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## Putting Wyoming's New LLC Statute to Work for You and Your Clients

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September 10, 2011

### I. 2010 Wyoming Limited Liability Company Act

In 1977 Wyoming became the first state to authorize the limited liability company (LLC).<sup>1</sup> Since that time, a Uniform Limited Liability Act has been developed, first in 1996 (<http://www.law.upenn.edu/bll/archives/ulc/fnact99/1990s/ullca96.htm>) and updated in 2006 ([http://www.law.upenn.edu/bll/archives/ulc/ullca/2006act\\_final.htm](http://www.law.upenn.edu/bll/archives/ulc/ullca/2006act_final.htm)). Last year, Wyoming enacted the 2010 Wyoming Limited Liability Company Act, representing a comprehensive update to Wyoming's LLC laws. This revised act completely repealed Wyoming's Original LLC Act from 1977 and replaced it with a modified version of the Revised Uniform Limited Liability Company Act.<sup>2</sup> The 2010 LLC Act can be found at Wyo. Stat. Ann. §§ 17-29-101 to -1105 (2011). A complete discussion of changes resulting from the new 2010 LLC Act can be found in a recent Wyoming Law Review article entitled *The 2010 Wyoming Limited Liability Company Act: A Uniform Recipe with Wyoming "Home Cooking."*<sup>3</sup> Primarily, under the 2010 LLC Act:

- The operating agreement governs virtually everything with respect to the LLC, including its management and the rights of its members. Lacking an operating agreement, or provisions addressing the matter, the 2010 LLC Act's provisions govern as "default rules."<sup>4</sup>

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<sup>1</sup> Dale W. Cottam, Thomas N. Long, Scott W. Meier, Timothy O. Beppler and Whitney M. Agopian, *The 2010 Wyoming Limited Liability Company Act: A Uniform Recipe with Wyoming "Home Cooking,"* 11 Wyo. L. Rev. 49, 51 (2011).

<sup>2</sup> *Id.* at 51-52.

<sup>3</sup> *See id.* at 51.

<sup>4</sup> *Id.* at 56.

- There are no longer provisions dealing with a separate “flexible” form of LLC.<sup>5</sup>
- A dissociating member does not have the right to demand a return of a capital contribution or other payment in exchange for his or her LLC interest, unless the operating agreement otherwise provides.<sup>6</sup>
- Creditors’ remedies are limited, and the availability of “reverse veil piercing” is curtailed by an “exclusive remedies” provision.<sup>7</sup>
- Default rules now call for distributions to be per capita rather than according to capital contributions.<sup>8</sup>

## II. Becoming a Wyoming Limited Liability Company

Because of advantages associated with flexibility and creditor protection, existing business entities may wish to become Wyoming LLCs. A corporation or partnership may become a Wyoming LLC through a merger<sup>9</sup> or conversion,<sup>10</sup> in order to take advantage of the 2010 LLC Act, even if currently domiciled outside the state. A “continuance” might also be available to cause a non-Wyoming LLC to continue its existence in Wyoming as a domestic LLC.<sup>11</sup>

### A. Merger

A statutory merger has been the traditional method of changing a corporation’s domicile, commonly called a “reincorporation,” where the original business entity ceases to exist, but a new one survives with all of the same attributes to continue business. This method typically involves the creation of a subsidiary in a new jurisdiction followed by the statutory merger of the parent into the subsidiary. Through this process, an existing entity is integrated into a separate, new entity in the target state. The original entity ceases to exist, which usually is of no consequence unless specific assets or agreements require the continuation of the original entity’s existence. Although merger, or “reincorporation,” protects the rights, privileges, immunities, franchises, liabilities, and obligations of the original entity, the cessation of the separate existence of the original entity “may provoke unwanted tax or other results which would not occur with a continuance.”<sup>12</sup>

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<sup>5</sup> *Id.* at 64.

<sup>6</sup> *Id.* at 86.

<sup>7</sup> Wyo. Stat. Ann. § 17-29-503 (2011).

<sup>8</sup> Wyo. Stat. Ann. § 17-29-404 (2011).

<sup>9</sup> *Id.* §§ 17-16-1102 to -1108; 17-29-1002 to -1005.

<sup>10</sup> *Id.* §§ 17-26-101; 17-16-1115; 17-29-1006.

<sup>11</sup> Wyo. Stat. Ann § 17-29-1010 (2011).

<sup>12</sup> Thomas N. Long, *Continuance and Transfer: Transnational Change of Corporate Domicile Under Wyoming Law*, 23 Land & Water L. Rev. 445, 453 (1988).

## B. Continuance

A continuance, on the other hand, has the legal effect of simply allowing the "old" business entity to continue its existence in the new jurisdiction. Once an entity's domicile is changed using continuance, the entity is treated as if it had always been incorporated in Wyoming.<sup>13</sup> Much like an individual changing his or her domicile, the entity's age, personal history, and existence carries over from the original domicile.<sup>14</sup> A continuance in English jurisdictions was the primary method of effecting changes of corporate domicile, and Wyoming was the first state in the United States to enact continuance legislation for corporations. Many state's have followed Wyoming's lead; continuance provisions are now also set forth in the Model Business Corporation Act and described as involving a "domestication."<sup>15</sup> A continuance procedure was added to the Wyoming Limited Liability Company Act in 1993, also the first such legislation in the country.<sup>16</sup> While not always preferred, a merger may be necessary when the current domiciliary jurisdiction does not recognize a continuance procedure or an alternative method of conversion.

## C. Conversion

A newer concept, conversion, may be preferable to merger because the process only requires one entity and may involve fewer steps. A single business entity can change structure, and may change domicile from the old state to the new state in the process.<sup>17</sup> "Following entity conversion, the surviving entity is deemed to exist without interruption and to have been incorporated or organized on its original date of incorporation or organization, and the rights and liabilities of the converting entity become those of the surviving entity."<sup>18</sup> Once rare, states are increasingly adding this method of restructuring a business entity to their statutes.<sup>19</sup> "A growing number of state statutes, and the Revised Model Business Corporation Act, provide authority and procedures for a business corporation, foreign or domestic, to convert to another form of business entity, and for other forms of business entities to convert to a business corporation."<sup>20</sup> A Wyoming

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<sup>13</sup> *Id.* at 455.

<sup>14</sup> *Id.* See generally Margaret M. White, *The New Wyoming Business Corporation Act and Close Corporation Supplement*, 25 LAND & WATER L. REV. 527 (1990).

<sup>15</sup> Historically, domestication involved creation of dual domicile rather than a change of domicile. The history of the Wyoming statute regarding continuance of corporations, the British Commonwealth legislation from which it was derived, and its comparison to the traditional concept of "domestication," are all discussed in Thomas N. Long, *Continuance and Transfer: Transnational Change of Corporate Domicile Under Wyoming Law*, 23 Land & Water L. Rev. 445, 453 (1988).

<sup>16</sup> Wyo. Stat. Ann. § 17-15-143 (1993), repealed and replaced with minor modifications by Wyo. Stat. Ann. § 17-29-1010 (2011)

<sup>17</sup> Wyo. Stat. Ann. § 17-26-101 (2011).

<sup>18</sup> 8 W. Fletcher, *Cyclopedia of the Law of Private Corporations* § 3993.50 (2011) (footnotes omitted).

<sup>19</sup> See Ala. Code § 10-12-8; Ga. O.C.G.A. § 14-11-212; Mo. Rev Stat. § 347.125; Tenn. Code Ann. § 48-204-101; Va. Code § 13.1-1010.1; see also See David Porter, *Competing with Delaware: Recent Amendments to Ohio's Corporate Statutes*, 40 Akron L. Rev. 175, 196 (2007).

<sup>20</sup> 8 Fletcher, *supra* note 12, § 3993.50 (footnotes omitted).

business may convert to an LLC structure in order to take advantage of the 2010 LLC Act, particularly its more liberal governance requirements and limited liability that other types of business cannot offer.

### **III. LLC Creditor Protection**

#### **A. Charging Order Remedy**

One significant advantage of an LLC over a corporation is the limitation of the remedies available to creditors of an owner of LLC membership interests. Corporations do not offer the two way protection of: (1) shielding the owner from the liabilities of the entity, and (2) shielding the entity from the liabilities of the owner. This latter element of limited liability is often sought in estate planning contexts to help assure that a family won't be disinherited by a creditor. A creditor may only obtain a "charging order" which allows the creditor to intercept LLC distributions that might otherwise be made to the debtor, but it does not allow the creditor to seize and sell the membership interest. The 2010 LLC Act expressly applies the limitation of remedies to LLCs that have only one member, and it rejected the provisions in the Uniform Act that would have allowed a foreclosure type of remedy if the charging order does not satisfy the judgment within a reasonable time.

#### **B. Piercing The Veil**

The traditional concept which lead to the extensive use of corporations was to allow corporate shareholders to limit personal liability for the business entity's actions to the amount of the financial investment.<sup>21</sup> However, the doctrine of "piercing the corporate veil" allows courts to "disregard the distinction between a corporation and its shareholders to prevent fraud and injustice."<sup>22</sup> A court may pierce the corporate veil when the need to protect the people dealing with the corporation is more important than the need to encourage business development.<sup>23</sup> "The doctrine of piercing the corporate veil, however, is the rare exception, applied in the case of fraud or certain other exceptional circumstances . . . and usually determined on a case-by-case basis."<sup>24</sup> Commonly, a court will look to factors in determining whether to pierce the corporate veil, such as: undercapitalization; absence of corporate records; fraudulent representation by the corporation's directors or shareholders; use of the corporation to commit fraud, promote injustice, or conduct illegal activities; the corporation's payment of individual obligations; commingling corporate and individual assets; failure to observe corporate

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<sup>21</sup> *Osloond v. Osloond*, 609 N.W.2d 118, 121 (S.D. 2000).

<sup>22</sup> *Id.*

<sup>23</sup> *In re Adelpia Communs. Corp.*, 322 B.R. 509, 521 (Bankr. S.D.N.Y. 2005).

<sup>24</sup> *Dole Food Co. v. Patrickson*, 538 U.S. 468, 475 (U.S. 2003).

formalities; and other factors that show a disregard of the corporate entity.<sup>25</sup> The Wyoming Supreme Court has extended the veil-piercing doctrine to LLCs, allowing their veil of limited liability to be pierced in the same manner as that of a corporation, even in the absence of fraud.<sup>26</sup>

### C. Reverse Veil Piercing

Despite the “exclusive remedy” language of the Revised Uniform LLC Act, the drafting committee’s comments to section 503 suggest a judgment creditor has an additional remedy based upon the judicially created concept of “reverse veil-piercing.”<sup>27</sup> A “reverse pierce” is a court’s determination that a business entity should be liable for the owner’s individual debts, and is based on similar facts and circumstances applicable to traditional forms of piercing of a corporate veil.<sup>28</sup> While there is no determinative test for when reverse veil piercing applies, it is generally held that it requires enough unity of interest and ownership that the separation of the corporation and its individual shareholders does not actually exist, and that, if the issue is decided as if the corporation is separate, inequity will result.<sup>29</sup>

For example, in a case from Connecticut, the ninety-seven percent owner of an LLC contributed over \$144,000 to the LLC while the other owners contributed only \$10 each.<sup>30</sup> Because of the disproportionate control the debtor had over the LLC, using the LLC to pay personal expenses and commingling business and personal funds, the court pierced the veil and held the LLC liable for the ninety-seven percent owner’s debts.<sup>31</sup>

### D. States Recognizing Reverse Veil Piercing

Depending on the circumstances, most states will apply forms of traditional and reverse veil piercing,<sup>32</sup> such as Colorado, Minnesota, Florida, Illinois, Michigan, Montana, Nevada, New Jersey, and Virginia. Cases in states where the courts rejected the doctrine did not do so completely, but simply because the particular facts did not warrant its application (e.g. Kentucky, Louisiana, New York, Oklahoma, Tennessee, Texas, and

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<sup>25</sup> See generally *Brant v. Krich*, 835 N.E.2d 582 (Ind. Ct. App. 2005); *Williams v. Security Nat. Bank of Sioux City, Iowa*, 2005 WL 535343 (N.D. Iowa 2005); *Litchfield Asset Management Corp. v. Mary Ann Howell*, 799 A.2d 298 (Conn. App. 2002).

<sup>26</sup> *Kaycee Land and Livestock v. Flahive*, 46 P.3d 323, 324–29 (Wyo. 2002).

<sup>27</sup> *Cottam*, *supra* note 1 at 81 (footnotes omitted).

<sup>28</sup> *Id.* See generally *C.F. Trust, Inc. v. First Flight Ltd. P’ship*, 580 S.E.2d 806 (Va. 2003).

<sup>29</sup> Elham Youabian, *Reverse Piercing of the Corporate Veil: The Implications of Bypassing “Ownership” Interest*, 33 Sw. U. L. Rev. 573, 577 (2004).

<sup>30</sup> *Litchfield Asset Mgmt. Corp. v. Howell*, 799 A.2d 298, 313 (Conn. 2002).

<sup>31</sup> *Id.* at 316.

<sup>32</sup> See generally Gregory S. Crespi, *The Reverse Pierce Doctrine: Applying Appropriate Standards*, 16 J. Corp. L. 33 (1990).

Utah).<sup>33</sup> Some states, such as California and Hawaii, specifically allow the less common reverse veil piercing, but conditioned on the extent of the debtor's ownership of the entity that is being pierced.<sup>34</sup> By providing that the charging order is the exclusive remedy not only against the membership interest of the LLC member, but also against the assets of the LLC itself, the 2010 LLC Act was intended to deny a reverse veil piercing remedy to a creditor.<sup>35</sup> Creditors nevertheless have the charging order remedy and the remedies which may be available under the Wyoming Uniform Fraudulent Transfers Act.

### E. Fraudulent Conveyances

Fraudulent transfer laws may apply when a debtor transfers property to another party, particularly a corporation, in order to diminish the property's value or put it out of creditors' reach. As noted above, an LLC not only protects the individual from liability for the LLC's obligations, but is used to protect the individual's assets from personal creditors.<sup>36</sup> Such protection will be available only if the transfer was not "fraudulent." Many modern fraudulent conveyance laws are based on a 1570 English statute, the Statute of 13 Elizabeth.<sup>37</sup> The first codification of the Statute of Elizabeth was the Uniform Fraudulent Conveyance Act of 1918, adopted by many jurisdictions. Despite the reference to transfers as being "fraudulent," a creditor may utilize a state's fraudulent transfer laws to reach property transferred validly, without the presence of actual fraud. Typically, if property was transferred with the intent to delay or hinder a creditor and without receiving equivalent value in exchange, then it may be voidable.<sup>38</sup>

While the exclusivity of remedies under Wyoming's 2010 LLC Act is clear, a judgment creditor should still be entitled to claim that an initial transfer of assets into the LLC was a fraudulent transfer, providing the creditor remedies available under the Wyoming Uniform Fraudulent Transfer Act. This is supported by material prepared by the 2010 LLC Act working group drafting committee and presented to the legislature, indicating that the remedies available to a judgment creditor would be a charging order *and* an ability to pursue remedies under the Wyoming Uniform Fraudulent Transfer Act.<sup>39</sup>

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<sup>33</sup> *Id.*; Jeffrey B. Klaus, *Reverse Piercing*, 31 Colo. Law. 109 (2002).

<sup>34</sup> Elham Youabian, *Reverse Piercing of the Corporate Veil: The Implications of Bypassing "Ownership" Interest*, 33 Sw. U. L. Rev. 573, 574 (2004).

<sup>35</sup> Wyo. Stat. Ann. § 17-29-503(g) (2011).

<sup>36</sup> *See also*, Larry E. Ribstein, *Reverse Limited Liability and the Design of Business Associations*, 30 Del. J. Corp. L. 199, 202 (2005).

<sup>37</sup> Elaine A. Welle, *Is It Time for Wyoming to Update Its Fraudulent Conveyance Laws?*, 5 Wyo. L. Rev. 207, 210 (2005).

<sup>38</sup> *See* Cal. Civil Code § 3439.

<sup>39</sup> *Cottam*, *supra* note 1 at 81 (footnotes omitted). The Uniform Fraudulent Transfer Act is located at Wyo. Stat. Ann. §§ 34-14-201 to -212 (2011).

#### **IV. LLC Flexibility.**

In addition to the additional protection from creditors, an LLC may be a superior type of business entity due to its contractual nature and the ability of its owners to shape it as they may choose. For example:

- Certain fiduciary duties can be waived under the 2010 LLC Act, freeing a managers and members from concern that their other activities might be competitive or preemptive of LLC opportunities.<sup>40</sup>
- Ownership rights can be structured and divided as the parties agree, and the 2010 LLC Act now makes clear what occurs when a member transfers the economic rights of membership without transferring the non-economic rights.<sup>41</sup>
- Management can be structured to permit complete separation of management rights from ownership rights, as centralized or decentralized as the members determine.

#### **V. Uses for LLC**

- 1. Single Member Asset Protection LLC**
- 2. LLC as Partner in a Partnership/LLC.**

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<sup>40</sup> Wyo. Stat. Ann. §§ 17-29-110(c) and 17-29-409 (2011).

<sup>41</sup> Wyo. Stat. Ann. § 17-29-502(g) (2011).

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