LLC Agreement (Operating Company)

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A long-form US LLC agreement to be used for an operating company in connection with a joint-venture transaction. This Standard Document assumes an agreement between two members, one of which is the managing member of the LLC. This Standard Document includes integrated notes with important explanations and drafting and negotiating tips.

DRAFTING NOTE: READ THIS BEFORE USING DOCUMENT

A limited liability company operating agreement (LLC agreement) is an agreement among the members of a limited liability company (LLC) that governs the operation of the LLC, including the members' contractual rights, obligations and restrictions relating to their membership interests in the LLC. An LLC agreement, together with the certificate of formation, are the basic documents entered into when forming an LLC (see Practice Note, Forming and Organizing an LLC (DE) (W-003-1342) and Forming an LLC Checklist (2-381-1369)).

The principal advantages of forming an LLC, as opposed to a different form of business entity, and entering into an LLC agreement include:

- The flexibility to describe the entire relationship of the parties, including the economics of the venture and any fiduciary duties, by contract, without being governed by a mandatory statutory scheme. Unlike state corporation statutes, most state LLC statutes (including Delaware's) primarily contain default provisions that can be altered by agreement among the members (with some mandatory provisions that cannot be altered).
- The benefit of the same limited liability as is available to a corporation's

stockholders. Unlike the partners in a partnership, the members of an LLC are generally not personally liable for the liabilities of the LLC.

- For US tax purposes, the opportunity to be treated as a partnership, or pass-through entity, which avoids taxation at the entity level and passes the LLC's profits and losses through to the members. Noncorporate members may also be eligible for a 20% deduction for US qualified business income earned through the LLC (IRC § 199A). However, the relative inefficiency of operating in corporate form is somewhat reduced by the 21% US federal corporate income tax rate that applies beginning in 2018. For a discussion of the US federal income tax rules that apply to US entities taxed as partnerships, see Practice Note, Taxation of Partnerships (W-000-6885).

For a more detailed discussion of the advantages of LLCs and LLC agreements, see:

- Practice Note, LLC Agreement Commentary (1-381-0515).
- Practice Note, Choice of Entity: Tax Issues (1-382-9949).
- Choosing an Entity Comparison Chart (7-381-0701).

Because of the advantages listed above (especially the flexibility afforded by the LLC structure), LLCs have become an increasingly popular vehicle for joint venture transactions carried out through a separate entity. This Standard Document is an LLC agreement for use with a joint venture formed to pursue a specific business. For more information on joint ventures and their formation, see:

- Practice Note, Joint Ventures: Overview (0-380-9579).
- Forming a Joint Venture Checklist (7-501-0646).
- Drafting a Joint Venture Agreement Checklist (5-501-0647).

ASSUMPTIONS USED IN THIS DOCUMENT

LLC agreements, especially those for joint-venture transactions, can vary widely depending on the transaction's legal, business, and tax considerations. For joint-venture transactions, business considerations play a large role in how the agreement is structured. While this Standard Document includes many of the provisions typically found in an LLC agreement, it is based on several assumptions. Parties should tailor the LLC agreement to the specific facts of the transaction.

This Standard Document assumes that:

- **The LLC has been formed in Delaware.** This Standard Document is based on Delaware law, including the Delaware Limited Liability Company Act (the Delaware Act) (6 Del. C. §§ 18-101 to 18-1109). This is an important assumption, not only for use of correct terminology, but for substantive issues like the permissibility of limiting the fiduciary duties of members or managers of an LLC. It is therefore important to become familiar with relevant statutory and case law before drafting the LLC agreement and, if necessary, to engage local counsel. This Standard Document is based on Delaware law for the following principal reasons:
  - The Delaware Act has a strong influence on the LLC statutes in other jurisdictions;
  - Delaware has the most developed and most rapidly developing common law regime governing LLCs;
  - Delaware statutory and common law provides for the greatest freedom of contract; and
  - LLCs for large, complex transactions are often formed in Delaware.
- **There are only two members, consisting of a majority and minority member.** This Standard Document assumes there is:
  - a majority member that will be contributing a larger percentage of capital in exchange for a larger interest in the LLC; and
  - a minority member that will be contributing less in terms of cash or assets but that will have the expertise in the industry and will be the sole managing member of the LLC.
- Because of this management structure, this Standard Document includes

many of the provisions you would find in a 50/50 ownership structure and does not contain other provisions often included to protect minority members. Certain changes should be made if there will be more than two members or if the transaction contemplates a different ownership structure. For example, based on the facts that there are only two members and approval from both is required for the issuance of additional membership interests (see Section 7.02(c)), this Standard Document does not contain pre-emptive rights. When there are more than two members and only majority consent is required for the issuance of additional membership interests, minority members generally want pre-emptive rights so that they do not get diluted when the majority votes to issue additional membership interests. If there are plans to have additional members in the future, the parties may want to consider including pre-emptive rights to protect minority interests. For an example of a pre-emptive rights clause, see Standard Clause, LLC Agreement: Pre-emptive Rights (5-383-8838). For further discussion about minority protections in joint ventures, see Practice Note, Minority Protection in US Joint Ventures (7-501-4611).

- **The members are domestic, privately held companies.** If any of the members are individuals, the transfer restrictions in the LLC agreement should be revised to allow transfers to family members (see Drafting Note, Permitted Transfers ()). If any of the members are incorporated outside the US, local counsel should be consulted regarding applicable foreign laws, including to determine whether foreign legal requirements should be reflected in the LLC agreement. If any of the members are public companies and the agreement is material to the public company member, the members should consider how the publicly traded company's reporting obligations under the Securities Exchange Act of 1934, as amended (Exchange Act) might be relevant, including regarding any of the LLC's confidential information disclosed to the public company member. For an explanation of the types of material agreements that a public company member must file with the Securities and Exchange Commission (SEC), see Practice Note, Form 8-K: Entry into a Material Definitive Agreement (9-381-0960). Other provisions not included in this Standard Document may also be appropriate if the members are public companies or affiliates of public companies. For example, the members may want to consider adding a standstill agreement in which the members agree to certain limitations on purchasing the public company's stock. For additional information about standstill agreements, see Practice Note, Standstill Agreements in Public M&A Deals (2-532-4753).
- **The LLC is managed by one managing member.** This is a common structure in joint ventures where one party with operating expertise brings in an investor to provide much of the capital for the project or venture. In this scenario:
  - the member with operating expertise acts as the managing member; and
  - the other member (often the majority member) takes a more passive management role, reserving veto rights over major decisions.
- In this Standard Document, the scope of major decisions requiring the consent of the non-managing member is greater than it would be if there were more members and if the non-managing member was not the majority member and had less negotiating leverage. Other common management structures include management by all of the members (more common when there are few members) or by a board of managers (who may or may not be members of the LLC). For an example of provisions providing for board management of an LLC, see Standard Document, LLC Agreement (Multi-member, Manager-managed): Article VIII (3-500-9206).
- **There is only one class of membership interests.** Many operating-company LLCs (especially two-party joint ventures) do not designate different classes of membership interests. Instead they define the rights of the parties on the basis of their respective percentage ownership interests in the LLC (and

explicitly describe any special voting or other rights in the agreement). By contrast, LLCs with many members, especially those with passive investors who have different economic and other rights, often designate various classes of membership interests. Different classes (with differing rights) may be given depending on when the investors came into the LLC (for example, if they were early investors versus late-stage investors) and the amount of the investment (significant investors may be given more voting rights than smaller investors). An LLC may also have different classes of membership interests for employee compensation. For an example of an LLC agreement that provides for multiple classes of membership interests, see Standard Document, LLC Agreement (Multi-member, Manager-managed) (3-500-9206).

- In this LLC Agreement, the term "units" is not used to describe a member's interest in the LLC because there is only one class of membership interests. While most state LLC statutes do not contain a concept of units, parties often use this concept in LLC agreements because it is analogous to the stock of a corporation. It can be helpful to use this concept when there are (or may in the future be) multiple classes of membership interests. However, when there are only a few members and one class of membership interests, it is common to just use the term "membership interest," which is usually expressed as a percentage interest, to describe a member's interest in the LLC.
- **The LLC has no subsidiaries.** If the LLC has subsidiaries, the LLC agreement should be revised to make the subsidiaries subject to the same rights and obligations as the LLC and to give the members the same rights and obligations with respect to the subsidiaries as they have with the LLC.
- **The transaction does not raise any antitrust concerns, including triggering any filing requirements under the** Hart-Scott-Rodino Antitrust Improvements Act of 1976 **(HSR Act) or foreign antitrust laws**. While most joint ventures tend to promote competition, they also have the potential to stifle competition, which can raise antitrust concerns, especially in joint ventures between competitors. Because of this risk, joint ventures that meet certain thresholds must file premerger notification forms with the Federal Trade Commission (FTC) and the Antitrust Division of the Department of Justice (DOJ). They must also wait a specified period before the joint venture can be formed (for more information on the HSR Act requirements, see Practice Notes, Hart-Scott-Rodino Act: Overview (9-383-6234) and Determining Hart-Scott-Rodino Applicability (9-516-9560)).
- In addition to HSR requirements, joint ventures can potentially violate other federal, state, or foreign antitrust laws. For example, if the parties or their affiliates are competitors, they must be careful when drafting the information-sharing provisions in the LLC agreement because there are rules that prohibit certain information from being shared among competitors (for additional information about antitrust risks of information exchanges with competitors, see Practice Note, Information Exchanges Among Competitors (Non-Merger) (W-001-0174)). For more information on antitrust issues raised by JVs, see Practice Note, Joint Ventures: Overview: Antitrust Issues Raised by Joint Ventures (0-380-9579) and Joint Venture Antitrust Compliance Checklist (2-570-5125). For more information on competitor collaborations and exchange of information in due diligence, see Practice Notes, Competitor Collaborations in the US (0-202-2806) and Information Exchange and Integration Planning in M&A: Antitrust (5-383-7853). If the parties or their affiliates are competitors, consult with antitrust counsel (including foreign antitrust counsel, if necessary) as early in the process as possible because the consequences of failing to comply with the antitrust laws can be severe.
- **The LLC is not formed to hold the control investment of a private equity sponsor.** If the majority investor is a private equity investor (commonly known as the sponsor), it often has a

tremendous amount of control over the LLC, especially if the other members are employees or members of management (as is often the case in a buyout). LLC agreements with sponsors do not typically include strong minority protections, such as supermajority voting rights or provisions commonly found in 50/50 ownership structures such as deadlock provisions. If the LLC agreement is meant for use by a sponsor, a co-investment vehicle or a management member in a buyout or other similar transaction, see Standard Document, LLC Agreement (Multi-member, Manager-managed) (3-500-9206).

Other assumptions related to specific sections of the LLC agreement are discussed in the relevant drafting notes.

TAX CONSIDERATIONS

LLC agreements require significant input from tax counsel. The allocations section in particular is mostly driven by tax issues and compliance with various Treasury regulations. The capital accounts and distributions sections also require thorough review by tax counsel.

When discussing certain tax-related provisions, the drafting notes in this Standard Document sometimes refer to the LLC as a "partnership" when describing the relevant tax issues. This is done for the sake of accuracy when explaining how the Internal Revenue Code (Code) and the Internal Revenue Service (IRS) may view certain provisions in the agreement, because LLCs are generally treated as partnerships for tax purposes. As an organizational matter, the company is an LLC, not a partnership.

BRACKETED ITEMS

Bracketed text in ALL CAPS should be completed with information about the parties and the facts of the transaction. Bracketed items in sentence case are either optional provisions or include alternative language choices to be selected, added, or deleted at the drafter's discretion.

Section 3.02 Additional Capital Contributions.

DRAFTING NOTE: ADDITIONAL CAPITAL CONTRIBUTIONS

Operating companies and joint ventures often need additional capital contributions to fund their ongoing businesses. LLC agreements for operating companies and joint ventures therefore often contain provisions that require the members to fund additional capital contributions, which can be detailed and lengthy. These provisions also vary in terms of the level of detail and severity of the penalties for a failure to fund a required contribution. For further discussion on additional capital contribution provisions generally, see Practice Note, LLC Agreement Commentary: Additional Capital Contributions (1-381-0515).

This Standard Document requires the members to make additional capital contributions as requested by the managing member, but only to the extent contemplated in a budget approved by the members (see Section 7.06).

If the members do not want to require additional contributions, revise Section 3.02 as follows:

> "No Member shall be required to make any additional Capital Contributions to the Company. However, a Member may make additional Capital Contributions at any time with the written consent of the other Member. To the extent that a Member makes an additional Capital Contribution to the Company, the Managing Member shall revise **Schedule A** of the Agreement to reflect an increase

> in the Membership Interest of the contributing Member that fairly and equitably reflects the value of its additional Capital Contribution in relation to the aggregate amount of all Capital Contributions made by the Members."

If there are several members in the LLC, the members may prefer to only require the consent of a majority (or another specified percentage) of the other members for permission to make additional capital contributions.

(a) In addition to the Initial Capital Contributions of the Members, the Members shall make additional Capital Contributions in cash, in proportion to their respective Membership Interests, as determined by the Managing Member from time to time to be reasonably necessary to pay any operating, capital or other expenses relating to the Business (such additional Capital Contributions, the "**Additional Capital Contributions**"), *provided*, that such Additional Capital Contributions shall not exceed the corresponding amounts expressly provided for in the then-current Budget, as it may be amended from time to time in accordance with Section 7.06(b). Upon the Managing Member making such determination for Additional Capital Contributions, the Managing Member shall deliver to the Non-Managing Member a written notice of the Company's need for Additional Capital Contributions, which notice shall specify in reasonable detail (i) the purpose for such Additional Capital Contributions, (ii) the aggregate amount of such Additional Capital Contributions, (iii) each Member's share of such aggregate amount of Additional Capital Contributions based upon such Member's Membership Interest, and (iv) the date (which date shall not be less than [NUMBER] Business Days from the date that such notice is given) on which such Additional Capital Contributions shall be required to be made by the Members.

DRAFTING NOTE: DETERMINATION OF ADDITIONAL CAPITAL CONTRIBUTIONS

This Standard Document gives the managing member the power to determine the timing and amount of additional capital contributions, but it only permits the managing member to request amounts:

- That are expressly contemplated in the LLC's then-current budget.
- From all members pro rata in proportion to their membership interests.

Section 3.02(a) also requires additional capital contributions to be funded in cash. If the members want the ability to use noncash assets to fund additional capital contributions, the phrase "in cash" in the first sentence should be deleted, and counsel should add a sentence about how to value assets stating:

> "If the Additional Capital Contribution shall not be funded in cash, the amount of such Additional Capital Contribution shall be the Book Value of such assets."

If the members also want to give the managing member some discretion to request amounts exceeding the budget to cover unforeseen costs and expenses that are still necessary for the operation of the LLC, they should consider adding the following sentence after the first sentence to allow the managing member to request up to a certain amount above the budget:

> "Notwithstanding the foregoing, the Managing Member shall be authorized to require Additional Capital Contributions in an amount of up to [PERCENTAGE]% in excess of the corresponding amounts set forth in the then-current Budget, which amounts shall also constitute Additional Capital Contributions."

Alternatively, instead of giving the managing member the discretion to make capital calls within the limits set by the budget, the members may agree to specify a fixed schedule of additional capital contributions in the budget and not provide the managing member with any discretion to decide when and how much capital is needed. In that case, Section 3.02(a) should be replaced with:

> "In addition to the Initial Capital Contributions of the Members, the Members shall make additional Capital Contributions [in cash], in proportion to their respective Membership Interests, in such amounts and at such times as set forth in the Budget, as it may be amended from time to time in accordance with Section 7.06 (such additional Capital Contributions, the "**Additional Capital Contributions**")."

If the parties decide to go with a preapproved schedule, the notice requirement is not necessary.

Another alternative would be to give the managing member full discretion to determine the timing and amount of additional capital contributions. In this case, delete the proviso at the end of the first sentence in Section 3.02(a) and add the phrase "in its sole discretion" after the phrase "as determined by the Managing Member."

If the non-managing member does not want to give the managing member full discretion and there is no pre-approved budget or schedule of contributions, it can try to limit the managing member's ability to make capital calls by only permitting it to request additional contributions for emergency or unanticipated and nondiscretionary expenses (expenses the LLC must pay by law or contract).

Section 7.08 Other Activities; Business Opportunities.

(a) Nothing contained in this Agreement shall prevent any Member, including the Managing Member, or any of its Affiliates from engaging in any other activities or businesses, regardless of whether those activities or businesses are similar to or competitive with the Business. None of the Members nor any of their Affiliates shall be obligated to account to the Company or to the other Member for any profits or income earned or derived from other such activities or businesses. [Except as otherwise provided in Section 7.08(b),] [n/N]one of the Members nor any of their Affiliates shall be obligated to inform the Company or the other Member of any business opportunity of any type or description.

DRAFTING NOTE: OTHER ACTIVITIES

Section 7.08(a) permits each member, including the managing member, to engage in other businesses and activities, whether or not those businesses are competitive with the LLC. This approach limits any interference with the members' (typically much larger and more valuable) primary businesses while they develop the joint venture for a narrowly defined purpose (see Drafting Note, Purpose; Powers).

However, in some cases, especially when only one member is responsible for managing the LLC, the non-managing member may expect the managing member to devote all (or a substantial amount) of its time to operating the LLC. In that case, Section 7.08(a) should be revised to only apply to the non-managing member and the following clause should be added for the managing member:

> "The Managing Member must manage the Company as it sole and exclusive function, and it may not engage in any other activities or businesses in addition to those relating to the Company."

(b) [Notwithstanding Section 7.08(a), if a Member [or any [controlled] Affiliate of a Member] is offered or discovers a business opportunity of the type and character that is [within the scope of/consistent with] the Business (a "**Business Opportunity**"), such Member [or Affiliate] shall, prior to pursuing such Business Opportunity, offer to the Company the right to pursue such Business Opportunity for the benefit of the Company, regardless of whether such Member [or Affiliate] believes the Company would be able (financially or otherwise) or willing to pursue such Business Opportunity. If the Company, by unanimous consent of the Members, determines not to pursue such Business Opportunity within [NUMBER] days after its presentation to the Company, the presenting Member [or its Affiliate] shall be free to pursue such Business Opportunity as such Member [or Affiliate] shall determine in its sole discretion.]

DRAFTING NOTE: BUSINESS OPPORTUNITIES

Especially if the LLC's business overlaps with the business of one or more members or their affiliates (or might overlap in the future), the members need to clearly define their respective obligations in relation to business opportunities that fall within the scope of the LLC's business. Their approach on this issue may have considerable implications for the successful development of the LLC as well as the ability of the members or their affiliates to conduct their primary businesses outside of the joint venture. If the members want to be free to pursue business opportunities within the scope of the LLC's business without first informing the LLC or each other, delete the bracketed phrase in the second sentence of Section 7.08(a) and all of Section 7.08(b). However, these provisions should be included if the members want to require each member to present any business opportunity that is within the scope of the LLC's business to the LLC (with the member having the right to pursue opportunities that are turned down by the LLC).

Section 7.08(b) only provides the right of first refusal to the LLC. The members may want to consider whether they want to give the other member a right to participate in the business opportunity on the same terms as those offered to the LLC.

AFFILIATES

If Section 7.08(b) is included, the members should consider the extent to which it should apply to the members' affiliates. Depending on the organizational structure of the members, it may only be appropriate to extend the application to controlled (as opposed to controlling) affiliates.

If Section 7.08(b) applies to the members' affiliates (especially controlling affiliates), consider also whether they should sign the LLC agreement to confirm their agreement to comply and establish contractual privity.

NON-COMPETE AND OTHER RESTRICTIVE COVENANTS

In addition to placing limitations on business opportunities, the members can also consider restricting themselves from competing with the LLC and from soliciting the LLC's employees and customers. Non-compete and non-solicit covenants protect the LLC by ensuring that the members' interests are aligned and that neither one will be engaging in activities that may adversely affect the LLC's development of its business. This becomes particularly important when the members have businesses that are similar to the business being developed by the LLC. For an example of non-compete and non-solicit covenants, see Standard Document, LLC Agreement (Multi-member, Manager-managed): Section 11.02 (3-500-9206).

However, if the parties decide to include non-compete and non-solicit covenants, they should be careful about how these provisions are drafted to ensure they:

- Are enforceable.
- Do not adversely affect the members' ability to operate its other businesses.
- Do not violate any antitrust laws.

Enforceability

The enforceability of non-compete and non-solicit covenants is a matter of state law. Most states require these covenants to be reasonable in duration and scope (both in the territory and restricted activity covered) to be enforceable. In general, the restrictions must be limited to what is necessary to protect the goodwill and business of the LLC. However, state laws can vary so counsel must check applicable law to confirm the enforceability of these covenants (for information on specific state law requirements, see Non-compete Laws: State Q&A Tool).

Other Businesses

The members need to consider how the covenants affect their other business interests. In particular, the members should consider:

- **Scope.** If the covenants are too broad, they may restrict the members from operating their other businesses.
- **Future plans.** If a member has future expansion plans, it must ensure that the restrictive covenants do not limit those plans.

Antitrust Concerns

The parties should consult antitrust counsel to ensure the non-compete covenant does not violate any applicable antitrust laws. Even if the joint venture itself does not violate antitrust laws on account of its procompetitive benefits, further restraints on non-venture activities or participants themselves may violate antitrust laws. These types of restraints are generally analyzed under the so-called "ancillary restraint doctrine." Under that doctrine, courts and agencies must determine "whether the non-venture restriction is a naked restraint on trade, and thus, invalid, or one that is ancillary to the legitimate and competitive purposes of the business association, and thus valid" (see *Texaco v. Dagher, 547 U.S. 1 (2006)*). For further discussion about antitrust issues raised by non-compete provisions, see Practice Note, Competitor Collaborations in the US: The Ancillary Restraint Doctrine: Testing Restrictions on Venture or Parent Operations (0-202-2806).

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