

A Cautionary Tale of an LLC



Once upon a time...

a lovely couple named Joe and Mary Leapfrog (herein "Leapfrog") owned a lovely four unit property filled to the brim with long-term, prompt paying tenants. They had owned the property for a very long time and after consultation with their attorney, decided to put title into an LLC.

They signed, acknowledged and recorded a deed from themselves into Cuteunits, LLC (herein "Cuteunits") which recited "Grantors and Grantees are the same parties and their respective interests remain the same."

Here's where things go a bit awry.

Unfortunately, they neglected to actually form and file the LLC in Sacramento and when they drew the deed they didn't identify what state the LLC was supposed to be the state of formation.

Some months pass.

Our Bad Guy now enters the scene. Snidely Whiplash (herein "Whiplash") somehow gets wind of this set of circumstances. We don't know exactly how, but he does.

He promptly creates Cuteunits and properly files the correct paperwork in Sacramento naming himself as sole manager.

Widget Title and Stormdoor Company (herein "Widget") gets a new order for refinance of this free and clear property for a loan in the amount of \$300,000 from a local mortgage broker. A preliminary report is issued vesting title in Cuteunits. The title officer properly calls for, and receives, the appropriate paperwork on the LLC and verifies with the State of California that it is formed and in good standing. The transaction proceeds and closes with Escrow wiring the funds to Cuteunits bank account which Whiplash had set up.

Not much time elapses before the Leapfrogs become aware of the existence of this loan. They notify the lender that they did not take this loan out and won't be held responsible for its repayment. The lender gets all testy and puts in a claim pursuant to their title insurance. To put it mildly, this has the potential to be a messy claim.

Alright then, what should have been done before this was closed? There are some markers here that should have led to additional questions and suspicions:

- The LLC was not formed for some months after the deed. That just makes no sense whatsoever.
- The deed recited that the parties remain the same yet the LLC filing does not mention the Leapfrogs. This alone should trigger contact with the Leapfrogs to find out what is going on.

The deed did not recite that the LLC was formed under the laws of California. That actually is pretty important. There is no

national database of LLC names and the same name could be used in multiple states by different people. In fact, Whiplash could have formed a similarly named LLC in another state and tried to get that through. The LLC filing did not use the address of the Leapfrogs, but did use the address of Whiplash. This doesn't make a lot of sense if the LLC belonged to the genuine owners.

- The nature of the lender. This was a mortgage broker arranged loan with a non-traditional investor-type lender. With this type of "hard money" loan, significantly less inquiry is done by the lender into the borrower's credit than a national bank would have done. Investors are much more interested in the equity available in the property than the credit worthiness of the borrowers. From their point of view, if they have to foreclose, there's additional profit to be made.

This property was free and clear with long time owners not living on the property. Free and clear properties are a target of the Bad Guys because a lot more cash can be generated without having to pay off prior loans. The Bad Guys are in it for the money, not the challenge of the thing.

All in all, the moral here is that while timing isn't EVERYTHING, it certainly matters. The largest and most obvious flaw here is the formation of the LLC long after the recording of the deed. Be careful that when dealing with an LLC, you are truly dealing with correct LLC and the correct people behind it.



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