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Business Law

Post-*Puelo*: Liability During Administrative Dissolution

Under current law, LLC members and managers are protected from personal liability even after the LLC is involuntarily dissolved, a level of protection greater than that enjoyed by corporations and partnerships. The authors explain how it works and issue a call for consistency.

By Owen R. Brugh and Terrence J. McConville

As it stands today, an involuntarily dissolved LLC never actually dies, at least when it comes to the liability shield that protects its members and managers. Even if the LLC is never reinstated, never files another annual report, never pays another fee, and still continues operating as if it is an LLC, it still exists for purposes of the liability shield. *Puelo v Topel*, 368 Ill App 3d 63, 856 NE2d 1152 (1st D 2006); see also Lin Hanson & Charles W. "Bud" Murdock, Puelo v Topel*: Respectfully, the Court Got it Wrong*, 96 Ill Bar J 158 (March 2008).

Members of the Institute of Illinois Business Law are working on draft legislation to correct, or at least clarify, this protection, which differs greatly from how courts treat corporations that are involuntarily dissolved. The consensus is that there should be consistency in the law in how LLCs and corporations are treated. However, it is worth reviewing how Illinois got to this point and how other states address the issue.

What other states are doing

Puelo involved an LLC owner and manager, Michael Topel, who failed to file the annual report for Thinktank, LLC. The Secretary of State involuntarily dissolved Thinktank, but Topel continued to operate the business as if it were an LLC. Several months later, he informed all employees and independent contractors that the business was closing immediately, and Thinktank failed to pay contractors for work already provided. The contractors sued Thinktank and Topel.

The trial court held that, although Thinktank was involuntarily dissolved and never reinstated, and the contractors' work was not within the scope of winding up the business, plaintiffs still could not sue Topel personally for payment because Topel retained the liability shield of the LLC.

If Thinktank had been a corporation, the shield would not have been available. *Gonnella Baking Co v Clara's Pasta Di Casa, Ltd*, 337 Ill App 3d 385, 786 NE2d 1058 (1st D 2003). The difference, according to the trial court, was that the state legislature in 1998 changed LLC law by removing the reliance on corporate case law and inserting a provision that makes LLC managers liable *to the LLC* for actions outside the scope of winding up the business when it is dissolved.

The provisions inserted in Illinois law in 1998 originated as the Uniform Limited Liability Company Act of 1996 § 804 and were removed from the Revised Uniform Limited Liability Company Act of 2006. Still, they persist in the Illinois statute and those of six other states, none of which have case law on the section.

Logic dictates that a member or manager facing personal liability for the acts of the LLC while involuntarily dissolved would simply reinstate the LLC by correcting the filing deficiency, allowing the LLC to relate back as if it were never dissolved. However, a few states have faced situations similar to *Puelo* or have explicitly legislated to clarify the issue.

A Washington state court in 2009 held that managers who fail to properly wind up a company whose certificate of formation was cancelled for failing to file annual reports or pay fees (similar to Illinois's involuntary dissolution) can be held personally liable for claims against the LLC. *Chadwick Farms Owners Assn v FHC LLC*, 166 Wash 2d 178, 207 P3d 1251 (2009). The Washington state legislature a year later removed from their LLC statute any provisions allowing for involuntary dissolution. However, members and managers remain personally liable for the improper winding up of an LLC.

Similarly, a Connecticut court in 2009 held that, when an LLC is in "default status" for failing to file an annual report, that failure is evidence that the LLC was being operated as an alter ego of the manager or member. *Mackin v Jila Const, LLC*, 2009 WL 1055479 (Conn Super).

The law in Nevada is even stronger in favor of allowing personal liability. It explicitly provides that a dissolved LLC no longer exists except to wind up the business, Nev Rev Stat § 86.505, and any person purporting to act on behalf of an LLC without authority is personally liable for any debt or liability. Nev Rev Stat § 86.361. Of course, a member or manager can avoid the liability by reinstating the LLC.

At the other end of the spectrum, the Delaware statute explicitly exempts members and managers from personal liability premised solely on the LLC's failure to pay fees or otherwise cease to be in good standing. Del Code Ann 6 §18-1107(n). Similarly, Michigan provides in its statute that company managers and members only lose the LLC liability shield when the LLC is voluntarily or judicially dissolved. Pennsylvania makes clear in committee comments to its LLC law that dissolution of an LLC does not weaken the liability shield, even for acts taken after dissolution.

A few other states, such as California, Colorado, Florida, and New York, explicitly extend corporation case law to apply to LLCs, as Illinois did prior to the 1998 changes. However, most of those states have held that involuntary dissolution of a corporation does not, without other factors, result in personal liability to shareholders for acts after dissolution.

Most of the remainder of states have never confronted the issue and have no explicit language in their statutes that address the issue.

A statutory solution

In an effort to clarify at least part of this problem in Illinois, a change to the Business Corporation Act (BCA), the Not For Profit Corporation Act (NFPCA) and the Limited Liability Company Act (LLCA) has been proposed to limit personal liability for anyone acting on behalf of an entity that has been administratively dissolved and then subsequently reinstated. This proposal by Sherwin D. Abrams and David Selmer of the Institute of Illinois Business Law would add a new subsection (e) to Section 12.45 of the BCA, as follows:

(e) Anyone acting on behalf of a corporation that has been administratively dissolved but reinstated will not be personally liable for acts that occurred during the period of dissolution solely by reason of the fact that the corporation was administratively dissolved at the time of such acts.

Similar provisions would also be added to the NFPCA and LLCA. It is important to note the phrase "solely by reason of the fact that the corporation was administratively dissolved at the time of such acts." The proposed language is not intended to give persons a complete pass on liability for their actions simply by reinstating the dissolved entity. Other theories of personal liability, such as piercing the entity veil and fraud are intended, in appropriate circumstances, to remain available.

Although this fix to the BCA, NFPCA and LLCA may not cure or correct all of the problems regarding the issue of personal liability during administrative dissolution of a business entity, it attempts to make the law more consistent by applying the same standards to all three forms of entities. However, to the extent the proposed language does not explicitly state that there is personal liability if an administratively dissolved entity is not reinstated, it may not rectify all of the ramifications of the *Puelo* decision.

While there is no consensus on the issue, a clarification of *Puelo* through statute is in order.

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