflecting the tradition of corporate-based LLCs from the old statute.²⁷

I find this innovation potentially quite useful and that is, in part, based on my observation of my students' simulations. Even for small start-ups, the board structure, although a bit more complicated and formalistic, is potentially quite useful. In the Minnesota Nicebook simulation, the board structure allows

20. MINN. STAT. § 322B (2013).

21. *Compare*, MINN. STAT. § 322B (2013), *with* MINN. STAT. § 302A (2014).

22. This explains why the agreement our students drafted was called a member control agreement rather than an operating agreement. *See supra* note 1. They are called member control agreements in Minnesota. As someone who practiced in California and who taught only the Uniform Acts and Delaware law until I shifted to this new structure, it took some getting used to.

23. MINN. STAT. § 322C (2014).

24. *See id.* § 322C.0407.4.

25. *Id.* §§ 322C.0407.2–3.

26. *Id.* § 322C.0407.4.

27. *See supra* notes 20–21 and accompanying text.

the two money providers to have some close oversight and control without being involved in day-to-day management.²⁸ Last year, our students were happy with the board structure, although we did push them in that direction because it is much easier to stay within the statutory structure. Although the old Minnesota LLC Act allows a company to be member-managed or manager-managed with no board,²⁹ many of the statutory default provisions then become useless, and one needs to be careful about how some provisions, which assume a board structure, will apply in the absence of one. It will be interesting to see how future students choose, given a statutory structure that provides for all three alternatives within the statute itself.

One concern I had in moving to the focus on negotiating and drafting was the grading process. I have been happy with that aspect of the experiment. I brought in the two adjuncts, in part, to help with the evaluation, since my own practical experience was limited. Students in the class are now evaluated on a number of dimensions in many contexts:³⁰

- four individual essays analyzing the simulations and law;
- four negotiations in which they are graded individually, but obviously must interact with fellow students;
- four group drafting exercises; and
- in-class participation.

Students vary in their strengths and weaknesses and the variety of forms of evaluation gives almost every student a chance to excel in some element of the course, as long as they work at it (most do). From my perspective, I feel I have a much richer and deeper appreciation for the strengths and weaknesses of each student than I achieve in courses with just an end of the semester final exam. It is a lot of work, but not overwhelmingly so, especially since the adjuncts help. However, the course has, so far, had enrollment near the seminar level—it might be hard to scale up to a much larger number of students.

Thus, as I enter the third year of teaching Unincorporated Business Associations through a semester-long series of simulations, I am mostly happy with the experience. The first year took a great deal of preparation, and I made a number of major adjustments the second year. The third time around, I am

28. Note that some have questioned why venture capitalists seem reluctant to fund firms that are not incorporated. My experience in the simulation suggests to me that the board structure may make a good deal of sense for their business model. A gap in most states, despite the proliferation of entity forms, is that the only form which provides default rules for a board structure is the corporation, which remains tax disadvantaged, as S corporation status involves a number of significant limitations. The Minnesota LLC Act will address that situation for Minnesota businesses.

29. MINN. STAT. § 322B.37(1) (2014).

30. Which reflects educational best practice better than the standard law school one exam model. *See, e.g.*, ROY STUCKEY ET AL., BEST PRACTICES FOR LEGAL EDUCATION 90 (2007).

doing much less tinkering and seem to have reached a workable equilibrium.³¹ The students are learning practical skills in negotiation and drafting. They are getting experience working in teams. They are being evaluated in a wide range of ways. Most importantly, they are getting a deeper understanding of the goals and a lived-experience of the law of business associations.

All of which is not to deny that problems remain, which may even prove fatal to the course. So far, too many students who take the 1L Corporations course have not gone on to take the Unincorporated Business Associations course, leaving those students without any exposure to unincorporated entities.³² In part, that was because I did not push hard for enrollment in this class in the first two experimental years, and then, this year, I foolishly missed a scheduling conflict that pitted this class against the Accounting and Finance for Lawyers class, which I believe is perhaps the most critical course for business law students to take after Corporations.³³ A serious threat to the course comes from the possibility that we are now considering eliminating the 1L elective slot, which would thus remove the Corporations course that is the intended lead-in for Unincorporated Business Associations. Should that happen, we may decide to retain the unincorporated entities class (with BA/Corps as a prerequisite), as a way for future transactional lawyers to get more familiar with those entities than they can become in the BA/Corps class and as a way to provide transactional training.³⁴ But, the target audience for the class would then be smaller, and we will see what teaching resources allow us to do under those circumstances.

I do hope the course continues despite those issues. Business associations, other than corporations, are an important and growing part of modern legal practice.³⁵ Understanding these types of entities and the law that enables them requires understanding the business contexts in which they arrive and the agreements which create and structure individual businesses. The heavily contractual nature of unincorporated business entities makes a course in this area a natural place to combine learning doctrine, policy, and transactional skills. It takes a good deal of work to put such a course together, but once it is up and running, it is quite manageable, rewarding, and even kind of fun. I guarantee you, if I can do it, then so can any other remotely qualified person teaching in this area.

31. Each time I have taught this course, I have engaged in extensive review of how it has worked through discussion with the students, the adjuncts, and self-reflection.

32. Which was the point of creating the course in the first place. *See supra* notes 8–10 and accompanying text.

33. *See* Coates et al., *supra* note 16 (manuscript at 3).

34. As I understand matters, the course should fulfill the new ABA experiential course requirement, so that may create an ongoing demand for the class.

35. *See supra* note 7 and accompanying text.

