

The Benefits of Opting-In to the New Utah LLC Act Affirmed by Utah Court of Appeals Decision

The Utah Court of Appeals solidified the need for LLCs to adopt the new Utah LLC act (effective January 1, 2014) to protect members who have loaned money to the LLC or are otherwise a creditor to their LLC. In a November 14, 2014, decision, the Court of Appeals said that the rights of the LLC member were subordinate to an unsecured third-party creditor during liquidation of the LLC. (See sidebar summary of DePatco, Inc. v. Teton View Golf Estates, LLC).

The ruling cites a [2009 Utah Bar Journal article](#), written by Russell K. Smith of Durham Jones & Pinegar. The article criticizes the old Utah LLC act and its effect on the members who have loaned the company money.

Smith wrote, “this member-creditor subordination penalty is neither warranted nor justified solely on the grounds that the creditor is a member.... The Utah LLC Act has the dubious distinction of being the only LLC statute that creates such an inequitable asset priority distribution.”

Companies who have yet to opt-in for the new Utah LLC act will still be subject to the old Utah LLC statute that does not protect members who have loaned funds to the LLC. The new Utah LLC act does not disadvantage members who loan money to their LLC.

Smith, who played a prominent role in drafting the New Utah LLC Act, mentions the issue in his article titled “[Utah Should Adopt a Modified Version of the Revised Uniform Limited Liability Company Act](#).”

“The Proposed Act eliminates both the member-creditor penalty and the winding-up-creditor penalty imposed by the Current Act wherein such creditors’ claims are subordinated,” Smith said. “The Proposed Act recognizes that no ordering or priority of the payment of creditor claims is necessary since such ordering and priority is already determined pursuant to other applicable law.”

A member of an LLC may become a creditor of the LLC in a variety of ways:

- members often lend money (either secured or unsecured) to the LLC,
- provide services to the LLC for which the member is to receive remuneration,
- sell goods to the LLC on credit,
- receive indemnification payments from the LLC,
- pay LLC expenses on behalf of the LLC for which the member will be reimbursed, and
- lease real or personal property to the LLC.

If you would like to consult with an attorney about opting-in to the new LLC statute, please contact Durham Jones & Pinegar at 801-415-3000.

Case Summary

In DePatco, a real estate developer formed a Utah LLC and loaned money to the LLC so that the LLC could purchase and develop Idaho real estate. The LLC issued a promissory note to the developer secured by a deed of trust on the Idaho real estate.

The developer then hired a construction company to provide materials and construction services to develop the real estate. The construction company recorded a lien against the real estate as security for payment.

The development eventually failed, and the developer brought an action to foreclose on its deed of trust. In the ensuing litigation, the construction company argued that the developer should be paid after non-member creditors during liquidation of the LLC.

The Court of Appeals agreed and held that unsecured non-member creditors will be paid before any secured member creditors. In issuing its opinion, the Court of Appeals noted that this outcome was “unusual” and “criticized” and that the result would be different under the new LLC act.

Related Links

- [Court of Appeals Ruling](#)
- [New LLC Act](#)