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# Think carefully when creating LLCs

## Knowing the rules beforehand will save developers from headaches later

CONSTRUCTIVE ADVICE

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**While the policy behind forming a single-purpose LLC is usually sound, the implementation of a new LLC is often flawed.**

Many developers create separate limited liability companies (LLCs) for each project they develop. LLCs are typically single purpose or single asset entities, meaning there is only one project owned or managed by the entity. While the policy behind forming a single-purpose LLC is usually sound, the implementation of a new LLC is often flawed. Consider the following:

First, many developers fail to realize that an LLC that owns an interest in the real property and intends to sell the property after development must be a licensed developer with the Oregon Construction Contractors Board (CCB). Thus, condominium developers need a license, but apartment developers who intend to hold rather than sell the asset usually do not need a license. Conversely, if the LLC has no ownership interest but is undertaking the project for compensation, then the developer must be licensed with the CCB as a contractor. Both licensed developers and contractors must carry the requisite insurance and bonding, but only contractors need to pass the CCB's license exam.

In addition, each LLC entity must have its own separate license. One LLC cannot rely on the license of an affiliate entity or an LLC member. Failure to hold a license can result in significant fines, work orders being stopped, the inability to later become licensed and the inability to bring legal action for compensation.

Second, many developers do not understand Oregon's licensed developer insurance requirements. While each LLC is required to be separately licensed and to maintain a separate bond, the CCB will likely find compliance with the insurance requirement when multiple affiliated entities are listed as named insureds under one "master" insurance policy. Unfortunately, many developers either spend more money by purchasing an unnecessary separate policy or, even worse, fail to buy a separate policy or list the LLC as a named insured under the master policy. This can lead to disastrous results in the event of a lawsuit against the uninsured entity. Of course, the statutory minimum insurance may be inadequate for the single project or portfolio risks, so higher limits should always be considered.

Another misunderstood aspect of LLCs is the level of protection afforded to LLC members and affiliate companies. Any plaintiff considering a claim against an LLC is also considering whether the LLC assets or insurance are sufficient to cover the claim. If not, the plaintiff will almost certainly name LLC members (including individuals) and LLC affiliates as defendants. The plaintiff will attempt to "pierce the veil" of the LLC to get to other assets by showing that the entity was not legally distinct from a controlling member or affiliate.

To mitigate the risk of piercing, LLCs should carefully separate their activities, assets and resources from their members and other entities as much as possible. While sharing an address can be unavoidable, an LLC should consider establishing a separate bank account, letterhead, and even payroll if possible. LLCs should also consider avoiding express association with any parent entity even though it provides name brand recognition to the project. LLCs should be properly licensed, adequately capitalized, and adequately insured to help avoid a piercing argument, and members should not "milk" profits from the entity.

Finally, developers should understand the pros and cons of dissolving an LLC once its business is concluded. The dissolution statutes in Oregon and Washington provide that, upon effective notice of dissolution by the LLC, plaintiffs generally have five years (Oregon) or three years (Washington) to bring a claim against the entity. These survival periods are likely to cut off any longer statute of limitations or repose otherwise applicable (such as Oregon's 10-year statute of repose for construction projects), which could provide a significant benefit to the LLC.

It is important to recognize, however, that early dissolution is not necessarily prudent. Before the survival period has expired, a plaintiff may be able to satisfy their claim by pursuing LLC distributions received by LLC members. Perhaps more importantly, dissolved companies may be unable to maintain insurance or bring claims for indemnity. Thus, if a claim is brought against the entity or its members before the survival period closes, the LLC and its members could find themselves uninsured and without a remedy against the contractors or design professionals that are potentially responsible for the damages.

Because there are serious consequences from improper LLC implementation and dissolution, businesses must carefully plan their use of LLCs from the day the doors open to the day the survival and repose periods close.

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