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Puelo v Topel: The Court Got it Wrong

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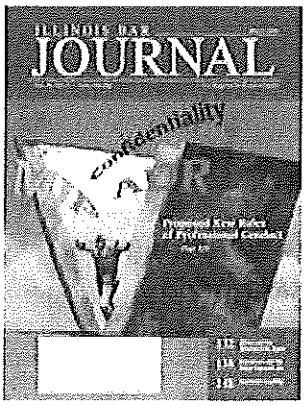

By Lin Hansonand Charles (Bud) W. Murdock

The *Puelo* court held that a dissolved LLC was on the hook for liabilities incurred after the dissolution. Wrong answer, the authors argue.

The authors of this column are founding members of the Institute of Illinois Business Law (formerly the Secretary of State's Business Laws Advisory Committee). We write at the request of the institute to set forth its view on a recent decision of the Illinois Appellate Court.

In *Puelo v Topel*, 368 Ill App 3d 63, 856 NE2d 1152 (2006), we believe the court missed essential points and reached the wrong decision.

The fact and holding of *Puelo*

In the *Puelo* case, the facts are undisputed. Michael Topel was the manager of Thinktank, LLC, an Illinois limited liability company primarily involved in Web design and marketing. Effective May 30, 2002, Thinktank was administratively dissolved by the Illinois Secretary of State due to its failure to file its 2001 annual report.

On December 2, 2002, Puelo et al. filed suit against Thinktank and Topel, alleging that from the time of dissolution until the end of August 2002, Topel, who knew or should have known of the dissolution, continued to operate the company. They charged that they had not been paid for their labor as independent contractors of the Company, and that the company and Topel should be held liable on theories of breach of contract, unjust enrichment, and on an account stated theory.

The plaintiffs cited similar cases in the corporate sphere, including *Gonnella Baking Co. v Clara's Pasta Di Casa, Ltd.*, 337 Ill App 3d 385, 786 NE 3d 1058 (2003).

Although it found that Thinktank continued to do business after its dissolution, and that the contractual obligations were incurred after dissolution, the circuit court found in favor of Topel, holding as follows:

This court bases its decision on its reading of the Illinois Limited Liability Company Act. Specifically, this court reads 805 ILCS 180/10-10 in concert with 805 ILCS 180/35-7 as well as the legislative notes to 805 ILCS 180/10-10 to determine that the Illinois Legislature did not intend to hold a member of a Limited Liability Company liable for debts incurred after the Limited Liability Company had been involuntarily dissolved.

The decision was affirmed on appeal. The key section of the Illinois Limited Liability Company Act at issue is 10-10, which provides as follows:

(a) Except as otherwise provided in subsection (d) of this Section, the debts, obligations, and liabilities of a limited liability company, whether arising in contract, tort, or otherwise, are solely the debts, obligations, and liabilities of the company. A member or manager is not personally liable for a debt, obligation, or liability of the company solely by reason of being or acting as a member or manager.

(b) (Blank)
(c) The failure of a limited liability company to observe the usual company formalities or requirements relating to the exercise of its company powers or management of its business is not a ground for imposing personal liability on the members or managers for liabilities of the company.

(d) All or specified members of a limited liability company are liable in their capacity as members for all or specified debts, obligations, or liabilities of the company if:

(1) a provision to that effect is contained in the articles of organization; and

(2) a member so liable has consented in writing to the adoption of the provision or to be bound by the provision.

Section 35-7 provides as follows:

(a) A limited liability company is bound by a member or manager's act after dissolution that:

(1) is appropriate for winding up the company's business; or

(2) would have bound the company under Section 13-5 before dissolution, if the other party to the transaction did not have notice of the dissolution.

(b) A member or manager who, with knowledge of the dissolution, subjects a limited liability company to liability by an act that is not appropriate for winding up the company's business is liable to the company for any damage caused to the company arising from the liability.

The language of 10-10 replaced former section 10-10 in a1998 amendment to the Limited Liability Company Act. The former section provided as follows:

(a) A member of a limited liability company shall be personally liable for any act, debt, obligation, or liability of the limited liability company or another member or manager to the extent that a shareholder of an Illinois business corporation is liable in analogous circumstances under Illinois law.

(b) A manager of a limited liability company shall be personally liable for any act, debt, obligation, or liability of the limited liability company or another manager or member to the extent that a director of an Illinois business corporation is liable in analogous circumstances under Illinois law.

Act not applicable to dissolved LLCs

We think the court correctly found this amendment was a highly significant change in the act, further limiting the personal liability of members and managers of an Illinois limited liability company. We think the court failed to note, however, that the language quoted applies to members and managers of Illinois limited liability companies. When Thinktank was administratively dissolved, it ceased to be an Illinois limited liability company, and whatever it then became (unincorporated business association?) its members and managers were no longer entitled to the protection of the Act.

To hold otherwise would lead to the rather illogical conclusion that one could obtain protection from personal liability *forever* by forming an Illinois LLC and doing business under its name, even while allowing it to be administratively dissolved at the end of

its first year of operation.

What is particularly interesting about this case is that the defendant did not oppose plaintiff's motion for summary judgment. Apparently, on its own motion, the trial court denied the motion for summary judgment and entered a final order dismissing plaintiff's claims. This clearly should not be done if there is any basis for sustaining plaintiff's claim. In this case, there are two other sound bases to support a claim against a "member" of a dissolved LLC.

First, the defendant breached his warranty of authority when he entered into a contract on behalf of the dissolved LLC. An agent warrants the existence of a principal and the agent's authority.

In this case, there was no principal because the LLC had been dissolved. The Illinois Supreme Court, in *Joseph T. Ryerson & Son v Shaw*, 227 Ill 524, 531-32, 115 NE 650, 653 (1917), stated that "a person who assumes to act as agent for a legally incompetent principal renders himself personally liable to the person with whom he deals unless such person knows of the want of authority."

Second, section 35-7 (b) of the Illinois act provides that a member who knows of the dissolution of the LLC but binds it by an act not appropriate to wind it up is liable to the company for the consequences of such an act. Since the defendant's contract with plaintiffs was not consistent with winding up the LLC, the defendant then was liable to the LLC for the consequences of the contract. Accordingly, if the LLC did not have funds, which it apparently did not, plaintiffs could be subrogated to the LLC's claim against the defendant.

We hope that the next time the question of the liability of members and managers of a *dissolved* limited liability company is reviewed, the court will note the significance of the fact of dissolution and recognize that there are numerous bases upon which to hold the defendant liable.

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Member Comments