New choice entity: Unlimited Limited Liability Companies?
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If it sounds too good to be true, it probably is. However, pursuant to a recent Colorado Supreme Court decision, Weinstein v. Colborne Foodbotics, LLC ("Weinstein"), we may be one step closer to an unlimited limited liability company. As a result, the Court's decision confirms, at least for now, that the LLC may be the entity of choice in Colorado.

In the Weinstein case, a creditor had received an arbitration award in federal court against a business. Subsequently, the managers of the business authorized a distribution to the members of the organization, which rendered the business insolvent and unable to pay the award the creditor had received. The creditor then sued both the members and the managers, claiming the members violated the Colorado Limited Liability Company Act ("LLC Act") by accepting an unlawful distribution and that the managers violated a fiduciary duty owed to creditors.

The Court concluded that (1) LLC members are not liable to LLC creditors for unlawful distributions and (2) LLC managers of insolvent LLCs do not owe the same fiduciary duty to LLC creditors that directors of insolvent corporations owe to corporations' creditors. The result is that LLC members and managers are not liable to creditors in these instances, though many believe creditors may still have recourse under the Colorado Uniform Fraudulent Transfers Act.

In reaching these conclusions, the Court struck down the argument that LLCs should be viewed the same as corporations. The Court pointed out several key distinctions between the two entity types. First of all, they are governed by separate statutory schemes. The Colorado Business Corporation Act ("Corp. Act") is more detailed and provides less flexibility than the LLC Act. Corporate shareholders are also not equivalent to LLC members. Additionally, the LLC Act contains distinct language limiting the application of corporate common law to LLCs. Only in a veil-piercing action is the corporate common law to be applied. Finally, the LLC Act provides that a general "rule that statutes in derogation of the common law are to be strictly construed shall have no application." Thus, the Court concluded that the LLC Act, not corporate common law, governs LLCs.

With the corporate common law set aside, the Court looked to the language of the LLC Act itself to reach its final determination. The LLC Act provides members who receive an unlawful distribution are liable to the LLC. There is no mention of creditors. Likewise, "[t]he LLC Act states that managers are not liable for debts of the LLC, and it extends no fiduciary duty to creditors."

So what does this mean for business owners? On the surface, the Weinstein decision seems to be extremely favorable to selecting the LLC as your business type. It also seems extremely harsh to creditors of LLCs, as their options for recourse in these situations is now very limited. The law, however, may not end up playing favorites at all. It will likely just change the relationship between LLCs and creditors. Creditors will likely require members and managers to put some more skin in the game, possibly through more detailed personal guaranties or other agreements specifically establishing the members and managers as owing duties to the creditor.

The downside to these types of arrangements is that it may make finding financing more difficult, thus inhibiting the very investment and business ventures the limited liability provisions of the LLC Act are meant to foster. The changes in the market may end up making the impact of this decision arbitrary in terms of evaluating risks and potential liability when deciding on what type of entity to form.

For already formed LLCs, there may be other ways for creditors to establish liability of a member or manager upon an unlawful distribution, such as breach of contract, fraudulent transfer, etc. Additionally, dependent on the facts, a court may still find members and managers to be fiduciaries of creditors. While it is clear a fiduciary duty is not owed to creditors pursuant to the LLC Act, there are other means by which a fiduciary relationship can be established. It has been long established that:

> A fiduciary relation exists between two persons when one of them is under a duty to act for . . . the benefit of another upon matters within the scope of the relation. The extent of trust, whether the repose of trust was justified, whether it was known, or should have been known, that one party was relying on the other to look out for their best interests, whether there was an invitation, acceptance, or acquiescence to the trust, and whether there was an undertaking to represent the other's interests all play into the determination of whether there is a fiduciary relationship.
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> Moses v. Diocese of Colorado, 863 P.2d 310 (Colo. 1993).

So, it is entirely possible that despite there being no fiduciary duty by statute, the actions of members and managers may still create a fiduciary relationship. These other means of establishing liability should caution members and managers when determining whether or not to make certain distributions.

Some read the Weinstein case as signaling a shift to a business-friendly court protective of those who risk their money in a business venture, to the detriment of creditors. Others see the opinion as nothing more than confirmation that the liability of members and managers in an LLC is truly limited. Whether that limitation of liability is now so broad as to really be unlimited, absent outright fraud, remains to be seen. For now, one thing is clear: members of an LLC should consider distributions to themselves over payment to creditors very carefully and not read this one decision as a license to not repay LLC debts. After all, the age-old maxim still holds true: if it sounds too good to be true, it probably is.

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