

THE VITAL ELEMENTS OF A LIMITED LIABILITY COMPANY

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All Limited Liability Companies should have an operating agreement which details the rights of its members. This operating agreement becomes critical for the one member L.L.C. when new members are added.

A Limited Liability Company is formed by the filing of Articles of Organization with the Secretary of State. These Articles of Organization are generally "bare bones" documents. It is vital to have an operating agreement detailing the rights of its members because these rights are not as well understood or defined in Louisiana laws as are the rights of the shareholders in a corporation.

In order to understand why the lack of an operating agreement can become a troublesome situation, I will discuss what an Operating Agreement does. First, let's look at two married women who own a frame shop that is an L.L.C. The operating agreement will address in detail the business relationship between the women (called members) and their company concerning the conduct of business and the affairs of the company. It will specify the management and operation of business.

The operating agreement will name the managing member or members and set out their authority and limitations. It will provide for the vindication (free from blame or fault) and the indemnification of its managing members and members from all losses, liability, and damage, absent gross negligence, fraud or criminal acts of the managing members or members. It will detail whether or not there can be business transactions between the managing members and the L.L.C. and if the managing members can conduct other business activities outside the L.L.C.

The operating agreement will address the capital contribution of each member, which means "anything of value" contributed by the members to the limited liability company which is a requirement for membership in an L.L.C. The contribution can be cash, property, service rendered, a promissory note or a binding obligation to contribute cash or services. These contributions must be made when demanded by the managing member.

The operating agreement will, additionally, spell out the rights and obligations of the members, which are similar to those of the managing members. It will generally provide that the personal liability of its members cannot exceed the value of the contribution made by the members for their ownership interest in the L.L.C.

The operating agreement will specify what books, records, and accounting are to be maintained, their location and their availability. These matters will be handled by the managing members of the L.L.C. It will spell out the issue of profit, losses, and distributions from the L.L.C. and its allocation among its members.

The properly written operating agreement provides a way for smooth transitions during times of change. The agreement will address the transfer of interests in the L.L.C. and the admission of new members. This means if one of the women wants out of the L.L.C., the

operating agreement identifies how she can dispose of her interest through a sale, assignment, gift, or transfer. Likewise, if a member dies, goes bankrupt or is declared incompetent by the courts, the operating agreement will determine how her interest will be handled.

Since Louisiana is a community property state, both husbands of our frame shop owners will intervene and agree to be bound by the terms of the operating agreement. This means that if one member gets divorced or dies, the ex-husband or surviving husband is obligated to transfer his community property interest to the other member of the L.L.C., unless the other member decides to let him become a member of the L.L.C. You can see how this provision protects members of the L.L.C. from spouses who may be difficult to deal with in the stressful situations of death and divorce. This provision helps with a smooth transition to maintain business continuity and success.

The operating agreement will address the resignation or withdrawal of a managing member as well as the removal of a managing member by its members. It also will determine what constitutes a dissolution (dissolving of the L.L.C.) and its liquidation (selling of the assets) of the L.L.C. and the distribution of the proceeds from the liquidation and the priority of payments and to whom.

Without an operating agreement, many issues can arise which may cause huge problems for the members of a L.L.C. However, with a carefully drafted operating agreement, these difficulties can be avoided because the members have agreed to the procedures and solutions to important issues in advance of the situations.

In conclusion, the Articles of Organization are the bones of the entity and the Operating Agreement is the meat of the L.L.C.

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