



Bailey Cavalieri LLC
ATTORNEYS AT LAW

CLIENT ALERT

About the Author:



Adam J. Biehl is an attorney with Bailey Cavalieri LLC, where he focuses his practice in Corporate and Business, Bankruptcy, Creditors' Rights, and Commercial Lending.

He can be reached at 614/229-3214, or at adam.biehl@baileycavalieri.com

Bailey Cavalieri LLC
One Columbus
10 West Broad Street, Suite 2100
Columbus, Ohio 43215-3422
phone - 614/221-3155
facsimile - 614/221-0479

Kettering Tower
40 North Main Street, Suite 2310
Dayton, Ohio 45423-0001
phone - 937/223-4701
facsimile - 937/223-0170

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 the LLC is the result of its simplicity and flexibility. LLCs are separate legal entities like corporations. The owners, called "members," are protected from personal liability for the company's debts. Unlike corporations, LLCs are treated for tax purposes as pass-through entities, like partnerships or sole proprietorships, unless the LLC makes an election with the IRS to be treated as a taxable entity. The LLC does not pay income taxes itself; profits and losses are allocated to the members.

An essential element to the efficient operation and governance of an LLC is the operating agreement. An Ohio LLC can be organized without a written operating agreement. However, if there is no written operating agreement, the provisions of Chapter 1705 of the Ohio Revised Code 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 Ohio and the courts, 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 among the LLC members and managers in the future.

Every LLC operating agreement should address these essential elements:

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.

Transferability of membership interests -

The operating agreement should describe the restrictions on the transferability of membership interests and explain the rules governing transfers.

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.

Death, bankruptcy or divorce of a member

- It is important that the members address what happens to their membership interests in the event of a death, bankruptcy or divorce of a member. Otherwise, there are a number of undesirable possible outcomes, such as an heir of a deceased member, a divorced member's ex-wife, or a creditor of a member becoming a member of the LLC.

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.

Management -

It is prudent to vest day-to-day authority in managers and permit only members who are also managers to bind the company. It may also be advisable to appoint "officers" given the unfamiliarity with LLC governance concepts among the parties and the public at large.

Indemnification -

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

Confidentiality -

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

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.

Adam J. Biehl

(614) 229-3214

Adam.Biehl@BaileyCavalieri.com

For more information on Bailey Cavalieri LLC, visit us on the Web: www.BaileyCavalieri.com

This Client Alert is published as a service to our clients and friends. It should be viewed only as a summary of the law and not as a substitute for legal consultation in a particular case. Please contact legal counsel to discuss your specific situation.