

Florida Bar Association Section of Taxation

Statement of Policy Favoring Limiting the Remedy of a Judgment Creditor of Member of Multi-Member Limited Liability Company (“LLC”) to Charging Order

This white paper is submitted on behalf of the Florida Bar Association Tax Section (the “Tax Section”).

On June 24, 2010, the Florida Supreme Court held in Olmstead v. Federal Trade Commission, Case No. SC08-1009 (June 24, 2010), that the remedy of a judgment creditor of a single-member LLC is not limited to a charging order and that a court may order a judgment debtor to surrender all right, title and interest in the debtor’s single-member LLC to satisfy an outstanding judgment.

The Tax Section believes that Olmstead has created uncertainty as to the remedies available to a judgment creditor of a member of a multi-member LLC, and that legislation should be enacted to clarify that the exclusive remedy available to a judgment creditor of a member of a multi-member LLC is a charging order. The Tax Section is still considering its position as to judgment creditors of the sole member of a single-member LLCs.

This paper provides background on the use of LLCs in Florida, the remedies available to judgment creditors of members of LLCs and partners of partnerships, as well as applicable case law, including Olmstead, and describes the potential adverse consequences if the uncertainty created by Olmstead is not legislatively corrected.

I. OVERVIEW AND BACKGROUND

A. Use of LLCs in Florida

LLCs first became available in Florida in 1982, but were rarely used primarily because LLCs were subject to Florida corporate income tax. By contrast, partnerships and S corporations were not subject to Florida corporate income tax.

In 1999 LLCs were exempted from the Florida corporate income tax. This change in the law caused LLCs to become popular and, according to statistics published by the Secretary of State on Sunbiz.org, by 2007 there were more new LLCs being created than any other form of organization, including corporations. It should also be noted that although the number of new corporations created has declined slightly since 2000 (from 119,282 in 2000 to 103,113 in 2009, a decrease of 16,169), the number of new LLCs has exploded (from 19,186 in 2000 to 128,548 in 2009, an increase of 109,362).

It is clear that the change in income tax treatment of LLCs had a major impact on the use of LLCs in Florida.

B. Assignee of Membership Interest Must Receive Consent of Other Members to Become Member

Florida Statute Section 608.433(1) provides as follows:

“Unless otherwise provided in the articles of organization or operating agreement, an assignee of a limited liability company interest may become a member only if all members other than the member assigning the interest consent.”

Accordingly, at least in the context of a multi-member LLC, an assignee of a membership interest would not become a member of the LLC without the consent of the other members.

C. Charging Order Remedy for LLCs

Florida Statute Section 608.433(4) (which has essentially been unchanged since its enactment in 1993) provides as follows:

“On application to a court of competent jurisdiction by any judgment creditor of a member, the court may charge the limited liability company membership interest of the member with payment of the unsatisfied amount of the judgment with interest. To the extent so charged, the judgment creditor has only the rights of an assignee of such interest. This chapter does not deprive any member of the benefit of any exemption laws applicable to the member's interest.”

Section 608.433(4) provides that a court may grant a judgment creditor of an LLC member a charging order. If a judgment creditor of an LLC member does obtain a charging order, then to the extent that distributions are made from the LLC, the creditor would be entitled to distributions allocable to membership interest in which it has obtained the charging order. However, a charging order does not grant management rights to the creditor.

D. Cases Interpreting Partnership Charging Order Remedy Prior to Olmstead

In Myrick v. Second National Bank, 335 So.2d 343 (Fla. 2d DCA 1976), the Plaintiff, Second National Bank, attempted to levy upon the defendant's partnership interest in a partnership known as Port Richey Shopping Village. The court considered whether the charging order statute in effect at that time, which was substantially similar to current Florida Statutes Section Florida 608.433(4), merely furnished the creditor with an additional remedy or whether it limited the remedy to a charging order. The court concluded that the judgment debtor's rights in the partnership were not subject to levy but could only be reached by the judgment creditor through a charging order.

The courts in Atlantic Mobile Homes, Inc. v. LeFever, 481 So.2d 1002, (Fla 4th DCA 1986) and Givens v. National Loan Investors L.P. (724 So.2d 610 (Fla 5th DCA 1999) reached similar results, concluding that the charging order remedy was the sole remedy available to a judgment creditor.

E. Charging Order Provision for Limited Partnerships Revised in 2005

In 2005, Florida Statutes Section 620.1703, which provides for a charging order remedy in connection with partnership interests of a limited partnership, was revised to indicate that the charging order remedy “was the exclusive remedy which a judgment creditor of a partner or transferee may use to satisfy a judgment out of the judgment debtor’s interest in the limited partnership or transferable interest.”

The Florida Bar Task Force was organized to consider revisions to the Florida LLC Act, including whether or not to revise the LLC charging order statute to provide that it is the exclusive remedy to a judgment creditor of a member of an LLC.

F. Remedies to Judgment Creditors of LLC Members in Other States

States that have statutes or case law permitting foreclosure include: California, Colorado, Connecticut, Hawaii, Idaho, Illinois, Iowa, Kansas, Kentucky, Maryland, Missouri, Montana, Nebraska, New Hampshire, Ohio, South Carolina, Utah, Vermont and West Virginia.

States that do not permit foreclosure include: Alabama, Alaska, Arizona (but see Ehmann, discussed below), Delaware, Minnesota, New Jersey, North Carolina, North Dakota, Oklahoma, South Dakota, Tennessee, Texas, Virginia and Wyoming.

G. Bankruptcy Cases Addressing Charging Orders

In Albright, 291 B.R. 538 (Bankr. D. Colorado, 2003), the debtor was the sole member and manager of a Colorado LLC. The Chapter 7 Trustee argued that because the debtor was the sole member and manager of the LLC at the time she filed bankruptcy, the Chapter 7 Trustee controlled the LLC and could cause the LLC to sell the assets owned by the LLC and distribute the sale proceeds to the bankruptcy estate. The debtor argued that the Chapter 7 Trustee was only entitled to a charging order and could not assume management of the LLC or cause the LLC to sell the assets of the LLC. The court held that where the debtor, on the date her Chapter 7 petition was filed, was the only member of the LLC, the debtor’s bankruptcy filing effectively assigned her entire membership interest in the LLC to the Chapter 7 estate, and the trustee obtained all of her rights, including the right to control management of the LLC. The court concluded that if, on the date the debtor’s Chapter 7 petition was filed, the debtor was not the only member of the LLC, and if other members had not consented to the substitute member status for the Chapter 7 trustee, then the bankruptcy estate would have been entitled only to receive a

share of the profits or other compensation from the LLC, and would not have had the right to participate in the management of the LLC.

In Ehmann, 319 B.R. 200 (Bankr. D. Arizona, 2005), the debtor was a member of an Arizona LLC that was formed by the debtor's parents and held two investments, one of which was converted to cash shortly after the bankruptcy case was filed. Distributions were made from the LLC to other members but not to the Chapter 7 Trustee. The court concluded that the operating agreement was not an "executory contract" because the members had no material obligations. The court held that where the operating agreement of the LLC was not an "executory contract," the bankrupt member's interest in the LLC became property of the bankruptcy estate, notwithstanding any language in the operating agreement otherwise restricting or conditioning the transfer of the bankrupt member's interest. Accordingly, the Chapter 7 Trustee had all the rights and powers with respect to the LLC that the debtor held as of the commencement of the bankruptcy.

In Modanlo, 412 B.R. 715 (Bankr. D. Maryland, 2006), the bankruptcy trustee moved for leave to cause the debtor's single-member LLC to call a meeting of shareholders of a corporation in which it was the largest shareholder and held control. The court held that the trustee was authorized to exercise management and governance rights in the LLC.

In A-Z Electronics, LLC, 350 B.R. 886 (Bankr. D. Idaho, 2006), the court held that the bankruptcy trustee exercised the sole and exclusive management of the debtor's single-member LLC.

II. OLMSTEAD

A. Facts

Mr. Olmstead operated an advance-fee credit card scam. Through corporate affiliates Mr. Olmstead mailed consumers credit card applications that created the impression that for a fee, they would receive a major credit card. More than 200,000 consumers purchased the credit cards, but none actually received a major credit card. The Federal Trade Commission sued Mr. Olmstead and others for unfair and deceptive trade practices. Assets of the defendants were frozen and placed in receivership. Among the assets were several single-member LLCs. The United States Court of Appeals for the Eleventh Circuit certified the following question to the Florida Supreme Court: "Whether, pursuant to Fla. Stat. Section 608.433(4), a court may order a judgment-debtor to surrender all 'right, title, and interest' in the debtor's single-member limited liability company to satisfy an outstanding judgment." Fed. Trade Comm's v. Olmstead, 528 F.3d 1310, 1314 (11th Cir. 2008).

B. Majority Opinion

The Florida Supreme Court in an opinion written by Justice Canady held that Florida law permits a court to order a judgment debtor to surrender all right, title, and

interest in the debtor's single-member LLC to satisfy an outstanding judgment. The Court stated that it based its conclusion on (i) the uncontested right of the owner of the single-member LLC to transfer the owner's full interest in the LLC and (ii) the absence any basis in the Florida LLC Act for not allowing the long-standing creditor's remedy of levy and sale under execution.

The Court concluded that (i) the limitation on assignee rights set forth in Florida Statutes Section 608.433(1) has no application to the transfer of rights in a single-member LLC, (ii) an assignee of the membership interest of the sole member in a single-member LLC becomes a member and takes the full right, title, and interest of the transferor without the consent of anyone other than the transferor, and (iii) the charging order provision of the Florida LLC Act does not give a judgment creditor of the sole owner of an LLC less extensive rights than the rights that are freely assignable by the judgment debtor.

The Court concluded that because the charging order provision for limited partnerships stated that it was the "exclusive remedy" but the charging order provision for LLCs did not state that it was the exclusive remedy, the legislature must have intended to not make the charging order remedy the exclusive remedy for LLCs.

C. Dissenting Opinion

The dissenting opinion in Olmstead was written by Justice Lewis who was joined by Justice Polston.

Justice Lewis concluded Florida law does not permit a court to order a judicial foreclosure of an LLC membership interest without first proceeding through the statutory requirements created by Florida LLC Act. Justice Lewis pointed out that, based on Givens and Myrick, Florida courts have determined in the partnership context that a charging order is the exclusive remedy for judgment creditors based on the "straightforward language of the statute."

Justice Lewis also concluded that the opinion of the Court applies equally to multi-member LLCs. He observed that "the actual language of the statute does not distinguish between the number of members in the LLC" and that the holding of the Court "is premised on a limited application of a charging order without express language in the statutory scheme to support this assertion."

Justice Lewis concluded that the restraint on transferability provided for in Florida Statute Section 608.433(1) has applicability to single-member LLCs and that a member of a single-member LLC continues to be a member unless all of the member's economic interest is transferred to the judgment creditor by the charging order.

Justice Lewis asserted that alternative remedies are available to judgment creditors of an LLC member, including (i) dissolution of the LLC if the charging order requires the surrender of all of the member's economic interest, (ii) an order of

insolvency against the judgment debtor, in which case that member's interest would become part of judgment debtor's bankruptcy estate, or (iii) reverse piercing of the LLC veil by a court to allow a judgment creditor to reach the assets of the LLC.

III. CONSEQUENCES OF OLMSTEAD

As pointed out by Justice Lewis, the holding of the Florida Supreme Court that Florida law permits a court to order a judgment debtor to surrender all right, title, and interest in the debtor's single-member LLC to satisfy an outstanding judgment could be applied equally to multi-member LLCs. At a minimum this will create uncertainty as to the remedies available to a judgment creditor of a member of a multi-member LLC.

The continued general use of LLCs in Florida will decline if the uncertainty created by Olmstead results in businesses deciding to either (i) create an LLC in another jurisdiction, such as Delaware or (ii) use limited partnerships instead of LLCs. The efforts that were undertaken over a decade ago to "free the LLC" may be thwarted

IV. CONCLUSION

The Florida LLC Act should be amended as soon as possible to provide that, consistent with the law applicable to limited partnerships, as to multi-member LLCs, a charging order is the exclusive remedy which a judgment creditor of a member may use to satisfy a judgment out of the judgment debtor's membership interest in the multi-member LLC.