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SHATTERING THREE COMMON MYTHS ABOUT MISSOURI LIMITED LIABILITY COMPANIES

I was asked recently to make a CLE presentation on the subject of Missouri limited liability companies. As I began my research, I confronted three common misconceptions about Missouri LLCs. First, some business owners complain that the creation of a limited liability company will have no practical impact in reducing their personal liability exposure. Second, many believe you do not need to create an operating agreement for the LLC under Missouri law. And finally, the Missouri Limited Liability Company Act supposedly does not provide the members with the same protection from their personal liability creditors as the comparable laws in other states. This article is designed to shatter these three common myths about the Missouri statute.

I. Limited liabilities companies provide members with important general - but not absolute - statutory protection from personal liability.

Members ordinarily created a limited liability company to limit their personal exposure to liability for the company's actions, or for the actions of other members or managers. I often hear small business owners complain that the creation of an LLC will have no practical impact in reducing their exposure. It is true that the LLC will not insulate the member from personal liability for his or her own tortious conduct. So, for instance, a member could not use the LLC to avoid personal liability for his or her own fraud. Nor could a lawyer, doctor, insurance broker or accountant use the company to avoid personal liability for professional malpractice. And if the member personally guarantees a company's lease or other debt obligations, the LLC will not insulate the member from personal liability under the guaranty.

Yet the Missouri Limited Liability Act is clear. Under the Act, a person who is a member or manager of a limited liability company is not subject to liability for company's obligations or the acts of others solely by reason of being a member or manager:

> A person who is a member, manager, or both, of a limited liability company, or both, is not liable, solely by reason of being a member or manager, or both, 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, whether arising in contract, tort or otherwise or for acts or omissions of any other member, manager, or agent or employee of the limited liability company.

§347.057.[1]

Generally speaking, a small business owner is far better off with this statutory protection than to be subjected to the unlimited personal exposure of a sole proprietor or a general partner in a partnership. This protection, while not absolute, can have important practical applications. So, for example, the statute can protect the member from liability for the negligent acts committed by another member or manager. And it can protect the member from liability for any default by the company on a contract with one of its vendors. In most instances, the protection also should insulate the members from personal liability if someone is injured on the company premises.

II. The Act compels the creation of an operating agreement.

Another common misconception about limited liability companies is that the creation of an operating agreement is unnecessary under Missouri law. Many owners of limited liability companies – especially the owners of single member companies - believe that they have met all statutory requirements by paying the filing fee and filing their Articles of Organization with the Secretary of State. Not so. It is true that an operating agreement does not have to be filed with the State. And the member or members have broad discretion to spell out what to include or not include in their operating agreement. But the obligation to create one is mandatory under §347.081.

By definition, an operating agreement is "any valid agreement or

[1] All statutory references are to RSMo (2016).

agreements, written or oral, among all members, or a written declaration by the sole member concerning the concerning the conduct of the business and affairs of the limited liability company and the relative rights, duties and obligations of the members or managers, if any." §347.015(13). The members have broad discretion to include in their operating agreement provisions on the following topics:

(1) vesting the management of the company in the managers or members, and imposing limitations on how those management powers may be exercised;

(2) providing classes of members with different rights, powers and duties;

(3) dividing the exercise of management or voting rights among the different classes;

(4) providing for meeting notices, actions by consent, waiver of notices, quorum requirements, authorization by proxy, and any other matters over the exercise of voting or approval rights;

(5) authorizing certain managers or members to execute or file documents on behalf of the company;

(6) restricting the transfer of membership interests, including buy-sell provisions in the event of death or disability, and giving rights of first refusal for any offers by third parties.

(7) allocating income gains, deductions, losses, and credits among the members; and

(8) making tax elections and authorizing managers or members to make such elections. See, §347.081.1.

So the member or members have great flexibility to include any provision, not inconsistent with the law, to govern the affairs of the company and their rights and duties as members. §347.081.1. And the agreement may include oral promises, so long as the members have a valid contractual agreement. §347.015(13). Yet make no mistake. The obligation to create the agreement is mandatory under the Act:

> The member or members of a limited liability company *shall adopt an operating agreement* containing such provisions as such member or member s may deem appropriate, subject only to the provisions of sections 347.010 to 347.187 and other law….

§347.081.1 (emphasis supplied).

A small business owner may ask, so what? What is the practical effect of

ignoring this requirement if you never have to file an operating agreement with the State? The greatest danger could happen when a creditor or claimant brings a lawsuit against the company. Upon learning that the company has no operating agreement, the claimant then might try to "pierce the company veil." If the member or members commingle personal assets and fail to observe statutory formalities, a court might well pierce the veil and hold the members personally liable.

III. The Act Does Not Allow Personal Creditors of Members to Foreclose on the Company to Satisfy a Debt.

A third common misconception about limited liability companies is that Missouri provides less creditor protection than other states. This faulty view focuses on the procedure when a creditor of one of the members tries to use a charging order satisfy a debt. A charging order is a post-judgment remedy that allows a judgment creditor of an individual debtor-member of a limited liability company to enforce the judgment by charging the individual member's distributional interest with the unsatisfied amount of the judgment. *Regions Bank v. Alverne Assocs*., LLC, 456 S.W.3d 52, 53 (Mo.App. E.D. 2014). Just like with general partnerships, the charging order procedure is permitted for LLCs under §347.119. The purpose of the charging order procedure actually is to protect the LLC or partnership business and to prevent the disruption that would result if creditors could execute directly on LLC or partnership assets. *Regions Banks,* 456 S.W.3d at 59.

In reviewing this issue, I read an article suggesting the personal creditor of one of the members could use the charging order procedure to foreclose on the assets of the limited liability company. And because of this perceived risk, the members were advised to consider creating their LLC in another state with more protectionist rules. Recent case law compels the conclusion that this advice is now incorrect. Unlike with general partnerships, the Missouri statute for limited liability companies does not allow foreclosure as a remedy. *DiSalvo Props., LLC v. Bluff View Commer. LLC,* 464 S.W.3d 243, 247 (Mo.App. E.D. 2015). "A foreclosure of court-ordered sale of charged membership interests in an LLC is not expressly contemplated by section 347.119 or any other section of the Missouri LLC Act." *Id.* at 247.

Conclusion

The creation of a limited liability company is a simple and effective way to avoid unlimited personal exposure of the members for debts and obligations of the business. Although the protections of the Missouri Act are not absolute, the organizers of a new business should carefully consider the importance of those protections when deciding if the formation of an LLC makes sense. In forming the LLC, the member or members must create an operating agreement to comply with the Act. Finally, the members of the business should not be overly swayed by claims that Missouri offers the members less creditor protection than the laws of other states.

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