

## Essential Elements for Operating Agreements of Limited Liability Companies

The limited liability company (“LLC”) is quickly becoming the business organization of choice for many small business owners. The growing popularity of LLCs is the result of its simplicity and flexibility. Limited liability companies are separate legal entities like corporations but are treated as pass-through entities for tax purposes provided they have not elected to be treated as taxable entities. The members are protected from personal liability for the company’s debts, and profits and losses are passed directly through to the members. The LLC does not pay income taxes itself.

An essential element to the efficient operation and governance of an LLC is the operating agreement. A Florida LLC can be organized without a written operating agreement. However, if there is no written operating agreement, the provisions of the Florida Statutes govern the relationship of the members and the operation of the LLC, and many of the statutory default rules leave open important issues.

An operating agreement should provide sufficient detail to serve as a road map for the members with respect to LLC governance and operation. This is all the more important since LLCs are a relatively new form of entity in Florida and the parties involved and the public at large likely have very little experience in dealing with them. The initial drafting of the operating agreement is very important because a well-drafted agreement will reduce the potential for disputes between the LLC members and managers in the future.

Every LLC operating agreement should address these essential elements:

1. Contributions of the members — Many statutory rights of the members are based on the value of their capital contributions, so it is vitally important that this information is recorded in the operating agreement. If contributions will be in a form other than cash (such as services), it is important that the members explain the form and value of such non-cash capital contributions.
2. Transferability of membership interests — The operating agreement should describe the restrictions on the transferability of membership interests and explain the rules governing transfers.
3. Withdrawal rights — If the members want a right to withdraw from the LLC, the terms and conditions governing withdrawal must be addressed in the operating agreement.
4. Death, bankruptcy or divorce of a member — It is important that the members specify what will happen to their membership interests in the event of a death, bankruptcy or divorce of a member. Otherwise, there may be a number of undesirable possible outcomes. For example, an heir of a deceased member, a divorced member’s ex-wife, or a creditor of a member may become a member of the LLC.
5. Allocation of profits, losses and distributions — It is often desirable to allocate profits, losses and distributions in a manner other than based on the value of the capital contributions of each member. By addressing these issues in the operating agreement, the members can ensure fair allocations to the members.

6. Management — It is important to indicate whether the LLC will be managed by its members or by elected managers. If managers are elected, the operating agreement should specify which actions managers may take on behalf of the LLC (such as day-today business activities) and which actions require the approval of the members (such as material financing or business acquisition transactions).

7. Indemnification — The operating agreement should outline the terms and conditions regarding indemnification by the LLC of the members and managers.

8. Confidentiality — The operating agreement should address restrictions on a member's rights to use or disclose the LLC's confidential information.

9. Covenants not to compete — The operating agreement should address any restrictions on a member's right to compete with the LLC's business or pursue opportunities that should first be made available to the LLC.

For a discussion of these and other items, you should consult with an attorney knowledgeable in the area of corporate entities and business law.