What is so good about an LLC?

3 January 2010

Typically one thinks of being able to shield personal assets from creditors that arise from their business activity ("inside liability") as the main reason to create a business entity. Once the decision to create a business entity is made, the type of entity, corporation (Inc.), professional corporation (P.C.), limited partnership (L.P.), or limited liability company ("LLC") is based on the corporate structure desired or other considerations. But there is one feature of the LLC that should be considered when making this decision; the shielding of the corporation from liability arising from personal acts ("outside liability"). Yes, it is important to consider outside liability in addition to inside liability when deciding the right business entity form to choose.

Understand, that no corporate entity can shield the corporation in all aspects, but the LLC has an advantage over other business entities in these situations. When a personal creditor seeks to take corporate assets from a (non LLC) corporate owner, he can take ownership of the stock. If it is a majority of the stock, generally, then this creditor will be able to run the company. Now, corporate agreements can be made to create the opportunity to prevent the creditor from taking control, like allowing the minority shareholder the option of buying the creditor out before exerting control. However, one may forget to import these clauses, or other shareholders may not be able to exercise them when it happens.

With the LLC, the creditor does not obtain the voting or management rights of the entity, but only a "charging order" that allows the creditor's judgment to be satisfied by the LLC member's interest. The major benefit is that the creditor never gets to run the company, and you maintain control. The creditor will be able to take corporate distributions, and although distributions should not be withheld in bad faith, it is still a decision the company (that includes you) makes. The reason behind this difference is that other members of the LLC should be protected from the other member's creditors.

A few caveats though; one is that although Massachusetts recognizes single member LLC's , there is an argument that single member LLC's should not receive its special protection. At least one out-of-state court has ruled that way. *In re* Albright, 291 B.R. 538 (Bankr. D. Colo. 2003). Another caveat is that when bankruptcy is involved, new considerations may alter these basic rules. Finally, when seeking to protect anything from a creditor in the corporate setting, you must follow the proper corporate rules and structure to ensure the creditor does not successfully "pierce the corporate veil." In closing, we urge you to consider the benefits of an LLC when making the decision what business form to start.

Contact: George E, Bourguignon, Jr.

(413) 746-8008

gbourguignon@bourguignonlaw.com