

VIABLE ADVANTAGES FOR ESTABLISHING A LIMITED LIABILITY COMPANY (LLC) IN NEVADA

As a natural consideration, entrepreneurs doing business in all types of industries want to pursue a business-building strategy that will give them the greatest advantages in

1. increasing profits,
2. protecting business and personal assets,
3. reducing costs, and
4. ensuring the longevity of their business enterprise.

If these are not factors that figure into business building and strategies, the business risks a lack of foresight and direction that will almost certainly mean failure.

While there are many factors that go into the start-up or even the evolving growth of a for-profit company, one of the most important factors that must be considered is where to establish the business enterprise, that is, where will the actual activities that generate and provide products or services be located? This decision can and should entail a variety of factors, some of which are local and state tax laws, proximity to resources, proximity to transport infrastructure, target markets, etc.

The kind of protections against personal liability that will be afforded to the company's owners and other responsible principals. When all is said and done, one of the most enduring and attractive reasons for placing a business enterprise inside of a business entity is so that while the company principals are acting for and on behalf of the company, if something goes wrong and the company incurs some form of liability, that liability, in most instances will be absorbed by the company, thus insulating the business' principals from suffering losses to their personal assets.

There are certainly some circumstances under which a company's principals *could* absorb liability personally, but such circumstances vary from state to state according to their respective laws and are not the topic under consideration in this paper. Suffice it to say that the concept of the limitation of liability engenders the basic notion that while they are acting in their capacity as a company principal, (LLC Member, LLC Manager, corporate Board Member, corporate officer, etc.) they will be protected from personal liability for the consequences of those actions, even if they result in the company's incurring liability. This is the heart of the concept of the limitation of liability for business principals. In today's world, the liability protections enjoyed by the principals of *various types of business entities* are similar but the differences that do exist are significant. These differences stem directly from the statutes that currently constitute the laws governing business entities in each of the fifty states.

This issue of personal liability protection for company principals is one of particular interest and importance to Nevada and its successive legislatures because Nevada has, for

many years now, been considered a state whose laws are particularly favorable to small business entity owners. That “favorability” rests solidly upon the cornerstone of the limitation of personal liability for business owners and principals.

In addition to personal liability protection, Nevada laws also afford other advantages to its business entity owners that place the State in the position of offering a superior statutory forum for forming and maintaining a business entity when compared to many of its sister states.

Just as importantly, some consideration must be given to deciding where or more specifically, which state the business entity that will house or within which the business enterprise will be formed. It is a generally well accepted and proven concept that any business enterprise should be housed within the protective structure of a strong business entity such as a limited liability company or a corporation of some kind. Sole proprietorships may have had their place in a time when the business community at large did not so readily seek redress by means of suing another party.

It is an inescapable fact that where a business entity is formed can have decidedly substantive advantages. The plain reason for this is essentially two-fold. First, some states have laws that are more purposefully designed to protect a business’ owners and other principals, and secondly, there are significant differences in the laws of each of the states having to do with the formalities of maintaining and operating a business entity organized under their laws. This issue of entity maintenance is of crucial importance in as much as it lies at the very heart of whether or not an entity can withstand a legal attack on its viability based on whether or not it has been maintained properly over the duration of its existence.

Particular advantages of housing a business enterprise within an entity organized under Nevada state law:

1. **CHARGING ORDERS AS A TYPE OF PROTECTION:** Nearly every state has either a statute or relies on case law precedent (Pennsylvania) that allows for a charging order to be used by a creditor in attempting to obtain what is owed to it by an individual or other entity that is also a member of a limited liability company.
 - a. **What is a charging order and how may it be used as a means of satisfying the debt of a debtor?** Any charging order must begin with a creditor suing the debtor and obtaining a judgment against that individual debtor. Once the creditor prevails and receives a judgment against the debtor there is an additional step that must then be taken. Oftentimes such debtors’ only assets are those that may be tied up in an ongoing business enterprise that is held within a limited liability company (LLC). In such cases, the creditor may take his/her judgment back to court and ask that the court issue a charge order against the debtor. With such a charge order in hand, a creditor is then able to do one thing, which is to collect what is owed to it by means of charging the balance of the judgment against any distributions made to the debtor by the LLC

until the debt is paid off. If the LLC never makes a distribution to that member/debtor, the creditor is left holding a judgment that is nearly impossible to collect on.

- b. **What is the specific protection or advantage gained by the debtor through a charging order?** The charging order does not allow the creditor to take over or in any way assume ownership or control of the member/debtor's ownership or management responsibilities (if any) in the LLC. The charging order entitles the creditor to simply take from the member/debtor, any cash received by him/her as the result of a distribution made to that member/debtor by the LLC.
- c. **Why does such a limitation exist?** The underlying rationale supporting such limited use of the charging order is premised upon the idea that a single member of an LLC that is a debtor to an outside creditor should not, simply by virtue of his/her debts be able to imperil the management or operations of the LLC by giving the creditor ownership of the member/debtor's ownership interest in the LLC. Other members of the LLC should not be forced into a situation in which an outside party gains a membership interest in the LLC simply by taking over the ownership interest of the member/debtor.
- d. **A significant difference between an LLC and a corporation relative to the charging order law in Nevada.** This stands in stark contrast to the situation involving a debtor that owns stock in a corporation and against whom a creditor received a judgment. In such a case, the stock itself could conceivably be used to satisfy the debt. Depending on what percentage of ownership that stockholder/debtor held in the corporation, the creditor could conceivably gain a substantial amount of control in that corporation.
- e. **Is there a difference in the application of a charge order between a regular LLC and a single-member LLC?** It is the law of every state in the country that an LLC may be owned and managed by a single person. LLCs that are owned by multiple members are also very common, but for many start-up companies, starting the company and putting it in an LLC can, and is often done by a single person. These types of entities are known as single member LLCs, or SMLLCs. Should an SMLLC be treated differently in the eyes of the law from a regular LLC with regard to the execution of a charging order? If, after all, the reason for limiting a charging order is to ostensibly protect the LLC to which the member/debtor is a member from unwanted outside control, should that rationale then be set aside if the member/debtor is the only member of the LLC? A limited number of states think so. For example, the legislatures of the states of Utah and Florida have clearly stated in their laws governing such issues, that the limitation to the satisfaction of a judgment debt to the distributions of the LLC do not apply to SMLLCs. Most states' legislatures have not considered this issue. This has left the courts in those states without statutory guidance when a case involving an SMLLC comes

before them. Accordingly, these courts are left to make a decision on a case by case basis. The substantial drawback in such a situation for the owner of an SMLLC in one of these states is that there is no guarantee that the charging order will afford any protection, leaving the single member owner of the LLC in continued control of his/her company, in spite of judgment and following charge order.

2. Single-member LLCs afford the greatest protection under Nevada's charging order statutes for single-member LLCs of any of the states in the Union. Only one other state, Wyoming, currently allows for a charging order to be the sole remedy against a single-member LLC.
 - a. **HOW DOES THIS WORK:** The specific advantage here is that while most states have put a charging order protection statute in place, they have done so as a means of protecting other members of an LLC that may have one member that is a significant judgment debtor. In these instances, the creditor that may have a judgment against a member of an LLC is only entitled to receive whatever distributions the judgment debtor would have been entitled to. In effect, if a litigant is successful in obtaining a judgment against a person that is a part owner in an LLC formed in almost any other state than Nevada, that litigant's remedy may only be enforced, if a charging order is put in place, against that one company principal. This seems fair. Other owners of the business shouldn't be penalized for the debtor's actions or judgments. But here is the fundamental problem with the statutory scheme enacted by most states. If the LLC is a single member LLC, the assets of the entire LLC are at risk if that single member has a judgment rendered against him or her. The likelihood is that the entity itself will be simply set aside by the court, placing all of the personal estate assets of the LLC owner at risk as well.
 - b. On the other hand, the state of Nevada has enacted laws that provide the same protection to the principals of an LLC even if that LLC is a single member LLC. This means that while a creditor may prevail in an action at law against the single member of the LLC, the creditor may not take the LLC away from the debtor, but will only be entitled to such distributions as the single member/debtor would have been entitled to as a means of satisfying the judgment debt. This single distinction in the underlying intent of the statutory scheme of the laws of the State of Nevada will make the difference between a single-member LLC being effectively lost as a result of a judgment, or the LLC simply being required to satisfy a judgment through distributions, and allowing the business to continue doing business.
 - c. It is of particular importance to note that while only Nevada and Wyoming allow for the enforcement of a charging order as a sole remedy against a single-member LLC, case law precedent on this issue has begun to diverge between the two states. In a 2012 case in which a single member LLC was sued in Nevada, the State's Supreme Court upheld the current state law regarding charging orders against LLCs, while a 2014 case heard by the Wyoming Supreme Court allowed

the veil of an LLC to be pierced in a situation in which the LLC itself did not hold any assets, allowing the plaintiff to reach through the veil and attack the personal assets of the LLC member. The outcomes of these two appellate cases could not be more diametrically opposed in their outcomes. Each case has, in its respective state, established the first steps that will accrue added precedent as time goes on and more cases are heard. Clearly, Nevada business owners emerge as the more carefully and completely protected class of business owner in this situation.

3. **STATUTORILY SPECIFIED PERSONAL LIABILITY PROTECTION:** The specific and substantial liability protection provided to the owners of Nevada-based business entities migrates to any other state in which that Nevada entity is also registered as a foreign entity doing business in that state.
- a. In effect, a Nevada entity takes with itself the liability protections that are afforded its owners under the laws of the State of Nevada to whatever other state in which it is registered as a foreign corporation doing business. In effect, that other state is willing to give the Nevada entity the benefit of adjudicating any issue having to do with the entity itself and its operation according to Nevada law. What is of particular significance about this kind of reciprocity is that Nevada's statutes dealing with the personal liability of business owners and principals are some of the most protective in the nation.
 - b. In addition, it is of paramount importance that this aspect of liability protection has its strongest foundation stones in the United States Constitution itself. In Article IV of Section I of the United States Constitution it states, "Full faith and credit shall be given in each state to the public acts, records, and judicial proceedings of every other state. . . ." Often referred to as the full faith and credit clause of the federal Constitution, the core concept of the clause mandates that as between the various states, each will interpret its' sister states' laws, public acts, records and judicial proceedings in the same way the originating state would in matters having to do with issues endemic to that state. This specifically includes how issues stemming from the operation and management of a business entity organized in another state will be adjudicated in another state in which it is doing business.
 - c. This is a technical fine point of jurisdictional choice of law that is often misunderstood, even by experts in the field of asset management and protection. What is crucial to understand about this important protection is premised upon the fact that any lawsuit that involves a business that is housed within some kind of entity, such as an LLC or a corporation will involve two important jurisdictional and procedural issues. (Jurisdiction in this context refers specifically to which state laws may be properly or lawfully used to decide certain aspects of a case. Which aspects of the case are to be decided by the laws of the originating state of the entity are determined by procedural rules.)
 - i. The first of these will have to do with what we can call the "substantive" aspects or issues of the case. Substantive issues have to do with the

essential point of disagreement between the parties in the lawsuit. For example, was there a breach of contract, was there a personal injury? These “substantive” issues that form the basis of a dispute will be adjudicated or decided on the basis of the laws of the state in which the alleged damages may have occurred.

- ii. However, a second, very important issue arises if the one or more of the parties is attempting to pierce the veil of the other party’s business entity as a means of gaining access to the personal assets of that entities’ principals. This is commonly referred to as piercing the corporate veil. It is a virtual certainty that any plaintiff that is suing a business will also attempt to pierce that business’ veil as a means of gaining access to additional assets held personally by a business owner. ***The fundamentally crucial issue in the contest over whether or not a veil will be pierced lies in the kind of protection that is embodied in the laws of the state in which that business entity was formed.*** One of the most important factors that must be taken into consideration by any business person deciding which state to form the business entity in. And of the factors to be considered, the kind of personal liability protection afforded to the business principals must be at the top of the list.
 1. A critical issue that lies at the heart of this point of personal liability protection stems from the specific statutory protections that are contained within a particular state’s laws that define not only the protections that will be afforded a company principal, but also the conditions under which those protections will actually take effect.
 2. A state’s laws may, on their face limit the liability of a company’s owner(s) in the event of a lawsuit. However, the true test of the strength of that state’s laws to actually protect the owner(s) will be found in what the state requires in the way of its statutory mandates that require the owner(s) to maintain the business entity. Maintenance requirements can be extensive, confusing, and most of all, time consuming, not to mention they are time-bounded by either calendar deadlines or periodic times within which certain requirements must be complied with. What is particularly problematic about these maintenance requirements is that compliance is not something that is monitored by the state, but must be monitored and maintained by the owner(s) themselves. Failure to comply with these maintenance requirements oftentimes provides an opposing party in a lawsuit with the de facto evidence required to pierce the business entity’s veil, thereby opening up the personal assets of the owners to whatever potential judgments may result from the litigation.
 3. Maintenance requirements are most often legislated as a means of protecting one of two sets of individuals, 1. The public at large

that may be doing business with a given company, or 2. The owners of the company.

- a. Laws based on the first group mandate extensive record keeping, extensive disclosure of recorded documentation of company activities, and penalties, such as the setting aside (piercing) of the liability protection if the maintenance requirements are not complied with. The majority of states' liability protections have been based on this underlying and potentially deadly caveat of compliance.
 - b. The second class of protection is rare, and of the few states whose laws are specifically designed to protect owners, Nevada's are by far the most powerful. The specific reason for this is that the maintenance requirements contained in its statutes are minimal and, more importantly, the specific remedy for a litigant to pierce an entity's veil is limited to the commission of fraud on the part of the company's principals.
- d. What are we to draw from the foregoing? It is specifically this. The personal liability protection afforded the owner of a Nevada business entity is of little or no value to that owner unless he or she can utilize that protection no matter where they happen to be doing business within the United States. A firmly established precedent in American jurisprudence is that as to the issues having to do with any aspect of maintenance, formalities, or technical issues having to do with the business entity being sued, the laws of the state in which that entity was formed are the controlling law and precedent upon which those issues must be adjudicated. More plainly stated, if you form your LLC or corporation in the State of Nevada, any court in any other state must make base its decisions about whether or not to allow that Nevada entity to be pierced on Nevada law, not the laws of the state in which the substantive issues are being adjudicated.
- e. What does this mean for you as a Nevada business owner? It means that while you may live and do business in a state other than Nevada, the laws protecting you are the laws of the State of Nevada. If the veil of your Nevada entity cannot be pierced in the state in which your company is being sued, the only assets that are at risk are limited to those that are held by the company itself. Your personal assets are not subject to the "blowdown" effect of any possible judgment that may be rendered against your company.
4. **DEDICATED BUSINESS APPELLATE COURTS:** While it is certainly true that most other states in the country also have long-standing appellate courts, very few have established an appellate level of judicial review that is dedicated solely to the hearing of cases dealing with business issues only. The most obvious advantage to this situation lies in the fact that the judges that occupy the appellate benches in the State of Nevada are

not only experienced in the adjudication of business-related laws and law suits, but that is in fact all that they adjudicate.

- a. An almost unseen advantage that also accrues from this situation is that since Nevada's appellate courts do not deal in other substantive statutory areas of appeal, there is not the tendency, as is the case in many other states, for other standards of proof, rules of evidence, or substantive precedents to "bleed" into case law precedent in the State of Nevada. As the saying goes, "Business law is the gatekeeper to its own yard."
- b. Similarly, a derivative advantage to Nevada business owners is that the reciprocity owed to Nevada state laws dealing with Nevada-based entities is equally applicable when a Nevada entity is a party to a lawsuit in any other state.
- c. For any business owner that has endured the seemingly interminable proceedings of a lawsuit, you know that between motion practice, calendaring, the limited number of courts available to hear cases all mean that a lawsuit can be devastating to doing business. Time certainly equates to money in the world of business and every day and every dollar spent on litigation are resources lost to business development and potential profits. The dedicated Nevada business court dockets are able to minimize the interruption of business and expedite the adjudication of cases to the benefit of all parties involved.