

1996

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### Recommended Citation

Gelb, Harvey (1996) "Liabilities of Members and Managers of Wyoming Limited Liability Companies," *Land & Water Law Review*. Vol. 31 : Iss. 1 , pp. 133 - 151.

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# LAND AND WATER LAW REVIEW

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VOLUME XXXI

1996

NUMBER 1

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## LIABILITIES OF MEMBERS AND MANAGERS OF WYOMING LIMITED LIABILITY COMPANIES

*Harvey Gelb\**

The purpose of this article is to alert readers to certain risks of liability for members and managers of a limited liability company formed under the WYOMING LIMITED LIABILITY COMPANY ACT (the Act).<sup>1</sup> It is understandable that there is a degree of euphoria connected with this statutory creature called the limited liability company (LLC). After all the properly designed LLC can be subject to federal tax like a partnership, if that is desired, and still provide limited liability for its members. There are various facets of the LLC which are worthy of exploration. For example, the transferability of interests in the LLC, its continuity of life, the nature of its management and pertinent tax issues all provide worthy material for discussion. As indicated, however, this article is more narrow in scope. Its focus is on one very important feature of the LLC, the limited liability feature itself.

At the outset it is important to state unequivocally that the Act does not guarantee complete immunity from liability for its members and managers and that the meaning of certain statutory sections bearing upon the immunity issue are not free of doubt. Lawyers and clients must be

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1. WYO. STAT. §§ 17-15-101-144 (1977 & Supp. 1995) [hereinafter THE ACT].

conscious of the ways in which liability may be incurred by members and managers of the limited liability company. If limited liability is an important goal, as it generally is, then some lawyers and clients must be mindful of the ways in which it may be lost so that they can take steps to minimize the chances for such loss while others search for ways to hold LLC members and managers liable or to defend against such efforts. This article considers a number of ways in which the limited liability attribute is, or may be, impaired.

## SECTION I

### *THE GIFT OF LIMITED LIABILITY*

The gift of limited liability is bestowed by the Wyoming statute in rather sweeping terms in § 17-15-113 which provides:

Neither the members of a limited liability company nor the managers of a limited liability company managed by a manager or managers are liable under a judgment, decree or order of a court, or in any other manner, for a debt, obligation or liability of the limited liability company.<sup>2</sup>

Notwithstanding this broad statutory immunity it is wise to consider how persons who are members or managers of the LLC may incur liability in situations where the LLC is liable or in other ways related to the LLC. This article first discusses liability arising from the Act's provisions, and then liability arising outside the Act's provisions. It also contains some special comments on the personal liability of professionals.

## SECTION II

### *LIABILITY ARISING FROM THE ACT'S PROVISIONS*

#### Part A - Name Problems

Section 17-15-105(b) of the Act provides:

Omission of the words "limited liability company," or its abbreviations "LLC" or "L.L.C.," "limited company," or its abbreviations "LC" or "L.C.," "Ltd. liability company," "Ltd.

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2. WYO. STAT. § 17-15-113 (1977).

liability co.” or “limited liability co.” in the use of the name of the limited liability company shall render any person who participates in the omission, or knowingly acquiesces in it, liable for indebtedness, damage or liability occasioned by the omission.<sup>3</sup>

If an LLC enters into a contract or transaction without using the magic words or letters referred to in the above section, the possibility of liability ensues. Notice two kinds of persons who may be liable: a person who participates in the omission and a person who knowingly acquiesces in it. Suppose an LLC advertises by circulating leaflets to sell certain items to the public and a consumer calls the LLC store and purchases an item referred to in the leaflet as a result of reading the leaflet, but the leaflet did not refer to any of the magic words or letters. Suppose the item purchased is defective and causes an injury. Can the injured consumer hold liable persons who participated in the omission by preparing the text of the leaflet or who were involved in the chain of delivery of the leaflet to the consumer?

One can conceive of a variety of uses of the name of an LLC which fail to contain the magic words or letters and one can imagine that members, managers, employees, or other agents are participants in the omission or knowingly acquiesce in it. It does not involve a great stretch of the imagination to interpret the language of this statutory section in a literal sense to make targets of all such persons.

One of the difficult questions arising from this statutory section involves the interpretation of the words “liable for indebtedness, damage or liability occasioned by the omission.”<sup>4</sup> Can it be said that a creditor who thought she was dealing with a partnership or an individual in extending credit to an LLC would have a viable claim against any members or other properly targeted persons who participated or knowingly acquiesced in the omission of the magic words or letters in the use of the name of the LLC? Does the inability of the LLC to pay the creditor constitute damage to the creditor occasioned by the omission? If the LLC is unable to pay the injured consumer referred to above, does that inability to pay constitute damage to the consumer occasioned by the omission? Does a showing that damage is occasioned by the omission involve proof regarding whether the creditor or injured consumer relied on dealing with a business which was not a limited liability company? If so, how would the burden of proof of reliance be allocated? How would reliance be defined?

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3. WYO. STAT. § 17-15-105(b) (1977 & Supp. 1995).

4. *Id.*

If the creditor or injured consumer did not even think about who would be liable when he or she entered a transaction with the LLC, could reliance still be shown? In claiming reliance, could it be argued that use of the magic words or letters would have triggered thought by the creditor or consumer about liability and that the omission cost the creditor or consumer the opportunity to consider his or her own course of action? Must the creditor or consumer present evidence that, if given that opportunity, he or she would have acted differently if informed by the magic words or letters? Suppose it could be shown that the creditor or consumer dealt with other LLCs without hesitation or investigation or taking precautions—could that be important evidence regarding reliance?

The statute refers to a “liability occasioned by the omission”<sup>5</sup>—what does that mean? Does it mean the liability to the creditor who would not have engaged in the transaction but for the omission? The statute refers to an “indebtedness” occasioned by the omission—what does that mean? Does it mean the indebtedness to the creditor who would not have engaged in the transaction but for the omission? Another question is, what is the significance of the placement of the word “knowingly” before the word “acquiesces” and not before the word “participates?”<sup>6</sup> Is one who “participates” “unknowingly” at greater risk than one who merely unknowingly “acquiesces?”<sup>7</sup>

Definitive answers to the questions raised above may await the development of case law which determines the meaning of the statutory section, but certainly, as a matter of preventive law, or for the purpose of making or dealing with claims, attorneys for persons involved with LLCs should be mindful of the need to utilize the magic words or letters of § 17-15-105(b).

Another interesting question is whether the statutory provision quoted above might be interpreted as sweeping within the liability net persons who are not LLC members, managers, employees, or agents who participate or knowingly acquiesce in the omission of the magic words or letters. For example, while it seems drastic or far-reaching to interpret the statute to cover outsiders who use the name to sell the products of the LLC, it is possible to include them within the technical wording of the statute. In some situations that interpretation may place an unfair burden on outsiders depending in part at least on the ultimate analysis of what constitutes actionable participation in the improper

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5. *Id.*

6. *Id.*

7. *Id.*

use of the LLC name. Indeed, even the burden on more likely targets such as LLC employees and other agents who may be deemed vulnerable participants may at times seem unfair. In any event, LLC members or managers or employees or other agents should be alert to the statutory possibilities as should outsiders who may be caught within the liability net.

Finally, failure to use the name with the magic words or letters may raise the issue of whether the LLC was actually functioning or whether creditors and others were dealing with or injured by a party or parties other than an LLC. If so, the liability consequences for that party or parties may be quite different than if they had been utilizing the LLC.

### Part B - Other Statutory Liabilities

It should be noted the Act contains provisions making members liable to the LLC. Section 17-15-121 contains a number of such provisions relating to contributions. Quite understandably a member is liable for contributions to capital listed as made or to be made in the future in certain documents, such as the articles of organization, executed by the member.<sup>8</sup>

Furthermore, the member holds as trustee for the limited liability company specific property stated to have been contributed in certain documents, such as the articles of organization, executed by the member, but which was not contributed or was wrongfully or erroneously returned.<sup>9</sup> In addition the member holds as trustee "[m]oney or other property wrongfully paid or conveyed to such member on account of

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8. Section 17-15-121(a) states:

A member is liable to the limited liability company:

(i) For the difference between his or its contributions to capital as actually made and that stated in the articles of organization, operating agreement, subscription for contribution or other document executed by the member as having been made by the member; and

(ii) For any unpaid contribution to capital which he or it agreed in the articles of organization, operating agreement or other document executed by the member to make in the future at the time and on the conditions stated in the articles of organization, operating agreement or other document evidencing such agreement.

WYO. STAT. § 17-15-121(a) (1977 & Supp. 1995).

9. Section 17-15-121(b)(i) states that the member holds as trustee: "Specific property stated in the articles of organization, operating agreement or other document executed by the member as contributed by such member, but which was not contributed or which has been wrongfully or erroneously returned . . . ." WYO. STAT. § 17-15-121(b)(i) (1977 & Supp. 1995).

his or its contribution."<sup>10</sup> Contributors to an LLC should also be aware that for six years after rightfully receiving a return of capital, a contributor may be liable for a sum not exceeding the return needed to discharge liability of the LLC to certain creditors.<sup>11</sup> Contributors who have received a return of capital should be advised of any potential liability under § 17-15-121(d) so that they can plan accordingly. Although § 17-15-121(c) deals with a possible compromise or waiver by the consent of all members with respect to the liabilities referred to above contained in § 17-15-121, the rights of certain creditors remain protected.<sup>12</sup>

Section 17-15-119 provides for the division and allocation of profits and losses of the business of the LLC among members and classes of members upon the basis stipulated in the operating agreement or, if the operating agreement does not so provide, on the basis of the value of the contributions made by each member to the extent they have been received by the LLC and not returned. There is a proviso however: "that after distribution is made, the assets of the limited liability company are in excess of all liabilities of the limited liability company except liabilities to members on account of their contributions."<sup>13</sup> The statute does not specifically provide for the return of improper distributions, that is where the lack of sufficient assets would preclude distribution under § 17-15-119, although § 17-15-121(b)(ii) may be construed as having some application to this matter of return.<sup>14</sup> It is hard to imagine that courts would not compel the return of excess distributions. Section 17-15-119 does provide, however, that "[t]he provisions of this section regarding the allocation of losses shall not affect the limitation on liability of members and managers

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10. WYO. STAT. § 17-15-121(b)(ii) (1977 & Supp. 1995).

11. Section 17-15-121(d) states:

When a contributor has rightfully received the return in whole or in part of the capital of his or its contribution, the contributor is nevertheless liable to the limited liability company, for a period of six (6) years after return of the capital contribution, for any sum, not in excess of the return without interest, necessary to discharge its liability to all creditors of the limited liability company who extended credit during the period the capital contribution was held by the limited liability company or whose claims arose before the return.

WYO. STAT. § 17-15-121(d) (Supp. 1995).

12. Section 17-15-121(c) states:

The liabilities of a member as set out in this section can be waived or compromised only by the consent of all members; but a waiver or compromise shall not affect the right of a creditor of the limited liability company who extended credit or whose claim arose after the filing and before a cancellation or amendment of the articles of organization, to enforce the liabilities.

WYO. STAT. § 17-15-121(c) (Supp. 1995).

13. WYO. STAT. § 17-15-119 (1977 & Supp. 1995).

14. See § 17-15-121(b)(ii), *supra* note 10 and accompanying text.

set forth in W.S. 17-15-113.”<sup>15</sup> A further question is the extent to which persons responsible for improper distributions may be liable for the distributions. Thus the question of liability of members or managers for improper distributions must be considered.

Liability stemming from failure to maintain a registered agent or office or to pay an annual fee should also be considered. Section 17-15-112 provides that under certain circumstances in such situations the LLC “shall be deemed to be transacting business within this state without authority and to have forfeited any franchises, rights or privileges acquired under the laws thereof and the forfeiture shall be made effective” by the secretary of state following a certain procedure.<sup>16</sup> The statute provides that absent compliance within a certain period after notice of noncompliance, “the limited liability company shall be deemed defunct and to have forfeited its certificate of organization . . . .”<sup>17</sup> The statute further provides that the defunct LLC may within one year after the forfeiture be revived and reinstated by taking certain steps.<sup>18</sup> These statutory provisions raise the question of the impact on the limited liability of members and managers of the loss of authority and forfeiture and the subsequent revival and reinstatement. In analyzing the problem of acting as an LLC without authority, consider § 17-15-133 which states: “All persons who assume to act as a limited liability company without authority to do so shall be jointly and severally liable for all debts and liabilities.” Section 17-15-133 should also be considered in connection with assuming to act as an LLC prematurely, that is, before the authority to act exists, and assuming to act when it is or may be too late to do so during and after completion of the dissolution process. Sections 17-15-109 (Effect of issuance of certificate of organization), 17-15-125 (Effect of filing of dissolving statement) and 17-15-128 (Filing of articles of dissolution) should be examined.

### SECTION III

#### *LIABILITY ARISING OUTSIDE OF THE ACT'S PROVISIONS*

##### Part A - Liability From the Behavior of the Member or Manager and From Out-of-State Operations

Section 17-15-113 immunizes members and managers from liability “for a debt, obligation or liability of the limited liability company.”<sup>19</sup> It is

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15. WYO. STAT. § 17-15-119 (Supp. 1995).

16. WYO. STAT. § 17-15-112 (1977).

17. *Id.*

18. *Id.*

19. WYO. STAT. § 17-15-113 (1977).



evident from the words of this section that the obligations of the LLC are not the obligations of the members or managers. This idea of limited liability is consistent with ideas of limited liability associated with corporations. However, the statutory immunization from limited liability does not state that members or managers should be freed of their own liabilities just because such liabilities are also attributed to their LLC. Nor could such an immunity be reasonably inferred from the statutory language. One example clearly illustrates the point: M, a member and employee of an LLC, drives a vehicle in the course of his employment with the LLC. M negligently runs into a pedestrian. Surely the legislature did not intend to repeal the liability of M for his negligent behavior just because his employer, the LLC, is also liable under normal agency principles, i.e., the master-servant doctrine.<sup>20</sup>

By way of further illustration, agency principles may call for the liability of an agent who is also a member or manager of the LLC in contract situations where the LLC is also liable. Both members and managers may be LLC agents. Indeed broad powers are seemingly conferred on both members and managers in § 17-15-117 which provides:

Except as otherwise provided in this act, no debt shall be contracted or liability incurred by or on behalf of a limited liability company, except by one (1) or more of its managers if management of the limited liability company has been vested by the members in a manager or managers or, if management of the limited liability company is retained by the members, then by any member.<sup>21</sup>

Still the meaning of this section is not free of doubt. Is it to be interpreted as a grant of actual authority to a member or manager in the sense of agency principles, or is it a form of apparent authority in light of

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20. Restatement of Agency § 343 provides:

An agent who does an act otherwise a tort is not relieved from liability by the fact that he acted at the command of the principal or on account of the principal, except where he is exercising a privilege of the principal, or a privilege held by him for the protection of the principal's interests, or where the principal owes no duty or less than the normal duty of care to the person harmed.

RESTATEMENT (SECOND) OF AGENCY § 343 (1957). To the extent that courts accept the principle of section 343, agents would have significant liability for their own torts. Since public policy considerations would favor and even necessitate that a wrongdoer be responsible for his or her own misdeeds, to infer relief from such responsibility from the language of section 17-15-113 would be highly inappropriate.

21. WYO. STAT. § 17-15-117 (1977). Power is also conferred on members and managers in 17-15-118 relating to the execution of instruments and documents for the acquisition, mortgage or disposition of LLC property. WYO. STAT. § 17-15-118 (1977).

such principles, or is it intended as a basis for a third party to rely on the power of the member or manager to act? To what extent can the LLC terminate the power granted under § 17-15-117? It should be noted that § 17-15-104 (a) (ix) allows an LLC to “[e]lect or appoint managers, officers, employees and agents of the limited liability company, and define their duties and authority, which may include authority also delegated to the members or managers under W.S. 17-15-117 and 17-15-118, and fix their compensation . . . .” In any event, it is doubtful that the legislature intended to eliminate the contract liability of an LLC member or manager acting as an agent of the LLC if such liability would otherwise be imposed by courts. An example of such potential liability is found in Restatement of Agency § 321 which provides: “Unless otherwise agreed, a person purporting to make a contract with another for a partially disclosed principal is a party to the contract.”<sup>22</sup> If the LLC is a partially disclosed principal, then the agent of the LLC who purports to make a contract for the partially disclosed principal may be a party to the contract under § 321. It is recognized that a situation involving a partially disclosed principal may also implicate § 17-15-105(b) which is discussed earlier in this article.

In addition, a member or manager may be using the LLC as his or her agent and may be liable as a principal for what the LLC does under agency principles. For example, a member or manager may be liable for a contract entered on his or her behalf by the LLC acting as his or her agent.

The kinds of principal-agent liability discussed above are analogous to those that would exist under corporate law, where shareholders happen to also be agents of their corporation or to be principals with respect to corporations acting as their agents, and should hardly be surprising. What would be shocking would be the inference that somehow the Wyoming legislature intended to alter such doctrines of individual liability by the simple language of § 17-15-113.<sup>23</sup>

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22. RESTATEMENT (SECOND) OF AGENCY § 321 (1957).

23. Nor should the language of § 17-15-130 be construed to mandate such a sweeping result. It provides:

A member of a limited liability company is not a proper party to proceedings by or against a limited liability company, except where the object is to enforce a member's right against or liability to the limited liability company.

A reasonable interpretation of this section is that, except as indicated, a person's status as a member does not make the person a proper party. However, the section should not preclude making a claim against a person as a tortfeasor or contract obligor as a party in a proceeding against an LLC or otherwise simply because the person happens to also be a member of the LLC. It is recognized that the statutes of some other jurisdictions are more explicit on the point of individual liability. For example, the Minnesota statute provides: “Subject to subdivision 2, a member, governor, manager, or

Still another concern for lawyers about the reliability of the limited liability feature of LLCs may arise from out-of-state operations of such entities. Aside from determining the need for special qualification of Wyoming LLCs out-of-state, the lawyer should consider the respect which will be shown for the Wyoming LLC limited liability attribute in the other state.

### Part B - Liability Arising from Piercing the Veil of the LLC

The Act does not expressly deal with the doctrine of piercing the veil of the LLC.<sup>24</sup> Evidently the development of such a doctrine for Wyoming LLCs would depend on courts. Courts have developed the doctrine of piercing the corporate veil. Courts have pierced the corporate veil for various reasons. Some of the broad reasons given are to prevent fraud or injustice, or unfairness, or inequity.<sup>25</sup> It is not unreasonable to expect the same kinds of considerations to be used by courts in deciding whether to pierce the veil of the LLC. Certainly in cases where members or managers utilize an entity in an inequitable, unfair, unjust or fraudulent manner, it can be said that it is their conduct or behavior which creates liability for themselves, even though the LLC is also liable. It is difficult to read statutory § 17-15-113 as intended to preclude courts from deciding to disregard the veil of an improperly used LLC.<sup>26</sup>

In view of the possibility of courts piercing the LLC veil, it seems only wise for lawyers to advise members or managers about steps to be

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other agent of a limited liability company is not, merely on account of this status, personally liable for the acts, debts, liabilities, or obligations of the limited liability company." MINN. STAT. § 322B.303(1) (1995). The Minnesota statute also contains a more explicit "proper party" provision. MINN. STAT. § 322B.88. See also § 322B.303(2) *infra* note 24. However, the presence of more explicitness in statutes other than Wyoming hardly justifies a revolutionary approach in Wyoming based on sheer and questionable inference.

24. Certain statutes do. See e.g. MINN. STAT. § 322B.303(2) (1995). The Minnesota statute provides: "The case law that states the conditions and circumstances under which the corporate veil of a corporation may be pierced under Minnesota law also applies to limited liability companies." *Id.* The Colorado statute provides:

(1) In any case in which a party seeks to hold the members of a limited liability company personally responsible for the alleged improper actions of the limited liability company, the court shall apply the case law which interprets the conditions and circumstances under which the corporate veil of a corporation may be pierced under Colorado law.

(2) For purposes of this section, the failure of a limited liability company to observe the formalities or requirements relating to the management of its business and affairs is not in itself a ground for imposing personal liability on the members for liabilities of the limited liability company.

COLO. REV. STAT. § 7-80-107 (Supp. 1995).

25. HARVEY GELB, PERSONAL CORPORATE LIABILITY: A GUIDE FOR PLANNERS, LITIGATORS AND CREDITORS' COUNSEL §§ 1.3 - 1.4 (PLI 1991).

26. The issue of piercing the veil of LLCs is discussed in LARRY E. RIBSTEIN & ROBERT R. KEATINGE, RIBSTEIN AND KEATINGE ON LIMITED LIABILITY COMPANIES § 12.03 (1995).

taken to minimize the risk of a veil piercing catastrophe. Obviously too, those lawyers who wish to pierce the veil as well as those defending against such actions need to become familiar with veil piercing doctrines. This short article is not the place for extensive consideration of the factors which may apply in veil piercing situations. There are numerous cases and considerable literature dealing with piercing of the corporate veil that may offer material for guidance in the LLC field.<sup>27</sup> In order to give the reader a brief start in considering the issue of Wyoming LLC veil piercing, some points from Wyoming corporate veil piercing caselaw follow.

In *Miles v. CEC Homes, Inc.*<sup>28</sup> the Wyoming Supreme Court reviewed the circumstances for disregarding the corporate entity as follows: 1) ordinarily the corporation is recognized as a separate entity, but in an appropriate case in furtherance of public policy or the ends of justice the entity will be disregarded;<sup>29</sup> 2) before the corporation's acts and obligations are recognized as those of a particular person, it must not only appear that the corporation is influenced and governed by the person "but that there is such a unity of interest and ownership that the individuality, or separateness, of such person and corporation has ceased, and that the facts are such that an adherence to the fiction of the separate existence of the corporation would, under the particular circumstances, sanction a fraud or promote injustice."<sup>30</sup> 3) a list of factors to be considered by the trial court in determining whether the corporate entity should be disregarded is as follows (The reader should bear in mind that the factors appear in different settings, such as where an individual or individuals own a corporation or where related corporate entities are involved.):

Among the possible factors pertinent to the trial court's determination are: commingling of funds and other assets, failure to segregate funds of the separate entities, and the unauthorized diversion of corporate funds or assets to other than corporate uses; the treatment by an individual of the assets of the corporation as his own; the failure to obtain authority to issue or subscribe to stock; the holding out by an individual that he is personally liable for the debts of the corporation; the failure to maintain minutes or adequate corporate records and the confusion of the records of the separate entities; the identical equitable ownership in the two entities; the identification of the equitable owners

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27. See, e.g., GELB, *supra* note 25, §§ 1.1 - 1.16.

28. *Miles v. CEC Homes, Inc.*, 753 P.2d 1021 (Wyo. 1988).

29. *Id.* at 1023.

30. *Id.* (citations omitted) (quoting *Arnold v. Browne*, 27 Cal. App. 3d 386 (1972)).

thereof with the domination and control of the two entities; identification of the directors and officers of the two entities in the responsible supervision and management; the failure to adequately capitalize a corporation; the absence of corporate assets, and undercapitalization; the use of a corporation as a mere shell, instrumentality or conduit for a single venture or the business of an individual or another corporation; the concealment and misrepresentation of the identity of the responsible ownership, management and financial interest or concealment of personal business activities; the disregard of legal formalities and the failure to maintain arm's length relationships among related entities; the use of the corporate entity to procure labor, services or merchandise for another person or entity; the diversion of assets from a corporation by or to a stockholder or other person or entity, to the detriment of creditors, or the manipulation of assets and liabilities between entities so as to concentrate the assets in one and the liabilities in another; the contracting with another with intent to avoid performance by use of a corporation as a subterfuge of illegal transactions; and the formation and use of a corporation to transfer to it the existing liability of another person or entity.<sup>31</sup>

Lawyers should be able to derive principles which may be analogously applied to piercing the veil of the LLC from cases such as the one just quoted. For example undercapitalization, which is of some significance in corporate veil piercing analysis, may also be of significance in LLC piercing analysis. If so, lawyers for persons trying to avoid liability should be aware of what steps should be taken to avoid inappropriate capitalization of an LLC. One Wyoming case which sheds some light on the undercapitalization issue is *Atlas Construction Co. v Slater*.<sup>32</sup> Lawyers should examine that case and other potentially relevant cases and materials.

### Part C - Liability from Fiduciary Misconduct

In the field of corporate law, it is well known that corporate officials such as directors and officers may be liable to the corporation and its shareholders for fiduciary misconduct. Actions by or in behalf of the corporation for breach of the duty of care or duty of loyalty against corporate officials could bring funds into the corporate treasury for the ulti-

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31. *Id.* at 1023-24 (citations omitted).

32. 746 P.2d 352, 356-57 (Wyo. 1987).

mate benefit of corporate creditors.<sup>33</sup> It is reasonable to believe that similar kinds of actions may exist in favor of LLCs against persons such as members or managers who are in positions like those of corporate officials. The Act contemplates the liability of members or managers for negligence or misconduct in the performance of duty in its indemnification provision which states that an LLC may:

Indemnify a member or manager or former member or manager of the limited liability company against expenses actually and reasonably incurred by him or it in connection with the defense of an action, suit or proceeding, civil or criminal, in which he or it is made a party by reason of being or having been such member or manager, except in relation to matters as to which he or it shall be adjudged in the action, suit or proceeding to be liable to the company for negligence or misconduct in the performance of duty or to have received improper personal benefit on account thereof; and to make any other indemnification that is authorized by the articles of organization or by an article of the operating agreement or resolution adopted by the members after notice.<sup>34</sup>

#### SECTION IV

##### *THE PERSONAL LIABILITY OF PROFESSIONALS*

The Wyoming Limited Liability Company Act allows for professional LLCs under certain circumstances. It expressly deals with the liability of licensed members or licensed employees. Consider the following section:

(b) Nothing in this act shall be interpreted as precluding an individual whose occupation requires licensure under Wyoming law from forming a limited liability company if the applicable licensing statutes do not prohibit it and the licensing body does not prohibit it by rule or regulation adopted consistent with the appropriate licensing statute. No limited liability company may offer professional services or practice a profession except by and through its licensed members or licensed employees, each of whom shall retain his professional license in good standing and

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33. See GELB, *supra* note 25, §§ 5.1, 6.1.

34. WYO. STAT. § 17-15-104(xi) (1977 & Supp. 1995).

shall remain as fully liable and responsible for his professional activities, and subject to all rules, regulations, standards and requirements pertaining thereto, as though practicing individually rather than in a limited liability company.<sup>35</sup>

The language of the above section calls for special analysis of the liability issue for professionals practicing in an LLC. There is a risk that the wording of this section may deprive an LLC professional member of immunity from personal liability for LLC professional activities primarily or solely or partially undertaken by others which are somehow deemed to be "his professional activities." It is simply not clear. It is similar to the following language which appears in connection with Wyoming professional corporation legislation:

No corporation may offer professional services or practice a profession except by and through the person or persons of its licensed stockholder or stockholders, or licensed employees, each of whom shall retain his professional license in good standing, and shall remain as fully liable and responsible for his professional activities, and subject to all rules, regulations, standards and requirements pertaining thereto, as though practicing individually rather than in a corporation.<sup>36</sup>

One illustration may be helpful in understanding some difficulties in interpreting the language of § 17-15-103(b). A, B, C and D are members of a law firm which is organized as an LLC. Client X comes to the office of the firm to discuss a securities fraud claim. A meets with and has some preliminary discussion of the claim with X and suggests that the best person to handle the claim is B. X and A then meet with B to discuss the matter and B works on preparation of the complaint. Because C has had experience in the securities fraud field, B talks over some of the potential allegations of the complaint with C. Can it be said that the phrase "his professional activities" encompasses the activities of A, B and C? If so, in order to avoid liability, will members in law firms limit their contact with clients or their communication with each other in representing clients? Would such a self-imposed ban on contact or communication be in the best interest of clients? Would fear of liability become the driving force inhibiting consultation and discussion with clients or among law firm members? These are disquieting questions, and beyond these questions

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35. WYO. STAT. § 17-15-103(b) (1977 & Supp. 1995).

36. WYO. STAT. § 17-3-102 (1977).

there lies the ultimate question over whether the LLC legislation is meant to relieve even D from liability.

Of course, the argument could possibly be made that because the statutory language regarding individual liability is inserted in § 17-15-103(b) but not in § 17-15-113, the latter section should be construed as destroying the individual liability discussed earlier in connection with nonprofessional LLCs. To imply such a legislative intent to alter the law would have very serious, far-reaching consequences that would seem beyond the scope of the simple language used in §§ 17-15-113 and 17-15-103(b).

It should be emphasized that previously discussed principles relating to the personal liability of members and managers of nonprofessional LLCs, may also be applicable to professionals and for the most part need not be repeated at this juncture. There is one point of caution which is perhaps worthy of special note. Professionals and others should be mindful of the possible relationship of malpractice or other insurance to corporate veil piercing and the potential analogous relevance of insurance to LLC veil piercing. The amount of liability insurance carried by an LLC may be important to a court in deciding if the LLC is being used in a sufficiently responsible manner to merit respect for the LLC veil. In a corporate veil piercing case involving the question of whether an injured party can sue a parent corporation for a subsidiary's alleged tort, the court held that the fact the subsidiary carried a considerable amount of liability insurance saved the parent because it showed the subsidiary was being utilized in a financially responsible manner even though undercapitalized.<sup>37</sup> In applying Missouri law, the court referred to the use by Missouri courts of undercapitalization in reaching a decision to disregard the corporate entity. The court explained:

The reason, we think, is not because undercapitalization, in and of itself, is unlawful (though it may be for some purposes), but rather because the creation of an undercapitalized subsidiary justifies an inference that the parent is either deliberately or recklessly creating a business that will not be able to pay its bills or satisfy judgments against it.<sup>38</sup>

The court further explained the significance of insurance:

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37. *Radaszewski v. Telecom Corp.*, 981 F.2d 305 (8th Cir. 1992).

38. *Id.* at 308.



The whole purpose of asking whether a subsidiary is "properly capitalized," is precisely to determine its "financial responsibility." If the subsidiary is financially responsible, whether by means of insurance or otherwise, the policy behind the second part of the *Collet* test is met. Insurance meets this policy just as well, perhaps even better, than a healthy balance sheet.<sup>39</sup>

Professionals and others who feel they can reduce the risk of personal liability by practicing through an LLC and at the same time reduce the need for malpractice or other insurance to protect against the misdeeds of other LLC members or agents may be on the wrong track since a lack of sufficient insurance or other assets for potential creditors may lead to a piercing of the LLC veil.

Finally it is worth noting that courts may be reluctant to allow LLCs or corporations or other entities to be used to reduce professional activity liability. This judicial reluctance may be reflected in narrow interpretations of statutory provisions for limiting liability, and in the case of lawyers it could lead to the out and out rejection of legislative authority to limit lawyers' liability. In a Georgia case involving a lawyer's professional liability for the behavior of another lawyer when their practice was conducted through a professional corporation, the court rejected the power of the legislature to define such liability, claiming such power improperly conflicted with judicial power pertaining to the practice of law by business entities.<sup>40</sup> In any event there are rules of the Supreme Court of Wyoming pertaining to practice of law by business entities including LLCs which should be examined carefully by lawyers. Rule 13 (c) provides *inter alia*:

Lawyers may form limited liability companies for the practice of law as authorized by W.S. 17-15-103, provided that such limited liability companies are organized and operated in accordance with the provisions of this rule. The articles of organization of such company shall contain provisions complying with the following requirements:

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39. *Id.* at 309. The second part of the *Collet* piercing test as referred to by the court requires that "control must have been used by the defendant to commit fraud or wrong, to perpetrate the violation of a statutory or other positive legal duty, or dishonest and unjust act in contravention of plaintiff's legal rights." *Collet v. American Nat'l Stores, Inc.*, 708 S.W.2d 273, 284 (Mo. Ct. App. 1986). The Wyoming Supreme Court referred to the insurance factor in *Atlas Construction Co. v. Slater*, *Atlas*, 746 P.2d at 356-57.

40. *First Bank & Trust Co. v. Zagoria*, 302 S.E.2d 674 (Ga. 1983).

(vii) No limited liability company may offer professional services or practice a profession except by and through the person or persons of its licensed member or members or licensed employees, all of whom shall retain their professional licenses in good standing and shall be subject to all rules, regulations, standards and requirements pertaining to their professional activities. All members or employees of a limited liability company organized hereunder shall remain fully liable and responsible for their own professional activities. In all other respect[], the rules of liability applicable to general limited liability companies shall apply to limited liability companies organized hereunder.<sup>41</sup>

To the extent that this Rule is any guide, it does not seem to reflect any judicial attitude at variance with any statutory effort to limit the liability of lawyers. However, it remains to be seen how the judiciary will interpret and apply the statutory language and the language of the rule involving professional liability for lawyers.

Obviously legal counsel must give careful consideration to all aspects of professional limited liability and the materials pertinent thereto.

## CONCLUSION

As stated from the beginning, the purpose of this article is a modest one: to alert readers to certain risks of liability issues which exist for members and managers of Wyoming limited liability companies. It seems that in recent times there has been a legislative rush in various states to curb liability when it comes to certain business organizations. The corporation with its limited liability feature has been with us for a long time. Other limited liability entities have taken root in different forms such as the LLC which was developed primarily for tax reasons.

In reflecting on the issues of liability discussed in this article the author has reached several conclusions.

*Notice:* One of the ways discussed above in which liability may arise is where the magic words or letters are not used. Presumably a policy served by the use of such words and letters is to give appropriate notice to those who deal with the LLC that it is a business form with limited liability. If this notice is not properly given, then at least in some circumstances a special liability will exist. Since people ought to be made aware

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41. WYO. R. SUP. CT. PROVIDING ORG. GOV'T BAR ASS'N & ATTYS. 13(C) (providing for the organization and government of the bar association and attorneys at law of the state of Wyoming).

of the kind of entity they will be dealing with and have a chance to determine its degree of responsibility, it is reasonable to place the burden of giving proper notice on the persons using the entity. In some cases such notice may be immaterial, but in others it may be quite significant. It affects the risk of doing business and it is sensible to assume that those connected with the LLC are in the best position to give proper notice to others. As indicated above, § 17-15-105(b) is not without ambiguity; it should be clarified.

*Financial and Moral Responsibility and Veil Piercing:* Application of the corporate veil piercing doctrine should encourage financial and moral responsibility on the part of those using the corporate form. Both contract and tort creditors are entitled to expect a degree of financial and moral responsibility from those using LLCs as well. As previously indicated courts have pierced the corporate veil for such noble purposes as preventing fraud, injustice, unfairness or inequity. The corporate veil piercing doctrine has been around for a long time and gained wide acceptance. Courts ought to be able to apply veil piercing principles to the LLC. It is hoped that special interest groups would desist from running to the legislature to preclude judicial LLC veil piercing. In any event the legislature should resist such efforts if they are made. If anything it would be better for the legislature to reinforce the case for LLC veil piercing by appropriate statutory language. It would be better to encourage financial and moral responsibility in our society than to make it easier to be irresponsible.

*Fiduciary Misbehavior:* Those who are fiduciaries in the limited liability organization should be held accountable in a manner similar to fiduciaries who occupy positions in corporations. Once again arguments about the need for responsibility in our society are appropriate. Principles similar to those applied in fiduciary duty situations in corporate law, such as in duty of care and duty of loyalty cases, could be drawn on to deal with fiduciaries connected to LLCs. At some point it may be appropriate for legislation to better define fiduciary responsibilities, although there is the risk that legislative action may result in the dilution of such responsibilities because of the importunings of special interest groups.

*Personal Responsibility:* This article points to the strong likelihood that persons remain responsible for their own misdeeds even though they are members or managers of a limited liability company. This point should not even be controversial in our society. For example, it would be a mistake to relieve persons of liability for their own torts because they are members or managers of a limited liability company which is also liable.

It would be unfortunate indeed for Wyoming and other states to get caught up in a race to see who can dilute or eliminate the liability of members and managers of LLCs the most in a competition to attract formation fees to state treasuries. Larger social issues are at stake in the flight from business liability and responsibility. There may be powerful forces at work in our society pushing for the dilution or elimination of liability; there may be some interest groups who will perceive the dangers of such a trend and work to prevent the passage of legislation that goes too far. It will be interesting to consider how the granting of credit has been and will be affected by the diminution of responsibility which has already occurred and how creditors will perceive and deal with their interests. Lawyers for both contract creditors and tort creditors should be sensitive to the issues involved. Those responsible for making our laws should carefully take into account how they will affect our society. The question of reducing the financial and moral responsibility of persons engaged in a business enterprise is of great importance.