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## Corporations - Mangers and Members of Limited Liability Companies Will Be Held to Corporate Agency and Personal Liability Principles - Water, Waste, & (and) Land, Inc. v. Lanham

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**CORPORATIONS—Managers and Members of Limited Liability Companies Will Be Held to Corporate Agency and Personal Liability Principles. *Water, Waste, & Land, Inc. v. Lanham*, 955 P.2d 997 (Colo. 1998).**

INTRODUCTION

Attorneys and businessmen anxiously await the reaction that courts will have to the relatively young state limited liability company (LLC) statutes. Case law concerning LLCs is sparse, and the few existing opinions are valued. In *Water, Waste, & Land, Inc., v. Lanham*,<sup>1</sup> the Colorado Supreme Court held that agency law may impose personal liability upon LLC members and managers, notwithstanding the LLC members' statutory grant of immunity from liability. The sound reasoning in *Water, Waste & Land, Inc.* is likely to be followed in Wyoming, filling in gaps and uncertainties currently existing in Wyoming LLC law.<sup>2</sup>

*Water, Waste, & Land, Inc.* was a land development and engineering company doing business under the name "Westec."<sup>3</sup> Donald Lanham and Larry Clark were managers and members of Preferred Income Investors, L.L.C. (P.I.I.), a limited liability company organized under the Colorado Limited Liability Act.<sup>4</sup> In March of 1995, Clark contacted Westec about the possibility of hiring Westec to perform engineering work for a development project which involved the construction of a fast-food restaurant known as Taco Cabana.<sup>5</sup>

In the course of preliminary discussions, Clark gave his business card to the representatives of Westec.<sup>6</sup> Although the company's name did not appear on that card, the letters "P.I.I." were written above the address.<sup>7</sup> There was no indication of the meaning of the acronym and no suggestion that P.I.I. was a limited liability company.<sup>8</sup> The business card did, however, include Lanham's address, which was also the company's address.<sup>9</sup>

On August 2, 1995, Westec sent a proposed contract to Lanham to be

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1. 955 P.2d 997 (Colo. 1998).

2. WYO. STAT. ANN. §§ 17-15-101 to 144 (Michie 1997). See *infra* notes 96-112 and accompanying text.

3. *Water, Waste, & Land, Inc.*, 955 P.2d at 999.

4. *Id.* The Colorado Limited Liability Act is found at COLO. REV. STAT. §§ 7-80-101 to 1101 (1997).

5. *Water, Waste, & Land, Inc.*, 955 P.2d at 999.

6. *Id.*

7. *Id.*

8. *Id.*

9. *Id.*

signed and returned.<sup>10</sup> Although Lanham never returned the contract, Clark gave Westec verbal authorization to begin the work.<sup>11</sup> Both parties conceded that a binding oral contract had been established.<sup>12</sup> Thus, after completion of the engineering work, Westec sent Lanham a bill for \$9,183.40, upon which no payments were ever made by Clark, Lanham, or P.I.I.<sup>13</sup>

Westec filed a claim in county court against Clark, Lanham, and P.I.I. seeking the amount due on the contract.<sup>14</sup> Using agency principles, the county court ruled in favor of Westec, dismissed Clark from the suit because he was an agent for Lanham and P.I.I., and entered judgment in the amount of \$9,183 against Lanham and P.I.I.<sup>15</sup> Lanham appealed the county court's decision to the Larimer County District Court.<sup>16</sup> The district court reversed the county court, holding that Westec had constructive notice that it was dealing with a limited liability company, which provided Lanham the limited liability protection of an LLC member.<sup>17</sup>

Westec appealed the district court's decision on the theory that Lanham was personally liable on the contract because the LLC he represented was only partially disclosed.<sup>18</sup> The Colorado Supreme Court held that the common law principles of agency apply to limited liability companies and concluded that Lanham was a party to the contract.<sup>19</sup>

This case note will argue that the Colorado Supreme Court correctly applied agency law to the LLC. Statutes giving managers and members of an LLC immunity from liability do not outstrip traditional agency principles. Agency principles applied to LLCs will help preserve and protect the reputation of the LLC as a business entity. Because the *Water, Waste & Land, Inc.* decision is founded on sound analysis it is likely that Wyoming courts will follow similar reasoning and utilize corporate common law principles to interpret the Wyoming LLC Act.

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10. *Id.*

11. *Id.* at 999 n.2.

12. *Id.* at 999.

13. *Id.*

14. *Id.*

15. *Id.* at 1000.

16. *Id.*

17. *Id.* at 999 n.1.

18. *Id.*

19. *Id.* at 998-99.

## BACKGROUND

*Development of the LLC as a Business Entity.*

The limited liability company is a newer business entity that may soon replace the need for the traditional general partnership and the close corporation.<sup>20</sup> Traditionally, there were only two basic forms of business ownership: the corporation<sup>21</sup> and the partnership.<sup>22</sup> Corporations enjoyed popularity because of the limited liability given to its members, while power of management and preferential tax treatment were attractive aspects of a partnership.<sup>23</sup> Notwithstanding the attractive features of these business entities, both had certain downsides. The corporation was subject to double taxation because the corporation itself was taxed on its profits, and shareholders were then taxed on distributions.<sup>24</sup> Although partnerships were not subject to double taxation, each member could be held personally liable for liabilities of the partnership.<sup>25</sup> In an effort to combine the best of both of these traditional forms of business ownership, the limited liability company was created.<sup>26</sup>

The principal purpose of an LLC is to provide a hybrid business entity that is classified as a partnership for federal income tax purposes and possesses the limited liability features of a corporation.<sup>27</sup> Wyoming became the first state to codify a limited liability act in 1977. The majority of states, however, did not adopt LLC legislation until the 1990s.<sup>28</sup> Limited liability company legislation was slow to catch on in other states primarily due to concerns about the LLC's tax status.<sup>29</sup> In 1988, the United States Internal Revenue Service issued a formal opinion, concluding that a limited liability company formed under the Wyoming act would be treated as a partnership for federal tax purposes.<sup>30</sup> Effective January 1, 1997, the Internal Revenue Service further simplified the classification regulations and adopted an

20. Kathleen D. Fuentes, Comment, *Limited Liability Companies and Opting-Out of Liability: A New Standard for Fiduciary Duties?*, 27 SETON HALL L. REV. 1023, 1023-24 (1997).

21. ANGELA SCHNEEMAN, THE LAW OF CORPORATIONS, PARTNERSHIPS AND SOLE PROPRIETORSHIPS § 4.2 (1993).

22. *Id.* § 2.1(b).

23. *Id.* §§ 4.4(a), 2.3(d).

24. *Id.* § 4.5(b.1).

25. *Id.* § 2.2(f).

26. FRANCIS X. MELLON, ESQ., LIMITED LIABILITY COMPANIES 3 (1995). The LLC is like a general partnership or a limited partnership where all partners have limited liability and the ability to participate in management. WILLIAM D. BAGLEY & PHILLIP P. WHYNOTT, THE LIMITED LIABILITY COMPANY § 2:20. However, the S corporation is the business entity with which most LLCs are compared and contrasted. *Id.* § 2:30.

27. MELLON, *supra* note 26, at 3.

28. *Water, Waste, & Land, Inc. v. Lanham*, 955 P.2d 997, 1000 (Colo. 1998).

29. 1 LARRY E. RIBSTEIN & ROBERT R. KEATINGE, RIBSTEIN AND KEATINGE ON LIMITED LIABILITY COMPANIES §§ 1.01, 2.03 (1998).

30. Rev. Rul. 88-76, 1988-2 C.B. 360.

elective regime known as the “check-the-box” regulations.<sup>31</sup> Under that scheme the limited liability company may elect whether it wishes to be taxed as a corporation or as a partnership.<sup>32</sup> Currently, every state in the union has legislation permitting the formation of limited liability companies.<sup>33</sup>

The limited liability company is a particularly attractive form of business organization because it allows members and managers to limit their personal liability.<sup>34</sup> Because of these features, businessmen and legislators have been enthusiastic about the LLC as a form of business ownership. In their enthusiasm, however, legislators have inadequately dealt with an important issue—when members of the LLC will be liable to third parties. To remedy this problem, courts should look to the common law development of corporate agency principles to hold members of LLCs personally liable in certain situations.

### *Agency Principles*

Agency is a relationship resulting from a person’s consent to act on behalf of a principal in forming contracts and other binding acts.<sup>35</sup> If, at the time of a transaction, the third party has notice that the agent is acting for a principal, and is aware of the principal’s identity, the principal is considered “disclosed.”<sup>36</sup> When the third party knows that the agent is acting for a principal but does not know the principal’s identity, the principal is only “partially disclosed.”<sup>37</sup> If the third party has no notice that the agent is acting for a principal, the principal is “undisclosed.”<sup>38</sup>

The agent will be a party to the contract if the principal which he is representing is undisclosed.<sup>39</sup> If the principal is partially disclosed, Restatement (Second) of Agency section 321 provides: “[u]nless otherwise agreed, a person purporting to make a contract with another for a partially disclosed principal is a party to the contract.”<sup>40</sup> Thus, an agent is liable for the principal’s contract if the principal is undisclosed or only partially disclosed. To avoid personal liability, the agent bears the burden of ensuring that his prin-

31. WILLIAM L. CARY & MELVIN ARON EISENBERG, CORPORATIONS 14-15 (1998 Supp.).

32. JEROME P. FRIEDLANDER, II, THE LIMITED LIABILITY COMPANY WITH A STATE-BY-STATE REVIEW § 1:2-B(1) (1997 Cum. Supp.).

33. *Id.* § 1:3.

34. COLO. REV. STAT. § 7-80-705 (1997) provides: “[m]embers and managers of limited liability companies are not 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.” The Wyoming LLC act, like many other states, contains a similar provision limiting the liability of LLC members. See WYO. STAT. ANN. § 17-15-113.

35. RESTATEMENT (SECOND) OF AGENCY § 2 (1958).

36. *Id.* § 4.

37. *Id.*

38. *Id.*

39. *Id.* § 322.

40. *Id.* § 321.

principal is fully disclosed.<sup>41</sup>

Under the common law of agency, the duty to disclose the identity of the principal lies with the agent. It is not sufficient that the third party has knowledge of facts and circumstances which would, if reasonably followed by inquiry, disclose the identity of the principal.<sup>42</sup> The third party with whom the agent deals has no duty to discover the existence or identity of the principal.<sup>43</sup>

*Personal Liability in Corporations Under Agency Principles.*

The axiom that an agent will be liable for a contract formed on behalf of an unidentified principal has long been recognized in the corporate context by the Colorado courts.<sup>44</sup> In *Fink v. Montgomery Elevator Co. of Colorado*, the Colorado Supreme Court states the rule that an agent who negotiates a contract is not liable if he has given notice of the identity of his principal to the third party.<sup>45</sup> Colorado common law also holds an agent liable on contracts negotiated on behalf of a "partially disclosed" principal whose existence, but not identity, is known to the third party.<sup>46</sup>

PRINCIPAL CASE

The principal issue in *Water, Waste, & Land, Inc. v. Lanham* was whether the members of P.I.I. were shielded from personal liability for the contract with Westec.<sup>47</sup> Central to this issue is whether Lanham and Clark were required to fully inform Westec as to the status of P.I.I. as a limited liability company.<sup>48</sup> Resolution of the controversy between Westec and Lanham required the court to analyze the relationship between the common law of agency and the reach of Colorado statutes governing the managers and members of a limited liability company.<sup>49</sup>

The case was brought to the Supreme Court of Colorado after trial in a

41. HAROLD GILL REUSCHLEIN & WILLIAM A. GREGORY, *THE LAW OF AGENCY AND PARTNERSHIP* § 118 (2d ed. 1990).

42. 3A JAMES SOLHEIM & KENNETH ELKINS, *FLETCHER CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS* § 1120 (rev. vol. 1994).

43. *Id.*

44. *Water, Waste, & Land, Inc. v. Lanham*, 955 P.2d 997, 1001 (Colo. 1998). The Wyoming courts have also readily applied agency principles in the corporate context.

45. 421 P.2d 735, 737 (Colo. 1966). *See also* Flatiron Paving Co. v. Wilkin, 725 P.2d 103, 106 (Colo. Ct. App. 1986); Hott v. Tillotson-Lewis Constr. Co., 682 P.2d 1220, 1222 (Colo. Ct. App. 1983); Charles Nelson Co. v. Morton, 288 P. 845, 849 (Cal. Dist. Ct. App. 1930); Condit v. Merritt Printing & Stationary Co., 184 P. 381, 381 (Colo. 1919).

46. *Water, Waste, & Land, Inc.*, 955 P.2d at 1002.

47. *Id.* at 998-99.

48. *Id.* at 999.

49. *Id.* at 1000.

county court and an appeal to the district court.<sup>50</sup> The county court found that Westec did not know that P.I.I. was organized as a limited liability company and that the letters "P.I.I." found on Clark's business card were insufficient to notify Westec that P.I.I. was a limited liability company.<sup>51</sup> Because Westec thought it was dealing with Lanham, the county court entered judgment against Lanham, holding him personally responsible for the contract.<sup>52</sup>

Contrary to the county court, the district court interpreted Colorado's LLC statutes to mean that Lanham was not personally liable for any judgment against P.I.I.<sup>53</sup> The district court excused Lanham, finding that Westec was placed on notice that it was forming a contract with a limited liability company.<sup>54</sup> This holding was based on two factors: (1) the business card with the letters P.I.I. given to Westec at the time the contract was formed, and (2) the notice provision contained in Colorado's LLC statutes.<sup>55</sup>

The district court read the notice provision to provide that as long as an LLC is properly filed with the Colorado Secretary of State, third parties have constructive notice that the company is an LLC.<sup>56</sup> In the contract negotiations, Clark gave his business card to Westec, which included the address listed as P.I.I.'s principal place of business.<sup>57</sup> The company's name did not appear on the card, but the acronym P.I.I. was part of the address.<sup>58</sup> Principally in reliance on the notice provision, the district court held that Westec knew it was dealing with the business entity P.I.I., and that the Colorado LLC Act protected Lanham from personal liability.<sup>59</sup>

The Colorado Supreme Court reversed the district court's interpretation of the Colorado LLC statutes.<sup>60</sup> The court held that the notice provision applied only where a third party seeks to impose liability on the members of

50. *Id.* at 999-1000.

51. *Id.* at 999.

52. *Id.* at 1000.

53. *Id.*

54. *Id.*

55. *Id.* COLO. REV. STAT. § 7-80-208 (1997) states:

The fact that the articles of organization are on file in the office of the secretary of state is notice that the limited liability company is a limited liability company and is notice of all other facts set forth therein which are required or expressly permitted to be set forth in the articles organization.

The Wyoming, the LLC Act does not contain a similar notice provision comparable to Colorado statute section 7-80-208. RIBSTEIN, *supra* note 29, § 4.09, App. 4-1 (1998).

56. *Water, Waste, & Land, Inc.*, 955 P.2d at 1001.

57. *Id.* at 999.

58. *Id.*

59. *Id.* at 1000.

60. *Id.* at 1005.

an LLC simply due to their status as members or managers of the LLC.<sup>61</sup> When a third party sues a manager or member of an LLC under an agency theory, the principles of agency law apply notwithstanding the statutory notice rules.<sup>62</sup> Thus, an agent of an LLC is liable for contracts negotiated on behalf of a “partially disclosed” principal, notwithstanding the limited liability status given by statute to an LLC member.<sup>63</sup>

The Supreme Court interpreted Colorado Statute section 7-80-208 differently than the district court.<sup>64</sup> Contrary to the district court’s decision, the Colorado Supreme Court held that the notice provision did not relieve the member-agent of his/her duty to disclose the identity of the LLC.<sup>65</sup> This interpretation of the notice provision means that a third party does not have notice of a company’s limited liability status until the LLC’s full name is disclosed to the third party.<sup>66</sup> However, the notice provision still prevents managers and members from being found liable simply due to their status as members.<sup>67</sup>

The Colorado Supreme Court supports its interpretation of the notice provision by explaining the meaning and impact of Colorado Statute section 7-80-201(1) (the name provision).<sup>68</sup> The name provision manifests legislative intent to compel any entity seeking to claim the benefits of the LLC Act to clearly identify itself as a limited liability company.<sup>69</sup> Therefore, the notice provision would only place Westec on constructive notice of P.I.I.’s limited liability status if the company was identified by a name such as “Preferred Income Investors, LLC.”<sup>70</sup>

The court concluded by stating that if Clark or Lanham had told Westec’s representatives that they were acting on behalf of “Preferred Income Investors, LLC,” Colorado Statute section 7-80-208 would have pro-

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61. *Id.* at 1001.

62. *Id.*

63. *Id.* at 1002. In holding Lanham personally liable the Colorado Supreme Court stated, “[i]n light of the partially disclosed principal doctrine, the county court’s determination that Clark and Lanham failed to disclose the existence as well as the identity of the limited liability company they represented is dispositive under the common law of agency.” *Id.* Because the county court found that the principal was not fully disclosed, Lanham was liable under the law of agency. *Id.* at 1001.

64. *Id.*

65. *Id.* at 1004.

66. *Id.* at 1003.

67. *Id.*

68. *Id.* COLO. REV. STAT. § 7-80-201(1) (1997) states, “[t]he words ‘limited liability company’ or the abbreviation ‘LLC’ shall be included in the name of every limited liability company formed under the provisions of this article. If ‘LLC’ is not used, the word ‘limited’ may be abbreviated as ‘Ltd.’, and the word ‘company’ may be abbreviated as ‘Co.’”

69. *Water, Waste, & Land, Inc.*, 955 P.2d at 1003.

70. *Id.* at 1004.

tected them from liability.<sup>71</sup> The missing link between the partial disclosure made by Clark and the protection of the notice provision was that Clark failed to state that "P.I.I." stood for "Preferred Income Investors, LLC."<sup>72</sup> The Colorado Supreme Court, accordingly, reversed the judgment of the district court, and remanded with instructions to reinstate the judgment of the county court.<sup>73</sup>

#### ANALYSIS

The Colorado Supreme Court's decision in *Water, Waste & Land, Inc.* correctly recognizes the need for courts to apply established common law agency principles to limited liability companies. The court was correct in determining that agency law is better equipped to determine LLC member personal liability issues than is the Colorado LLC Act. The principles of disclosure, partial disclosure, and nondisclosure provide clear guidelines as to the liability of the agent.<sup>74</sup>

The absence of statutory language outlining the extent of an LLC member's personal liability leaves a considerable gap in the Colorado LLC Act. In its attempt to shield members of an LLC from liability, the Colorado legislature simply left open the question of how immunity from liability could be lost. When faced with this gap in the law, the *Water, Waste & Land, Inc.* court correctly holds that LLC statutes that ignore or override the common law should be strictly construed.<sup>75</sup> If the Colorado Supreme Court would have allowed the notice statute<sup>76</sup> to override common law agency principles, it would have opened the door to possible fraud or deceit.<sup>77</sup> By applying the agency principles to this gap in the LLC Act, the Colorado Supreme Court sets a precedent that the common law of agency will apply to LLCs notwithstanding statutory oversight.

The *Water, Waste & Land, Inc.* decision was consistent with several other cases in which courts have applied common law agency theories to disputes involving LLCs.<sup>78</sup> For example, in *Ditty v. Checkrite* a Utah district

71. *Id.*

72. *Id.*

73. *Id.* at 1005.

74. See *supra* notes 35-42 and accompanying text.

75. *Water, Waste, & Land, Inc.*, 955 P.2d at 1003. See also *Peters v. Smuggler-Durant Mineral Corp.*, 930 P.2d 575, 580 (Colo. 1997); *Leader Federal Bank for Savings v. Saunders*, 929 P.2d 1343, 1348 (Colo. 1997); *Gleason v. Becker-Johnson Assoc., Inc.*, 916 P.2d 662, 664 (Colo. Ct. App. 1996).

76. COLO. REV. STAT. § 7-80-208 (1997). See *supra* note 55 and accompanying text.

77. In *Water, Waste, & Land, Inc.*, the court felt that the interpretation urged by Lanham would be a radical departure from the settled rules of agency under the common law. 955 P.2d at 1003. The court required the legislature to express its desires more clearly if they intend a departure of such magnitude. LLC statutes that come into conflict with common law principles are going to be strictly construed. *Id.*

78. *Ditty v. Checkrite*, 973 F. Supp. 1320, 1333-35 (D. Utah 1987); *J.M. Equip. & Transp. Inc. v.*

court applied agency law in addressing whether a principal was liable for the debt collection practices of its agent attorney, where the agent violated the Fair Debt Collection Practices Act (FDCPA).<sup>79</sup> In *Ditty*, the principal, Checkrite, Ltd., was charged with violating the FDCPA.<sup>80</sup> Checkrite argued that its agent, Richard Deloney, was responsible for the violations because debt collection efforts had been relinquished to his law firm.<sup>81</sup> The court rejected this argument and imposed liability upon the principal, because Checkrite vested its agent, Deloney, with implied, actual, and apparent authority.<sup>82</sup>

In *J.M. Equipment & Transportation, Inc. v. Gemstone* agency principles were applied to an LLC by the Connecticut Superior Court.<sup>83</sup> The issue presented in that case was whether the LLC entity, Gemstone L.L.C., could be held liable for the contractual obligations created by one of its members.<sup>84</sup> Glenn Reid, a member of Gemstone L.L.C., had contracted for equipment repair services for his bulldozer with J.M. Equipment.<sup>85</sup> Upon nonpayment for the services, J.M. Equipment looked to Gemstone to make good on the contract. Gemstone denied liability, claiming that the services were for Reid personally and that he should be personally liable.<sup>86</sup> The court held that there was ample evidence to establish that Reid had apparent authority<sup>87</sup> to bind Gemstone and entered judgment in favor of J.M. Equipment.<sup>88</sup>

Both *Ditty* and *J.M. Equipment & Transportation*. illustrate that courts

Gemstone, CV 9662031, 1998 Conn. Super, LEXIS 2425 (Conn. Aug. 25, 1998).

79. *Ditty*, 973 F. Supp. at 1320. Deloney, a Utah LLC and agent of Checkrite, conducted business as a debt collector. *Id.* at 1324-25.

80. *Id.* at 1325.

81. *Id.* at 1335.

82. *Id.* To impose liability against Checkrite for Deloney's violations of the FDCPA pursuant to a theory of actual authority, Checkrite must have consented to the manner in which Deloney collected debts owed by debtors. To impose liability for acts of an agent under a theory of apparent authority, the principal must conduct itself in such a way as to clothe its agent with apparent authority to perform acts committed, and there must be reasonable reliance on that apparent authority on the part of the injured party. *Id.* at 1334-35.

83. *J.M. Equip. & Transp. Inc.*, 1998 Conn. Super, LEXIS 2425 at \*2.

84. *Id.*

85. *Id.*

86. *Id.*

87. *Id.* at \*3. The court interpreted Connecticut Statute, section 34-130, which provides in part that:

every member is an agent of the limited liability company . . . and the act of any member . . . for apparently carrying on in the usual way the business or affairs of the limited liability company of which he is a member, binds the limited liability company, unless the member so acting has, in fact, no authority to act for the limited liability company in the particular matter and the person with whom he is dealing has knowledge of the fact that the member has no such authority.

CONN. GEN. STAT. § 34-130 (1997).

88. *J.M. Equip. & Transp., Inc.*, 1998 Conn. Super, LEXIS at \*4.

are willing to apply agency principles to LLCs. In both instances the principal was held liable for the actions of its agent based on actual or apparent authority.<sup>89</sup> The courts in both cases saw the necessity of extending the long established common law of agency to the LLC to protect against fraud. If the LLCs in *Ditty* and *J.M. Equipment & Transportation* could have escaped liability based solely on their election of business entity, third parties might hesitate to do business with LLCs. Parties contracting with members of LLCs must be assured that the assets of the LLC are behind the contract, and that the member will not be able to unjustly receive the benefit of the contract by using the name of the LLC.<sup>90</sup>

In *Water, Waste & Land, Inc.*, the Colorado Supreme Court properly applied agency law to LLCs, thereby preserving the integrity and validity of the LLC as a valuable business entity and preventing the LLC statute from inviting fraud.<sup>91</sup> The Colorado General Assembly did not intend to open the door to unfair practices and outright fraud when it passed the LLC Act.<sup>92</sup> The court stated that if “the legislature had intended a departure of such magnitude, its desires would have been expressed more clearly.”<sup>93</sup> Limited liability companies could not establish or retain respect as significant business entities without adhering to these common law principles.

The decision to apply agency law in *Water, Waste & Land, Inc.* was also appropriate because agency principles will generally give an LLC member more protection from liability.<sup>94</sup> The holding of *Water, Waste &*

89. See *supra* notes 78-88 and accompanying text.

90. Although this note deals with the court's willingness to hold an LLC member liable as the agent of a partially disclosed principal, it should be noted that P.I.I. was also held responsible as the principal for the contract negotiated by Clark. It appears that P.I.I. was not able to satisfy the contract, making it necessary for Westec to seek recovery from Lanham. The court did not discuss the assets of P.I.I.; however, it appears that P.I.I. may have been merely a shell or an “alter ego” of its members. At the very least P.I.I. was probably severely undercapitalized and unable to pay the debt to Westec. Although the Colorado Supreme Court did not apply veil piercing theories in this situation, arguably they could have. Colorado Statute section 7-80-107 provides for resort to the case law which interprets the conditions and circumstances under which the corporate veil of a corporation may be pierced under Colorado law. In *Water, Waste, & Land, Inc.* the court was very specific in drawing a distinction between the use of an agency theory and the doctrine of piercing the corporate or limited liability company veil. *Water, Waste, & Land, Inc. v. Lanham*, 955 P.2d 997, 1004 (Colo. 1998).

91. *Id.* at 1002. The court felt that the interpretation urged by Lanham would be an invitation to fraud,

because it would leave the agent of a limited liability company free to mislead third parties into the belief that the agent would bear personal financial responsibility under any contract, when in fact, recovery would be limited to the assets of a limited liability company not known to the third party at the time the contract was made.

*Id.* at 1003.

92. *Id.*

93. *Id.*

94. Karin Schwindt, Comment, *Limited Liability Companies: Issues in Member Liability*, 44 UCLA L. REV. 1541, 1549 (1997). Because one of the objectives of the LLC entity is limited liability for its members, it is beneficial for the LLC to adhere to agency principles. Therefore, when courts impose

*Land, Inc.* should not be primarily regarded as reducing the limited liability status of an LLC member, but rather as a decision upholding agency principles. Agency law does not necessarily have to expose the LLC member to more liability. When the member properly discloses his principal, agency law provides the member with an extra layer of limited liability.<sup>95</sup> As demonstrated by *J.M. Equipment & Transportation, Inc.*, courts will readily hold the LLC entity itself liable when there is sufficient authority given to the member. Furthermore, under an agency regime LLC members will know the extent of their liability by looking to well established legal principles, such as those pertaining to disclosure, partial disclosure, and nondisclosure.

Because *Water, Waste & Land, Inc.* is consistent with the law applied to other business entities, the expectations of parties dealing with LLCs will be upheld in future business transactions. When dealing with a member of a business entity, third parties can expect either that the entity will be fully disclosed or that the member will become a party to the contract. In the wake of *Water, Waste & Land, Inc.*, Colorado member-agents who contract on behalf of LLCs now assuredly have the burden of stating that they are representing an LLC. This disclosure gives the third party an opportunity to request a personal guarantee from the member on the contract if desired.

*Water, Waste & Land, Inc.* is a good model for jurisdictions that are faced with member liability issues arising in the context of LLCs. Because agency law deals effectively with member liability and protects the integrity of the LLC entity, it is appropriate that it apply to LLCs.

#### *Wyoming Will Likely Apply Agency Law to LLCs.*

Wyoming courts will likely follow the sound reasoning in *Water, Waste & Land, Inc.* and apply common law agency principles to the Wyoming LLC Act.<sup>96</sup> This is true for several reasons. The Wyoming LLC Act does not appropriately deal with the possibility of imposing personal liability on LLC members, and Wyoming common law has consistently applied agency principles in the corporate setting. In addition, the policy reasons supporting *Water, Waste & Land, Inc.* are equally applicable to Wyoming LLCs.

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agency principles in a case dealing with an LLC, it will not always lead to member liability. Often agency principles work in favor of the member, holding the principal liable for the agreement contracted on its behalf. *See supra* notes 78-88.

95. *Schwindt*, *supra* note 94, at 1549. If an LLC member has the power to bind his or her LLC and the limited liability company is disclosed as the party to the contract, agency law immunizes the member from liability on the contract. *Id.* at 1549 n.38.

96. WYO. STAT. ANN. §§ 17-15-101 to 144 (Michie 1997).

The Wyoming LLC Act is a broad statute that was designed primarily to limit the liability of LLC members.” This grant of immunity is tempered only by the “magic language” provision of the Wyoming LLC Act which provides that “[o]mission of the words ‘limited liability company,’ or its abbreviations . . . 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>98</sup> Thus, members of a Wyoming LLC can only be held liable under the statute if they fail to include the magic words “limited liability company” in their communications with the world. It is not certain whether this statute was designed to prevent fraud by LLC members or simply to incorporate agency principles in a more limited form. In any case, the statutory exception to the immunity rule is insufficient to account for the host of issues likely to arise in the future regarding LLC member liability in Wyoming.

Under the “magic language” provision, a member of an LLC may incur personal liability for misuse of the company name, but this statute leaves a gap similar to that found in the Colorado LLC Act. The gap, or loophole, is that the Wyoming statute makes LLC member liability contingent upon a complex factual determination. Unlike its common law counterpart, the liability provision in the Wyoming LLC Act leaves an unacceptable number of issues unresolved.

To illustrate the gap in Wyoming LLC law it is beneficial to consider how *Water, Waste & Land, Inc.* would have been resolved in Wyoming.” Lanham and Clark failed to use the words “limited liability company” or one of its abbreviations in the transaction with Westec, which would make them subject to the “magic language” provision. However, for this statute to impose liability upon Lanham, the court would have to specifically find the

97. The Wyoming statute provides that “[n]either 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.” WYO. STAT. ANN. § 17-15-113 (Michie 1997); compare with COLO. REV. STAT. § 7-80-705.

98. WYO. STAT. ANN. § 17-15-105(b) (Michie 1997). The Wyoming Act contains a name provision in section 17-15-105(a) requiring every limited liability company formed to include the words “limited liability company” or an approved abbreviation. This provision is very similar to the name provision in the Colorado Act. See *supra* note 68. The Wyoming LLC Act section 17-15-105(b) extends the name provision, and is referred to as the “magic language” provision, as it appears to subject a member-agent of an LLC to personal liability if the member-agent does not use the “magic words” in the use of the name of the LLC. While this section was obviously enacted to protect parties dealing with LLCs, it may precipitate more problems. See *infra* note 101 and accompanying text.

99. The Wyoming LLC Act does not contain a notice statute comparable to the notice provision in the Colorado Statutes. See *supra* note 55. Thus, if a Wyoming court was faced with the facts of *Water, Waste & Land Inc.* the applicable statute would be the “magic language” provision. See *supra* notes 3-12 and accompanying text for the specific facts of *Water, Waste, & Land, Inc.*

elements required by the statute.<sup>100</sup> First, it would have to find that Lanham either participated in the omission of the magic language or knowingly acquiesced in the omission. Second, it would have to find that Westec suffered damages. Third, and most difficult, the court must find that the damage suffered by Westec directly resulted from the omission of the LLC initials by Lanham and Clark. P.I.I.'s inability to satisfy the contract may not be sufficient to show damage occasioned by the omission. Under the "magic language" provision, Westec would be required to show some sort of reliance upon the name of P.I.I. upon entering into the transaction.<sup>101</sup> Because the facts do not show that Lanham participated or acquiesced in the omission of the LLC acronym, or that the damage to Westec was caused by the omission of the LLC acronym, Lanham would probably not be found liable under the Wyoming LLC Act.

Considering the complexity of the factual issues raised under Wyoming's LLC Act, agency principles are necessary to fill in the gap. The Wyoming statute would only appear to hold Lanham personally liable for the contract if very specific facts were found.<sup>102</sup> While section 17-15-105(b) initially seems similar to the agency principles of partial disclosure and nondisclosure, it actually creates a stricter test for finding an LLC member liable. This specialized approach differs from the general rules of agency law and precipitates more complicated issues than it resolves. If the Wyoming court followed the Colorado rule and applied agency law to LLCs, the court would need only determine if the principal was disclosed, partially disclosed, or undisclosed, rather than answer the myriad of question arising under the "magic language" provision.<sup>103</sup> If Wyoming courts adopt the reasoning in *Water, Waste & Land, Inc.* and apply agency law notwithstanding the wording of the "magic language" provision, the decision would be much easier. The analysis would be simplified and would not contain the loopholes and gaps that the "magic language" provision contains. Agency law

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100. See *supra* note 98. The Wyoming statute requires that for the member to incur liability: (1) the member must participate in or knowingly acquiesce in the omission of the words "limited liability company;" (2) damage must occur to the third party, and (3) the damage must be caused by the omission of the LLC reference inferring reliance of the third party upon the name disclosed to them. WYO. STAT. ANN. § 17-15-105(b) (Michie 1997).

101. See Harvey Gelb, *Liabilities of Members and Managers of Wyoming Limited Liability Companies*, 31 LAND & WATER L. REV. 133, 135 (1996). There are several difficult questions arising from the "magic language" provision, specifically the interpretation of the words "liable for indebtedness, damage or liability occasioned by the omission." This language seems to place a burden upon the injured party to show evidence that they were at a disadvantage solely because the agent of the LLC failed to show the proper language in the use of the LLC. Such evidence may be that if the agent had used the magic letters it would have triggered thought about liability and given the injured party the opportunity to request a personal guarantee. It might be shown that the injured party would not have engaged in the transaction but for the omission. If the injured party did not think about who would be liable then they may not be able to show reliance on the name of the business entity disclosed to them. *Id.*

102. See *supra* note 100 and accompanying text.

103. See *supra* notes 35-42 and accompanying text.

provides a test that can be consistently applied to situations contemplated by section 17-15-105(b), and applying it to the Wyoming LLC will simplify the issue of member personal liability rather than increase the complexity of the situation.

Wyoming is likely to follow *Water, Waste & Land, Inc.* in extending agency law to the Wyoming LLC<sup>104</sup> because the Wyoming courts have routinely applied common law agency principles in the corporate setting.<sup>105</sup> It is natural to compare the LLC with corporations because of the similar limited liability existing in both entities.<sup>106</sup> The Wyoming Supreme Court has held that an agent of an undisclosed principal is subject to all liability, expressed or implied, created by the contract in the same manner as if he were the principal.<sup>107</sup> Conversely, an agent will generally not be liable when contracting on behalf of a fully disclosed principal.<sup>108</sup>

In *S.C. Ryan, Inc. v. Lowe*, the Wyoming Supreme Court applied agency principles to a personal liability issue in the corporate setting.<sup>109</sup> The Montana corporation (S.C. Ryan, Inc.) filed suit to hold Bill Lowe personally liable for a debt incurred by Lowe on behalf of Willor Company.<sup>110</sup> Lowe contended that the debt was incurred by the corporation, Willor, Inc., for which Lowe was an agent.<sup>111</sup> The issue presented to the Wyoming Supreme Court was whether Lowe, as an agent for Willor, Inc., was personally liable for contracts he had made on behalf of the corporation.<sup>112</sup> The court used the undisclosed principal theory of agency law to hold that Lowe could be personally liable for the contract.<sup>113</sup>

104. See Gelb, *supra* note 101, at 141. Professor Gelb indicates that it is doubtful that the Wyoming legislature intended to eliminate the contract liability of an LLC member or manager acting as an agent for the LLC if such liability could otherwise be imposed by the courts. *Id.* See also *supra* notes 39-40 and accompanying text.

105. See *S.C. Ryan Inc. v. Lowe*, 753 P.2d 580, 583 (Wyo. 1988); *Hogan v. Postin*, 695 P.2d 1042, 1045 (Wyo. 1985); *Starrett v. Shepard*, 606 P.2d 1247, 1249-50 (Wyo. 1980); *Kure v. Chevrolet Motor Div.*, 581 P.2d 603, 609 (Wyo. 1978); *S-Creek Ranch, Inc. v. Monier & Co.*, 509 P.2d 777, 783 (Wyo. 1973); *United States v. Van Diviner*, 822 F.2d 960, 963 (10th Cir. 1987).

106. See *supra* notes 26-27 and accompanying text.

107. *S-Creek Ranch, Inc.*, 509 P.2d at 783.

108. *Kure*, 581 P.2d at 609 (Wyo. 1978). An agent who contracts on behalf of a disclosed principal, in absence of some other agreement to the contrary or other circumstances showing he has expressly or impliedly incurred or intended to incur personal responsibility, is not liable to the other contracting party. *Id.*

109. 753 P.2d 580, 583 (Wyo. 1988).

110. *Id.* at 581.

111. *Id.* at 582.

112. *Id.* at 583.

113. *Id.* The court used agency law to find that Lowe could be found personally liable and remanded back to the district court.

Where an agent or officer enters into a contract with a third party on behalf of the corporation, and the third party is not aware of the existence of the corporation and

The Wyoming Supreme Court will also likely recognize the necessity for applying agency principles to LLCs because of the policy implications. Agency law will help to preserve the integrity of the Wyoming LLC as a business organization by preventing possible fraudulent uses of the LLC. Agency law will also protect the interests of third parties who are dealing with a member-agent of an LLC. Although *Water, Waste & Land, Inc.* is not binding outside of Colorado, the sound reasoning behind its holding is applicable to similar situations in Wyoming.

#### CONCLUSION

Agency law was correctly applied in *Water, Waste & Land, Inc.* to the LLC, as agency law is better equipped to deal with personal liability issues than is the current Colorado LLC Act. Limited liability statutes that appear to replace or ignore established common law should be strictly construed. Moreover, courts that apply agency law will preserve and increase the integrity of the LLC as a business entity. Agency law forms a basis upon which parties forming contracts with members of LLCs can rely. Wyoming courts will likely follow the reasoning propounded by the Colorado Supreme Court in applying agency law to LLC statutes. The principles of agency law offer a broader, more complete rule, for member personal liability in a Wyoming LLC than does Wyoming Statute section 17-15-105(b). Members of Wyoming LLCs wanting to avoid future liability would be well advised to acknowledge the growing trend of courts willing to extend personal liability to LLCs and expect that the same reasoning will eventually apply in Wyoming.

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no disclosure is made to him, the agent is personally liable on the contract . . . . To avoid personal liability on a contract to be entered into on behalf of his principal, where agency and identity of the principal are unknown, the agent has a duty to disclose both the fact that he is acting in a representative capacity and the identity of his principal, and the party dealt with is not required to discover or make inquiries to discover such facts. On the other hand, the agent is not liable where actual knowledge is shown, whether the agent himself makes the disclosure or the other party acquires the knowledge from some other source. Express notice of the agency relationship is not required. If the facts and circumstances surrounding the transaction affirmatively demonstrate that the contracting party should have been aware that he was dealing with a corporation, the officer will not be held personally liable for the contract. Whether the fact of agency and the name of the principal were disclosed or known to the third party so as to protect the agent from personal liability on the transaction is essentially a question of fact, and disclosure may be shown by circumstance surrounding the transaction and by the course of dealing between the parties. The officer claiming the agency relationship has the burden of proof on the issue

*Id.* (citing SOLHEIM & ELKINS, *supra* note 42, §118).