

LIMITED LIABILITY COMPANY MANAGEMENT AND OPERATIONS

This memo will set forth a few guidelines regarding the operation of your limited liability company. This list does not detail every aspect of company operations, but consists of some important points to remember and to refer to in the future.

1. GENERAL. You should understand the basic concept of the company management structure. The company may either be managed by managers or by members as described in its Articles of Organization. Within these two major ways of establishing a management structure, there can be numerous variations.

If managed by managers, its management structure could be rather like that of a corporation. This structure can be viewed as a pyramid. Within this pyramid, the members elect managers who establish company policies and elect officers (if any) to carry out those policies. The members are generally passive investors. If a manager-managed company is desired, you must seek advice of your attorney for proper structuring of the company.

On the other hand, if the company is managed directly by its members, such a structure is very much like a partnership because the members have authority to directly manage the business. Almost all one, two or three person limited liability companies are run by the members (without officer titles) as the decision-makers.

The managers or a company may, under its Operating Agreement, be authorized to elect or appoint separate officers. This may also be the case with members who have direct management authority. However, not all companies have separate officer positions.

The management structure of a limited liability company can be established in a great many ways, and you will want to be thoroughly familiar with these aspects of your particular company's structure.

2. OPERATE AS A SEPARATE COMPANY. The company should always be treated like a separate person. It is imperative that you operate and act only in the capacity in which you serve the company, whether as a member with management authority, a manager, an officer, or other employee. The company must be respected as a separate entity apart from you personally. As a manager or member with management authority (*i.e.*, as a top-level decision-maker) or as an officer of the company, you have been hired by the company to set policy or to implement the policies of the company, or both. If you do not operate as a company and all decisions are merely personal decisions, the "company veil" may be pierced, and the members or managers can be held personally liable for the obligations of the company. Although limited liability companies need not have as formal a process as is expected of corporations, an appropriate level of decision-making process (consistent with the Operating Agreement) is needed to demonstrate respect for the company entity.

a. **Comply with the Operating Agreement.** In all company actions, you should carefully follow the procedures outlined in the company's Operating Agreement. Although the members may amend the Articles of Organization or the Operating Agreement, each member's, manager's and officer's authority is under the law limited by those documents. Formal company actions may be needed as the source of authority for those who act on behalf of the company, depending upon how the company's management structure is established. In any event, formal action may well help protect officers, managers, members, and employees who could otherwise be personally liable for their acts. Furthermore, courts are likely to consider observance, or the lack of observance, of company formalities in deciding whether the company has operated as a separate entity. While oversights in authorization may be corrected by later ratification, it is best to hold documented meetings of the company's management officials on important matters.

b. **Policy Decisions.** Any officers will have been hired as the day-to-day operators of the business, or if there are no officers (and many companies do without them), the managers or members (depending on the type of management system used) will perform these functions themselves. The basic policy decisions of the company must be made by the top-level decision-makers, who are the managers or the members with management authority, depending on the sort of management the company has chosen in its Articles of Organization. This does not mean that every little decision must be made by the managers or the members, whichever are the top decision-makers. Obviously, a line exists between general policy decisions made by the top decision-makers and management decisions to carry out those policies; if the company has officers, the top decision-makers need not be as involved day to day, but without separate officers, the top decision-makers also are making the day-to-day management decisions, not just setting policy.

c. **Major Action.** Major actions within ordinary business operations should be authorized by the top decision-makers (the managers or the members with management authority, as applicable). Such actions include, for example, purchasing real property, purchasing a major piece of new equipment, leasing additional space, taking out loans, or entering into a major agreement with another company. Such actions should be reflected in minutes or actions in the minute book or other company records establishing that the top decision makers authorized the action. This may take the form of minutes of an actual meeting or may be done by a signed consent without a meeting. Major transactions outside the ordinary course of business, such as a sale, lease, exchange, or other disposition of substantially all company assets, may need to be approved by the members as such (*i.e.*, including those without management authority), depending on the terms of the Operating Agreement. Mortgaging or encumbering substantially all company property might not require such member approval, however, but any such transaction should be specifically authorized by the top decision-makers and should be reviewed by them with respect to whether it meets the terms of the Articles of Organization, Operating Agreement, and Utah law.

d. **Legal Advice.** If you have any doubt about whether the top decision-makers should authorize a decision and whether there should be a resolution or other action in the minute book or company records, consult your attorney. To avoid personal liability for the obligations of the company, you must observe all the formalities required by law or by the Articles of Organization and Operating Agreement.

e. **Amend Articles.** The Articles of Organization will need to be amended if there are major changes, such as a change in the company name, the character of its business, the time set for dissolution, etc. You must consult your attorney regarding when the Articles of Organization must be amended.

3. PERSONAL LIABILITY OF DECISION-MAKERS. The following are some of the areas in which you can become personally liable for the obligations of the company.

a. **Taxes.** The company managers, members with management authority, or officers responsible for the operation of a company can be personally liable for a variety of unpaid taxes. The Internal Revenue Service will seek to collect, and collect, a 100% penalty from officers, managers, or members for failing to pay withholding taxes (including employee withheld income tax and the employee's share of FICA (*i.e.*, social security) tax) during the period in which that person was in charge of the operation of a company. In fact, the 100% penalty can be collected from more than one such person. There is also a similar state tax 100% penalty with respect to state withholding and with respect to sales taxes. Seek advice of your accountant regarding this tax liability.

b. **Conflicting Interest Transactions.** Utah limited liability company law is not as specific as Utah corporate law on conflicts of interest. The terms of the Operating Agreement may provide limits or exonerations with respect to such matters. However, beyond the terms of the Operating Agreement, public policy is generally not favorable to conflicts of interest and the corporate law should be taken into account as an analogous indication of public policy in this area. Utah corporation law specifically provides for procedures to be used in the case of transactions in which members of the board of directors may have a conflict of interest. If appropriate approvals are not received, the director involved may be subject to damages.

Lending money to or guaranteeing the obligations of its decision-makers or buying, selling, or leasing property and similar transactions with decision-makers or related individuals or organizations all need to be reviewed in light of the conflict of interest principles. Decision-makers for limited liability companies are well advised to act similarly to their corporate counterparts where conflicting interests exist in transactions.

c. **When Dealing with Others.** To avoid personal liability for actions on behalf of the company always:

1 Company Name. Use the company name and avoid use of the words with any reference to a personal interest.

2 Signing of Obligations. Always write out the company name and then designate your office or representative capacity when you sign for the company. Here is how documents (including checks) executed for the company should be signed:

_____ L.L.C.
By: _____, Manager (or Member, if members have management authority)

The key is that the name of the company be set forth and that the word "By" and the office held be set forth to establish that the signer is a person signing and acting in his or her agency or representative capacity.

3 Signs, Etc. Your company signs, equipment, letterheads, business cards, and advertisements should identify the company and should set forth the company name, or its registered assumed business name, exactly as they are set forth in the records of the Utah Department of Commerce Division of Corporations and Commercial Code.

4 Outdated Printed Matter. Do not use old letterheads or cards. Destroy them.

d. **Cash Distributions.** Decision-makers can be held personally liable for making distributions in violation of the Articles of Organization, Operating Agreement, or Utah law. Ask legal counsel about the solvency requirements and other possible restrictions.

e. **Purchase of Interests.** You could be held personally liable if the company purchases its own membership interests in violation of Utah law because such a transaction may be a distribution subject to the restrictions on distributions. You should obtain legal advice and your accountant's advice before making such a purchase.

f. **Distribution of Assets.** You can be held personally liable for voting to distribute assets without payment of the indebtedness of the company. Again, such a transaction is limited by the distribution rules.

g. **Personal Acts; Insurance.** A company does not protect you from personal liability for your personal negligence or wrongdoing. Liability insurance is highly recommended. The company should also insure its company assets from exposure due to the tortious acts of its employees, fire, and other hazards. Some top decision-makers like to obtain umbrella coverage of their own. Your insurance agent should be able to assist you in determining the kinds and amounts of coverage you require. To protect your personal assets from the company's creditors the company must, in fact, be treated as a company. These guidelines require some extra paperwork, but compliance with the Articles of Organization, Operating Agreement and Utah law (and maintaining a record of compliance) will be of considerable aid should a creditor of the company try to reach your personal assets.

h. **Workers' Compensation.** Nearly all employers in Utah, including a limited liability company, are subject to the Utah Workers' Compensation Law and must obtain workers' compensation insurance for their employees. This requirement may be met by purchasing workers compensation coverage from any commercial insurance company qualified to write workers' compensation insurance, or from the state Workers Compensation Fund. The employer, under certain conditions, may provide coverage as a self-insured employer.

Failure to provide workers' compensation insurance may in many states result in personal liability for the decision-makers of the company. In Utah, operating a business without compliance with workers compensation insurance requirements is a class B misdemeanor on both the employer and its decision-makers (in addition to other penalties applicable to the noncomplying employer).

i. **Environmental Matters.** It may be possible for decision-makers to be held personally responsible as an owner or operator in certain circumstances for environmental contamination or the violation of environmental laws; the law in this area is rather unclear.

j. **Personal Guarantees.** If you sign a personal guarantee with a creditor such as a lender or supplier, you are voluntarily giving up the protection of the company shield with respect to that creditor

k. **Benefit Plans.** If the Company has benefit plans, such as ERISA-covered or tax-qualified pension, profit sharing, money purchase, or 401(k) retirement plans, or has “cafeteria” or welfare plans (such as health, insurance, day care, etc.), you may well be a fiduciary of those plans and subject to liability for any breach of fiduciary duty. Also, special prohibited transaction rules may apply to prevent self dealing, with strong penalty excise taxes, as well as civil liability as sanctions for breaching the rules. Please consult legal counsel on these matters.

l. **Special Rules.** Some industries and professions are subject to rules that may impose personal liability for certain regulatory violations. For example, physicians are responsible under the antiseif- referral rules, antikickback rules, false claims act, and similar rules even if they practice through a professional limited liability company. Also, there are for almost all employers, anti-discrimination rules, a number of which contain definitions or provisions which make agents (such as managers or members with management authority or officers) responsible as employers for their own discriminatory conduct. Examples of such laws are Title VII of the Civil Rights Act, the Age Discrimination in Employment Act, Family and Medical Leave Act, and the Americans with Disabilities Act.

4. OTHER FORMALITIES TO AVOID PERSONAL LIABILITY.

a. **Bank Accounts and Cash.** You should deposit all company receipts in a company account. Do not commingle company funds with any of your own or with those of other organizations. Pay all company bills out of the company account. Similarly, company invoices should not be paid from individuals' checking accounts. Sign all company checks as indicated above.

b. **Dealings Between the Company and a Decision-Maker.** You should first obtain legal advice whenever you as an individual or a close family member or affiliated organization anticipate having any dealings with the company, such as entering into any agreements with the company to sell to or buy from, rent to or from, or otherwise deal with the company or any benefit plan sponsored by it.

c. **Dealing with Third Parties.** At any time you are offered an interest in a transaction in which the company might be interested, you may need to offer the transaction to the company, depending on the terms of the Operating Agreement. If you do not, you may be considered a trustee for the company and need to account to it for any profits. Do not enter into any business dealing with others in any area in which the company might be interested unless you first obtain legal advice.

d. **Action by the Decision-Makers.** The top decision-makers may need to act, in whole or in part, through meetings, depending on the terms of the Articles of Organization and the

Operating Agreement of the company. If so, the Operating Agreement will prescribe the meetings to be held to elect managers or other officials, review results of the last year, and make plans for the coming year. Special meetings may be called at any time by persons specified in the Operating Agreement. Written notice may need to be given within specific times. Notice may generally be waived by written consent. If meetings are required or allowed, quorum requirements will be contained in the Operating Agreement. Meetings can usually be held by means of conference telephone equipment.

If a meeting of the decision-makers is not possible or is not convenient, action may be taken without a meeting, provided all of the decision-makers consent in writing. Other informal action mechanisms may be available, as well. Legal counsel should be consulted to assure that the proper formalities are observed.

On day-to-day matters, usually decision-makers need not act through meetings, and some management arrangements do not call for meetings at all; in any event, the decision-makers, whether officers, managers, or members with management authority, must act within the scope of powers granted to them by the Operating Agreement.

e. **Maintain Company Records.** When you hold a meeting, the secretary or member should take minutes and send them to each member. You may want the minutes, company documents, and records to be reviewed by legal counsel at least annually.

f. **Proper Authority.** You must act only with proper authority. Check with legal counsel if you are in doubt. The acts of managers, members, officers, or employees of a company outside the scope of their authority can result in personal liability. Be sure that the activity is properly authorized.

g. **Dissenting.** You may be deemed to have agreed to a decision, unless you properly dissent to the decision. If you are present at a meeting and dissent, you must have it entered in the minutes, or file a written dissent before adjournment, or file a written dissent immediately after the meeting; otherwise, you may be deemed to have agreed to the action.

h. **Tax Payments.** If the company gets into financial difficulty, do not neglect to pay the withholding, social security, unemployment, and workers' compensation taxes for employees, and sales and use tax collected by the company to the federal and state tax agencies. Failure to pay these obligations may result in personal liability to members for the amount not paid. The obligation for employee taxes has priority over other creditors, and must be paid before other creditors, even before wages owed to employees. These obligations may not be dischargeable in bankruptcy.

i. **Reports.** IT IS IMPERATIVE THAT THE ANNUAL REPORT AND ALL TAX AND OTHER GOVERNMENT REPORTS BE FILED TIMELY. ALTHOUGH YOUR ACCOUNTANT MAY BE PREPARING THOSE, IT IS YOUR OBLIGATION TO SEE TO IT THAT THEY ARE FILED TIMELY. IF THE COMPANY IS INVOLUNTARILY SUSPENDED OR DISSOLVED BY THE STATE FOR FAILURE TO FILE THE ANNUAL REPORT, THE DECISION-MAKERS ARE AT RISK OF LIABILITY.

5. ANNUAL CONSIDERATIONS. In some companies, managers must be elected annually. Also, an annual review is advisable for just about all companies, and this generally considers: changes in salary, changes in the business, qualifications to do business in other states, major transactions, and ratification of actions already taken. Company actions may be facilitated by the routine use of waivers of notice, etc. Technical defects in the notice of a meeting can be surmounted by obtaining a waiver of notice from all who were entitled to notice. Waivers of notice, proofs of notice, and the minutes of actual meetings should be kept in the minute book.

6. ANNUAL ACTIONS. As part of the annual maintenance of the company, a member (or legal counsel or accountant) must complete the company's annual report and file it with the State of Utah Corporation Division. See LLC Form 7.

7. GENERAL OPERATING REQUIREMENTS.

a. **Employer Identification Number.** You should obtain from the Internal Revenue Service a federal employer identification number. The number is needed for quarterly withholding reports and other tax returns. Banks require the number to open accounts. See LLC Form 6.

b. **Accountants.** One common factor to a successful business is close work with the company's accountant. In nearly every business failure, the decision-makers failed to keep track of the company's current financial status. Regular and accurate cash flow statements and accrual statements are absolutely essential.

c. **Business Licenses.** Check with your city license bureau to confirm whether a city license is required. The company should also check with the county license bureau in the counties where it does business to confirm whether a county license is required. See LLC Form 10.

d. **Out-of-state Activity.** If you engage in activity in states other than Utah, these other states may require the company to qualify to do business in their jurisdiction. Failure to qualify might make any contract voidable by the other party and may prevent you from bringing suit there. You should review your out-of-state activities with legal counsel to determine whether you need to qualify in those states.

The information above summarizes general guidelines and rules for operating your company. Should you have any questions regarding this information, or other company matters, contact your attorney.