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Otten Johnson Alert:

Good News for LLC Members and Managers; Bad News for Lenders and Other Creditors

In a recent surprising case, *Weinstein v. Colborne Foodbotics*, the Colorado Supreme Court ruled that (1) a member of an LLC is not liable to creditors of the LLC, even when the member knowingly receives unlawful distributions in violation of a Colorado LLC Act statute designed to protect creditors, and (2) a manager of an insolvent LLC does not owe fiduciary duties to the creditors of the LLC. Both rulings are contrary to prior Colorado judicial law for corporations in similar circumstances.

The case involved an LLC with two members and two managers. Each manager was a corporation that had one of the members of the LLC as its sole shareholder. A creditor received an arbitration award against the LLC, but was unable to collect the award from the LLC after the managers authorized a distribution of the LLC's assets to the members, rendering the LLC insolvent. The creditor filed suit, making (1) a statutory claim against the members for receiving an unlawful distribution in violation of Section 7-80-606 of the LLC Act (which prohibits a distribution to members to the extent the distribution renders the LLC insolvent), and (2) a common law claim for breach of fiduciary duty against the managers of the LLC for authorizing the distribution.

The first claim in the *Foodbotics* case alleged that the managers made an unlawful distribution under the LLC Act, and the members who knowingly received the distribution were therefore liable to the creditor. An earlier Colorado Supreme Court decision permitted creditors of a corporation to sue an insolvent corporation's directors for making an unlawful distribution to shareholders, despite statutory language that directors who made unlawful distributions were liable only to the corporation. In the *Foodbotics* case, however, the Colorado Supreme Court chose to apply the LLC Act as written (i.e., that members are liable only to the LLC for unlawful distributions), and determined that a creditor of an LLC may not assert a claim against the members of the LLC for knowingly receiving unlawful

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The second claim in the *Foodbotics* case alleged that the managers breached a common law fiduciary duty to a creditor of an insolvent LLC. An earlier Colorado Supreme Court decision held that directors of an insolvent corporation owed creditors of the corporation a limited fiduciary duty to avoid favoring their own interests over the creditors' claims. This earlier case may have been overruled by a subsequent statute, but nonetheless, in 2009 the Colorado Court of Appeals in the *Sheffield Homes* case extended to the managers of an LLC the limited fiduciary duty owed by directors of an insolvent corporation to the corporation's creditors. The Colorado Supreme Court expressly overruled the *Sheffield Homes* case, and held instead in the *Foodbotics* case that a manager of an insolvent LLC does not owe any fiduciary duties to the LLC's creditors, including the limited fiduciary duty that an insolvent corporation's directors owe the corporation's creditors.

The *Foodbotics* case, in applying the Colorado LLC Act as written, is good news for both members and managers of an insolvent LLC. The case, however, is not good news for lenders and other creditors of an LLC, because the *Foodbotics* case and the Colorado LLC Act may prevent lenders and other creditors in many instances from collecting from insolvent LLCs, even in instances where a distribution to members is made in violation of the LLC Act. Thus, lenders and other creditors may need to consider or assert other legal and private remedies, rights, or claims to protect themselves in circumstances such as those presented in the *Foodbotics* case.

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