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## Single-Member LLC Will Not Shield Debtor's Assets from Judgment Creditor

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In a much-anticipated decision, the Florida Supreme Court closed what many creditors considered a statutory loophole that provided judgment debtors the opportunity for asset protection by the use of a wholly owned limited liability company to put assets beyond the reach of their judgment creditors. In *Olmstead v. FTC*,<sup>1</sup> the Florida Supreme Court ruled that the provision of the Florida Limited Liability Company Act<sup>2</sup> providing a judgment creditor with the right to a charging order against the judgment debtor's ownership interest in a single-member limited liability company (LLC) was not intended to be an exclusive remedy, and that the judgment creditor also may pursue the standard remedy of levy and sale upon execution that conveys the right to control the LLC.

*Olmstead* reached an equitable result based on the egregious facts of the case, but, as pointed out by Justice Lewis in a lengthy and well-reasoned dissent, the decision was a judicial rewriting of the settled language of Florida's LLC statute. The Florida Supreme Court wanted to give the creditor access to the LLC's assets to satisfy its judgment against the sole member. This judicial activism was unnecessary and unwise because the charging order provision of the Florida

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LLC statute was not a practical problem for creditors in Florida, existing law afforded an adequate remedy, and the Court's ruling may have the unintended consequence of producing more harm than good for creditors generally.

Olmstead and Connell for engaging in a deceptive advance-fee credit card scheme. Defendants used wholly-owned LLCs to mail solicitations for "platinum" credit cards. These solicitations led consumers to believe that in exchange for \$45 or \$49, they would receive a platinum credit card such as a Visa or MasterCard. In reality, the defendants provided each consumer with a card usable only for purchasing merchandise through the defendants' catalog or website. More than 200,000 consumers purchased these platinum cards, and only a small percentage of them were able to recoup their money upon learning of the true nature of the credit card. The assets of the defendants—including several single-member Florida LLCs

## Feature

*Olmstead's* holding that a charging order is not a judgment creditor's exclusive remedy to reach a debtor's membership interest in a single-member LLC will undoubtedly influence the law in other states as their courts struggle with the same question and similar statutory language. New York's LLC statute is virtually identical to the Florida law. Moreover, the policy considerations supporting *Olmstead* would apply to the LLC statutes of Delaware, California, Illinois and Texas as well as the Uniform Limited Liability Company Act (ULLCA).

### Facts

The facts of *Olmstead* provided a compelling factual basis for the Florida Supreme Court to look beyond the charging-order provision of the Florida LLC statute in order to reach an equitable result. The FTC sued defendants

in which either defendant Olmstead or Connell was the sole member—were frozen and placed in receivership. The District Court for the Middle District of Florida entered a judgment against defendants Olmstead and Connell for more than \$10 million in restitution as a result of the credit card scheme.

The FTC was unable to collect its judgment because the defendants held their assets in LLCs and the defendants, acting in the capacity as managers of the LLCs, chose to pay no distributions with respect to the LLC ownership interests. The district court granted the FTC's motion to require the defendants to "endorse and surrender to the receiver, all of their right, title and interest" in the LLCs. The defendants appealed to the Eleventh Circuit Court of Appeals, claiming that the only remedy available to creditors under Florida's LLC Act is a charging order.

<sup>1</sup> *Olmstead v. FTC*, 2010 WL 2518106 (Fla. June 24, 2010).

<sup>2</sup> The Florida Limited Liability Company Act, at Florida Statutes § 608.433(4), provides:

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 to 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.

Acknowledging a complete absence of Florida case law interpreting this issue, the Federal Appellate Court referred the question to the Florida Supreme Court based on the following certified question: “Whether, pursuant to Fla. Stat. § 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.”<sup>3</sup> Given the context and language of the Eleventh Circuit’s certified question, the Florida Supreme Court appears to have erroneously assumed that the only way to permit a receiver for the LLC was to rule that a charging order was not a judgment creditor’s sole remedy to reach a judgment debtor’s interest in a sole-member LLC.

### **Florida’s LLC Statute**

Initially adopted in 1982, Florida’s statute was only the second LLC act in the United States.<sup>4</sup> The drafters of the Florida LLC Act drew heavily on corporate, partnership and limited partnership law with the expectation that courts would apply existing case law to analogous LLC provisions.

Under Florida law, an LLC is separate and distinct from its members. The owners of an LLC, referred to as members, have no direct ownership claim to the LLC’s assets. The right of the members to LLC assets is subordinate to the interests of the LLC’s creditors.

Section 608.433 of the Florida LLC Act, derived from the corresponding section of a prior version of the Revised Uniform Partnership Act, provides that a member may assign its economic interest in the distribution and profits of the LLC, but the assignee shall not be admitted as a member, and thereby permitted to participate in management of the LLC, without the unanimous consent of the other members. Like the Uniform Partnership Act, upon the application of a judgment creditor of a member, a court may charge the LLC interest of a member with payment of the unsatisfied amount of the judgment, but the judgment creditor has only the rights of an assignee of such interest. The charging order does not give the judgment creditor governance rights with respect to the LLC. The Florida statute was designed to protect nondebtor members of an LLC from either having to liquidate their assets in satisfaction of a judgment against another member or being forced into business with a creditor.

The charging order made sense within the historical context of the general partnership, based on the rationale that partners cannot be forced to accept a new partner without their unanimous consent because all partners are entitled to participate in management of the partnership and all partners are jointly and severally liable for the debts of the partnership. However, the rationale does not apply within the context of a single-member LLC, where the judgment debtor owns the entire company and there are no co-owners in need of protection.<sup>5</sup>

Frankly, the drafters of Florida’s LLC statute never specifically considered the application of the charging-order provision in the single-member context. However, given their familiarity with the charging order in the context of partnership law, it is safe to say that the drafters understood the charging order to be an exclusive remedy. The Florida Bar Business Law Section did not consider the requirement for a charging order in the single-member LLC context to be a practical problem for Florida creditors meriting amendment of the statute.<sup>6</sup>

### **Florida Supreme Court Rules Charging Order Is Not an Exclusive Remedy**

The Florida Supreme Court ruled that the charging-order provision must be understood within the context of the basic rule that an assignee of an LLC interest may only become a member if all members other than the member assigning the interest consent. This limitation on assignee rights has no application to the transfer of rights in a single-member LLC. Justice Canady found that “[t]he provision does not...support an interpretation which gives a judgment creditor of the sole owner of an LLC less extensive rights than the rights that are freely assignable by the judgment debtor.”<sup>7</sup>

Justice Canady noted that the Florida LLC statute, unlike the Florida partnership statute and Florida limited-partnership statute, does not expressly state that a charging order is a judgment creditor’s exclusive remedy. Accordingly, the court found that the legislature did not intend to make the charging order an exclusive remedy in the LLC context, and therefore the remedy of execution

on the judgment debtor’s freely alienable membership interest in a single-member LLC is available.

However, the difference in wording must be viewed in a historical context. The charging order provision of the Florida LLC statute was adopted by the legislature in 1993 and is based on § 28 of the Uniform Partnership Act (1914), which makes no reference to a charging order being an exclusive remedy. The charging-order provision of the Florida partnership statute was adopted by the legislature in 1995 and is substantially similar to § 504 of the Revised Uniform Partnership Act (1994), which contains the provision that a charging order is an exclusive remedy. The official comment to the Revised Uniform Partnership Act states that “[s]ection 504 continues the UPA Section 28 charging order as the proper remedy by which a judgment creditor of a partner may reach the debtor’s transferable interest in a partnership to satisfy the judgment.”

Although *Olmstead* purports to limit its holding to the single-member context, there is no basis in the statutory language to distinguish the “exclusive” vs. “non-exclusive” language based on the number of members. Instead, the Florida Supreme Court is merely limiting the extent of its statutory revision.

### **Florida LLC Statute Contained Adequate Remedy for Creditors**

Justice Canady, writing for the majority in *Olmstead*, appears to have been under the mistaken impression that giving the judgment creditor the right to levy and sell the membership interest, and thereby control management of the LLC, was the only way to effectuate liquidation of the LLCs held by the receiver. However, the FTC could have implemented judicially-supervised liquidation of the LLCs at issue under the plain language of the Florida LLC statute without resort to judicial activism.

In *Olmstead*, the FTC obtained an order to freeze the defendant’s assets and place them in a receivership. Florida law contemplates that a receiver can be appointed in connection with a charging order. In fact, the Florida partnership statute expressly authorizes appointment of a receiver for the share of partnership distributions due or to become due to the judgment debtor.<sup>8</sup>

The Florida LLC statute provides that a person ceases to be a member of an LLC upon bankruptcy, adjudica-

<sup>3</sup> *Fed. Trade Comm’n v. Olmstead*, 528 F.3d 1310 (11th Cir. 2008).

<sup>4</sup> S. Cohn and S. Ames, *Florida Business Laws Annotated*, 2009-10, p. 267.

<sup>5</sup> In *In re Albright*, 291 B.R. 538 (Bankr. D. Colo. 2003), one of the few reported cases to address the issue, the court held that the charging-order provisions of the Delaware LLC law did not apply to a single-member LLC because its purpose was to protect nondebtor members.

<sup>6</sup> Mr. Davis participated in the Florida Bar Business Law Section committee, which considered revisions to the Florida business organization statutes.

<sup>7</sup> *Olmstead*, 2010 WL 2518106 at 6.

<sup>8</sup> Fla. Stat. § 620.8504(1).

tion of insolvency or appointment of a receiver for the person or a substantial part of the person's assets unless the receivership is dismissed within 90 days.<sup>9</sup> The commentary to the Florida LLC statute notes that the provision is based on the premise that a "receiver will...not necessarily act in the best interests of the LLC or the other members."<sup>10</sup> Therefore, in *Olmstead*, as a result of the appointment of the receiver for the defendants' assets, including the LLC interests, the sole member ceased to be a member.

The Florida LLC Act specifically provides for dissolution of the LLC "at any time there are no members."<sup>11</sup> The Florida LLC statute also expressly provides for the court to appoint a receiver or custodian to manage the LLC's business and liquidate its assets in connection with a judicial dissolution proceeding.<sup>12</sup> Therefore, the Florida Supreme Court, based on unambiguous language of the statute, could have held that liquidation by a receiver was authorized without reaching the issue of whether a charging order was an exclusive remedy.

In addition, Florida courts have the traditional equitable tools necessary to prevent a judgment debtor from using a single-member LLC to hinder or delay creditors, including the legal theories of fraudulent transfer, piercing the veil, and constructive trust. For example, Hon. **Jerry Funk** of the U.S. Bankruptcy Court for the Middle District of Florida, in a case involving similar facts, recently held that sufficient unity of interest and ownership existed between the judgment debtor and nondebtor business entities, and trusts that under various equitable theories, including alter ego, joint venture, fraudulent transfer and conspiracy, the assets of the nondebtor entities would be available to pay the creditors of the debtor.<sup>13</sup> The same legal theories applied to the single-member LLCs in *Olmstead* would presumably lead to a similar result without the need for judicial rewriting of the LLC statute.

### **Judicially Supervised Liquidation Protects Interests of LLC Creditors**

The Florida Supreme Court's ruling was intended to protect judgment creditors from unanticipated economic

hardship. From the perspective of the LLC's creditors, however, judicially-supervised dissolution and the appointment of an independent liquidator probably would be preferable to turning over control of the LLC's assets and business to an unknown judgment creditor. The Florida LLC Act provides detailed procedures for court-supervised dissolution by a receiver and submission of creditor claims for payment.<sup>14</sup>

The drafters of the Florida LLC statute were concerned that the economic interests of a trustee or receiver for an insolvent member would not be aligned with the best interests of the LLC and therefore provided the insolvent member would cease to be a member.<sup>15</sup> A tension clearly exists between the interests of the LLC's creditors and employees and the interests of the judgment creditor of the sole member. The legislature, not the court, should decide whether creditors of the LLC will receive the protection of judicial supervision during the liquidation process.

### **Other State LLC Statutes Have Similar Provisions**

New York's LLC statute, like the Florida statute, provides that, upon application to the court by a judgment creditor, distributions of a debtor member's interests can be charged toward repayment of the debt with interest but does not specifically provide that this is an exclusive remedy.<sup>16</sup> *Olmstead* should be directly on point for New York courts facing a similar issue.

In other states such as Delaware, Texas, Illinois and California, the statutory language makes clear that a charging order is the only remedy.<sup>17</sup> In these states, entry of a charging order is the exclusive remedy available to a judgment creditor to satisfy a judgment from a debtor's limited liability company interest. However, the rationale of *Olmstead* that the charging order is not necessary in the single-member context because no other members need protection may be persuasive.

Unlike the Florida LLC statute, the ULLCA makes a charging order the exclusive remedy available to a judgment creditor.<sup>18</sup> In the commentary to the ULLCA, the drafters make it clear that this exclusive remedy is not meant to prevent reverse piercing "where

appropriate."<sup>19</sup> The commentary specifically cites a case much like *Olmstead v. FTC*, where the judgment debtor created an LLC in a "patent attempt [to] frustrate the judgment creditor," as an example of when reverse piercing would be appropriate.<sup>20</sup>

The preface also notes that the 2006 revision of the ULLCA added provisions on charging orders. This suggests that other states that have not adopted the 2006 version of the ULLCA may have provisions similar to Florida's, which do not make charging orders the exclusive remedy for judgment creditors of an LLC member.

The Florida Supreme Court's majority decision in *Olmstead* that a judgment creditor of the sole member of an LLC is not limited to a charging order and may levy on the debtor's interest in the LLC will presumably lead to similar rulings in other courts. Although *Olmstead's* legal analysis may be flawed, the message is clear that the technical statutory requirement for a charging order is not going to stand in the way of a judgment creditor seeking to collect from the debtor's assets held in a single-member LLC. The viability of the single-member LLC as an asset-protection device appears in question. ■

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<sup>9</sup> Fla. Stat. § 608.4237.

<sup>10</sup> S. Cohn and S. Ames, *Florida Business Laws Annotated*, 2009-10, p. 307.

<sup>11</sup> Fla. Stat. § 608.441(1)(d).

<sup>12</sup> Fla. Stat. § 608.4492.

<sup>13</sup> *In re B.L. Jennings Inc.*, 373 B.R. 742 (Bankr. M.D. Fla. 2007).

<sup>14</sup> Fla. Stat. § 608.4421.

<sup>15</sup> Fla. Stat. § 608.4237.

<sup>16</sup> N.Y. Ltd. Liab. Co. Law § 607.

<sup>17</sup> See Del. Stat. § 18-703(c); Tex. Bus. Orgs. Code Ann. § 101.112(d); 805 Ill. Comp. Stat. Ann. § 180/30-20(e); Cal. Corp. Code § 17302(e).

<sup>18</sup> Unif. Ltd. Liab. Co. Act § 503(g) (2006).

<sup>19</sup> Unif. Ltd. Liab. Co. Act, comment to § 503(g) (2006).

<sup>20</sup> Unif. Ltd. Liab. Co. Act, comment to § 503(g) (2006).