



# Limited Liability Company Operating Agreement Creation Guide

## Ganje Law Office

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**David L. Ganje** is founder of the Ganje Law Office, which has earned a reputation for quality in the areas of Business and Corporate law as well as Commercial law. In this capacity, the Ganje Law Office has extensive experience in drafting operating agreements for LLC's and other business entities. Mr. Ganje has been named an Upstate New York Super Lawyer for 2007, 2008, 2009, and 2010 and is a member of the Capital Area Technology Association and the Business Law Section of the New York State Bar Association.

Operating Agreements are unique in that, with very few restrictions from the outside world, the members of a business can determine exactly how their business should be run. This provides management with liberal powers to frame operations going forward, but also has the potential to bind and restrict the business if certain considerations taken into account by the drafter of the agreement. Every operations agreement should include:

**Definitions and Introductory Clauses-** These generally provide basic information about the persons or entities forming the business and, what the purpose and objectives of the business are going forward. Also, these statements may introduce a new member into the business or refer to a prior agreement between the parties to the new operating agreement.

**Membership structure-** Depending on the nature and type of business entity, what is included here will vary. In an LLC this section should discuss the identity of members and their respective interests in the company. For an LLC the percentage of ownership held by each member should be listed.

**Duration and Purpose-** This section should provide the reasons for which the business is being formed. In many states all that is required is some legal objective, and many businesses will include no other purpose than a simple statement saying that the business is being formed for a lawful business activity. Corporations may last into perpetuity, but the operating agreement may provide for a fixed date or event which will cause the ending of the businesses operations. On the other hand, LLC's are as mortal as their members and this section of the operating agreement may be an area where the members of a business, particularly a close corporation, LLC, or small partnership, can plan for the death of a member and its consequences.

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**Capital Contributions, Capital Accounts, and Distributions** - Every operating agreement should list the contributions of cash and property to the business, as well as provisions for the allowance of additional capital contributions to the business. In addition, there should be provisions detailing when and under what circumstances distributions, capital withdrawals or draws on capital accounts may be made. Capital account maintenance rules will consider the effect that profits, losses, and contributions will have on the interests of the parties. The parties must also consider who bears the burden of loss if the business fails.

**Tax Considerations** Good capital account maintenance rules almost always comply with § 704 of the Internal Revenue Code and its voluminous associated treasury regulations. “Special allocations” may allow one member a greater amount of tax deductions than another, but this is a particularly thorny issue and must be discussed with a skilled tax or business law attorney. An artfully crafted partnership or LLC operating agreement can have tremendous individual tax advantages to the members of the business. The business may also consider using a fiscal year, which is very important for businesses with strong seasonal upswings.

**Dissolution and Withdrawal**- While most entrepreneurs like to focus on planning for expanding a business, it is critically important to plan for the ending of the business. Certain events may trigger dissolution or withdrawal as agreed upon by the parties. The agreement should also plan for voluntary withdrawal and rights of first refusal in the events of a withdrawal. As alluded to earlier, the planning for a member’s death is critically important. If careful planning is not done, a business may cease to exist after the death of a member, or the deceased member’s family may be uncertain as to their financial stake in the business. Generally in dissolution external creditors are paid off first, then internal creditors next, with individual members taking the residuary in accordance with their interest. The operating agreement may solidify certain members’ rights to take capital assets in dissolution before others, or plan for individual members to receive specific articles of property. The operating agreement should also plan with specificity the accounting procedures utilized in the event of dissolution.

**Management**- The operating agreement should name the initial officers or managers of the new business while identifying procedures for determining management in the future. This simple concept can be made more structured by including terms for cumulative voting, quorums, committees, and appointments. The agreement should also contemplate removal of officers or managers and specify (or leave open ended) the powers, duties and responsibilities of managers and officers. The parties may also chose to abrogate, to an extent, certain notions of fiduciary duty between members. All managers should take steps to indemnify themselves.

**Books and Records**- Annual meetings and procedures for taking minutes should be incorporated to maintain the legitimacy of the limited liability nature of the entity. The Courts will set aside the limited liability protections of an LLC if, (1) business formalities are not adhered to, (2) the LLC is merely acting as the “alter-ego” of an individual in control of business, or (3) the business is severely undercapitalized (though for undercapitalization *alone* is generally not enough for New York Courts to dispose of the limited liability shield). Complete and accurate records should also be maintained for the same reason, and also as a matter of good business practices.

**General Provisions**- The agreements should include a merger clause, stating that the written operating agreement is the only document or agreement which governs the running of the business and that it supersedes all prior or contemporaneous agreements. The agreement should state the governing law and forum for legal action if a dispute arises. The agreement should contemplate the assignability and transferability of rights and obligations created under the agreement. Finally the agreement should provide for what types of notices need to be given on the occurrence of certain events and must include a clause allowing for later amendment of the agreement.