

Ask SCORE for Business Advice

**“Ask SCORE” Column
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LLCs also need an operating agreement by Tina Dettman-Bielefeldt

At SCORE counseling sessions, clients often ask about the protection offered by forming an LLC. There is the misconception that once they've formed the LLC, they're ready to set up shop. "Not so fast," say three Green Bay SCORE counselors.

Jon Olson, a local attorney, KaraLynne Moore, a commercial lender and Mary Guldán-Lindstrom, a CPA, say that too many entrepreneurs think the LLC is all they need for protection. The need for an operating agreement is often ignored.

"An operating agreement is the rulebook for running the limited liability company," explained Olson. "It contains the agreements of the members as to the operation of the company, and can spell out issues like the amount of money each member is to contribute, the amount of time and effort each member is to spend on the business of the LLC, and the ability of the members to sell or transfer their membership interests either during life or upon death."

While the State of Wisconsin doesn't require that an operating agreement be filed online, Olson says that the importance of the document can't be emphasized enough. Matters that arrive without an operating agreement can become complex very quickly. Anticipating potential issues can help members avoid some of the problems.

The length of the agreement depends on the complexity and size of the organization. A small LLC might get by with a fairly simple document; a larger LLC might need to include procedures for buyout, buy-sell, allocation of profits and losses, detailed expectations and rules for holding meetings and voting. In addition, if the LLC is applying for a loan, the bank or other lending institution will ask for a copy.

Moore noted, "A lender needs to know how the borrower entity is organized, who the members, partners, directors, managers, etc. are, how the ownership and management are divided, who has authority to sign contracts, and the like."

She said she is surprised at the number of clients who ask for a loan but haven't prepared an Operating Agreement. For most lenders, the agreement is required in order to verify who can sign loan documents or guarantee debt on behalf of the organization.

The need for the agreement extends to the business accountant.

"It will state how the company will be taxed," Guldán-Lindstrom said. "Note that an LLC is not recognized as a taxable S corporation. It will state who has the authority to contract with banks in regard to loans. It will state what the original contribution was by each member in the creation of the LLC and distinguish member contributions from member loans."

Given the importance of the document, all three recommend using an attorney to focus the ideas of the members into a coherent agreement. The attorney will try to address as many potential legal issues as possible.

So, what kind of issues might a business have?

Olson responds, "How many ways can business partners disagree? Potential problems are limited only by your imagination!"

Tina Dettman-Bielefeldt is co-owner of DB Commercial Real Estate in Green Bay and assistant district director for SCORE, Wisconsin.