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Florida Supreme Court Surprises Practitioners With LLC Charging Order Opinion

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INTRODUCTION

On June 24, 2010, the Florida Supreme Court issued its opinion in *Shaun Olmstead, et al. v. Federal Trade Commission*, in which it held that a charging order is not the sole remedy available to a creditor seeking to seize a debtor's membership interest in a single-member limited liability company. The decision surprised the estate planning and business communities by indicating that collection remedies besides a charging order could apply to multiple-member limited liability companies. The opinion was also startling because it appears that the Supreme Court either did not understand or chose not to acknowledge the legislative history of the applicable statute.

The Supreme Court's exact holding, as stated several times in the opinion, was that the charging order was not the sole remedy for a creditor of a debtor who is the sole member of an LLC. This conclusion is not surprising, given that three other opinions in other states have reached the same conclusion.[2] While the holding appears to be non-appealable, it may be incorrect because of the Court's analysis of the legislative history of the applicable charging order statutes, which is described below. Nevertheless, single-member LLCs organized under Florida law appear to be ineligible for charging order protection, at

least for now, in Florida. The debtor in this opinion has, nevertheless, requested a re-hearing from the Court.

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[2] *In re Albright*, 291 B.R. 538, 540 (D. Colo. 2003); *In re Modanlo*, 412 B.R. 715, 727–31 (D. Md. 2006); *In re A-Z Electronics, LLC*, 350 B.R. 886 (D. Idaho 2006).

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HISTORY AND POSSIBLE ERROR

The Florida Supreme Court heard oral arguments in July of 2009, and apparently deliberated extensively, given the tone of the opinion and the published and well-reasoned dissent. The Eleventh Circuit Court of Appeals had certified the following question to the Supreme Court: "Whether, pursuant to Florida Statute Section 608.433(4), court may order a judgment-debtor to surrender 'right, title, and interest' in the debtor's single-member limited liability company to satisfy an outstanding judgment." In reaching its decision, the Florida Supreme Court ultimately rephrased the certified question as follows: "Whether Florida law permits a court to 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."

In its analysis, the Court concluded that the Florida Legislature had not intended that a charging order be the exclusive remedy available to the creditor of an LLC member, noting that the charging order remedy language in the applicable LLC statute [3] does not specifically state that it is the creditor's "exclusive" remedy. The Court based this conclusion of the Legislature's intent upon the fact that the current version of the Florida limited partnership charging order statute, which was passed 12 years after the LLC statute, explicitly provides that a charging order is the sole remedy for the judgment creditor of a partner in a limited partnership. However, the LLC statute was passed in 1993 with the purpose of providing sole remedy charging order status, as described below, while the limited partnership statute was passed in 2005.[4] The Florida Supreme Court appears to have thought that the 1993 LLC charging order statute was enacted at the same time as the 2005 limited partnership charging order statute which obviously was not (and cannot be) the case. This in effect changes Florida law by allowing the action of a later Legislature to control what the intent of a prior Legislature meant, if that is at all possible.

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[3] Fl. Stat. § 608.433 (2008).

[4] Fl. Stat. § 620.1703 (2005).

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What the Supreme Court seems to have overlooked was that the 1993 LLC charging order statute was taken word-for-word from the previously enacted 1973 partnership charging order statute, which simply stated that "On application to a court having jurisdiction by any judgment creditor of a partner, the court may charge the interest of a debtor partner with payment of the unsatisfied amount of the judgment with interest...." From 1976 through 1998, there were three separate Florida District Court of Appeals decisions (Florida has five District Courts of Appeal (hereinafter DCA) and two have never heard the issue) indicating that the 1973 partnership statute provided that the charging order was the exclusive remedy of a judgment creditor.[5]

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[5] *Myrick v. Second Nat'l Bank of Clearwater*, 335 So. 2d 343 (Fla. 2d DCA 1976); *Atlantic Mobile Homes, Inc. v. LeFever*, 481 So. 2d 1002(Fla. 2d DCA 1986); *Givens v. Nat'l Loan Investors L.P.*, 724 So. 2d 610 (Fla. 5th DCA 1998).

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In 1993, when the Legislature passed Florida's first LLC charging order statute, the drafting committee sponsored by the Florida Bar Business Section simply took the 1973 partnership statute, with all of its precedential history, and placed it into the 1993 LLC statute, including the specific language regarding the charging order remedy. The 1993 LLC charging order statute was, therefore, identical to the limited partnership charging order statute as it existed in 1993.[6] It is sound legislative policy and strategy to take language from one statute and to insert it in the other statute in order to have the benefit of already established meaning. It was common knowledge in 1993 that the sole remedy interpretation of the adopted limited partnership statute would apply in the context of LLCs. If the Legislature had intended otherwise, it would have added language to explicitly state that the charging order was not the sole remedy with respect to LLCs.

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[6] The charging order statute that specifically references limited partnerships (Section 620.153) was first drafted in 1986, and remained unchanged when the LLC charging order statute was first drafted in 1993. The 1993 limited partnership statute and the 1993 LLC statute were virtually identical, with the only differences being the references to the type of entity.

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A 1994 Florida Bar Journal article written by drafting committee member Thomas O. Wells first noted that the charging order is the sole remedy for the judgment creditor of an LLC member.[7] Later, in addition to the confirmation of this principle in continuing legal education outlines and seminars, a 1999 Florida Bar Journal article authored by Mr. Wells, Carlos Lacasa and Ronald Klein reiterated that "[a]creditor's right against a member's interest in an LLC *is limited to a charging order*" (emphasis added).[8]

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[7] Wells, Thomas O., "Asset Protection in the Partnership Context: What's all the Hoopla?"68 *Fla. Bar. J.* 43 n.6 (Feb. 1994). This article was quoted in *Givens v. Nat'l. Loan Investors, L.P.*, 724 So. 2d 610.

[8] Klein, Ronald; Lacasa, Carlos;Wells, Thomas O., "The New Limited Liability Company in Florida,"73 *Fla. Bar. J.* 42, 46 (July/Aug. 1999).

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In 2005, the Florida Legislature passed a revised limited partnership statute, without making any change to the LLC statute. This was because the Florida Bar appointed a limited partnership statute revision committee that had no responsibility or involvement concerning the LLC statute. The revision committee restricted its work to the limited partnership statute and suggested language which made more clear on its face that the charging order is the exclusive remedy of a judgment creditor of a limited partner.[9] The clarification of this statute after nearly 23 years of stability under the prior limited partnership statute did not mean that somehow the 1973 Legislature's thinking and intention had changed. Legislatures can be powerful, but not that powerful.

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[9] Fla. Stat. § 620.1073(3)(2005).

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It was expected that the Supreme Court would respect nearly 20 years of DCA opinions dealing with multiple-party charging order situations in the limited partnership context.[10] It has been clear for many years that the sole remedy of a judgment creditor of an LLC member is the charging order.

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[10] Appellant's counsel requested in their brief that the Court follow the 5th DCA's opinion in *Givens v. Nat'l Loan Investors, L.P.* and construe the LLC statute in the same way the identical limited partnership statute had been dealt with. 724 So. 2d 610. The Court found this unpersuasive, however, perhaps because of the lack of authority cited by Appellant's counsel. (As mentioned above, other Florida DCA cases reinforce this same principle, such as *Myrick*, 335 So. 2d 343, and *Atlantic Mobile Homes, Inc.*, 481 So. 2d 1002.)

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CONTINUING BARRIERS TO CREDITORS OF A MULTIPLE-MEMBER LLC MEMBER

In addition, the Supreme Court did not discuss how a creditor of a multiple-member LLC organized under Florida law could overcome other statutory language that limits the assignability and loss of control by members in a multiple-member LLC. This language is further evidence of legislative intent to have the charging order as the sole remedy, and still constitutes practical barriers to a creditor of a multiple-member LLC to "take over a member's interest and participate in control or access to assets of the LLC." [11] However, it *is* possible for the Supreme Court to conclude in a subsequent case that it has not considered multiple-member LLC charging order issues, and that the assignability language and legislative intent is such that a creditor is, as a practical matter, still stymied significantly in the context of a multiple-member LLC.

[11] Fla. Stat. § 608.432 specifically describes the rights of an assignee and they are extremely limited;the assignee may share in profits and losses as the member would have and is also entitled to distributions. However, the assignee has no rights to manage or vote within the LLC nor do anything else unless the operating agreement specifically provides for it.

WELCOME TO FLORIDA; WE WILL MISS YOU

Florida's 1993 LLC statute was the second of its kind passed in the United States and was a prominent step to establish the "Sunshine State" as a favorable jurisdiction for businesses and investors who would expect treatment equivalent to that offered by states like Delaware,[12] Texas,[13] and others, many of whom subsequently adopted the Uniform Limited Liability Company Act.[14] These jurisdictions treat limited liability companies as a corporate hybrid, offering the advantages of limited partnerships under a simplified, corporate-like form.

[12] 6 Del. Code § 18-703 (2005) (specifically restricting judgment creditor's remedy to a charging order).

[13] 3 Tex. Code § 101.112 (2006)(designating the charging order as the exclusive remedy).

[14] Unif. Ltd. Liability Co. Act 2006 § 503 (limiting any remedy to a charging order and any potential sale of a charged interest gives the purchaser only the rights of a transferee).

The Florida Supreme Court's decision calls into question whether Florida can be a respectable and stable jurisdiction for businesses and investors.

NEW LEGISLATION COULD RESOLVE THE ISSUE

The Business Law, Tax, and Real Property Probate and Trust Law Sections of the Florida Bar have been collaborating for almost two years on a complete re-write of The Florida Limited Liability Company Act. The charging order section of the re-write has been on hold pending the *Olmstead* decision. The pre-*Olmstead* preliminary draft of the charging order section of the rewrite states that the charging order is the exclusive remedy, using the following language: "Other remedies, including foreclosure on the judgment debtor's transferable interest and a court order for direction, accounts, and inquiries that the judgment debtor might have made, are not available to the judgment creditor attempting to satisfy the judgment out of the judgment debtor's transferable interest and may not be ordered by a court."

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It is also noteworthy that Wyoming has, effective July 1, 2010, become the first state to give explicit protection to single-member LLCs, with a law that provides that the charging order "is the exclusive remedy by which a person seeking to enforce a judgment against a debtor, including *any judgment debtor who may be the sole member*, disassociated member, or transferee, may, in the capacity of the judgment creditor, satisfy the judgment from the judgment debtor's transferable interest or from the assets of the limited liability company." [15] (emphasis added). The Florida Legislature would seemingly be compelled to address the treatment of single-member LLCs, as well as multiple-member LLCs, in a manner similar to the Wyoming Legislature. If the Florida Legislature does not address the treatment of single-member LLCs, its clarification of the LLC charging order statute will be somewhat ineffective.

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[15] Wyoming Statute § 17-15-503. The *Olmstead* case addressed the rights of a single member of a Florida LLC and reviewed Florida Statute Section 608.433. However, it is not clear that such holding would apply in Florida to a creditor of a single member of a Wyoming (and Delaware) LLC that provides a charging order as an exclusive remedy. See *New Times Media, LLC v. Bay Guardian Co., Inc.* Del. D.C. No. 10-72-GMS-LPS (June 28, 2010)limiting the rights of a California judgment creditor to foreclose because Delaware law does not allow for such remedy.

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The uncertainty caused by this questionable opinion, and its consequential effect on practitioners, will hopefully be resolved soon by the Legislature, with the assistance of the Florida Bar Committee that was in the process of revising the Florida LLC statute.[16] The Florida Legislature need only add a few words to the LLC charging order statute, so that it matches the 2005 limited partnership statute, to avoid future confusion of judges, legal advisors, and business and estate planning clients.

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[16] Drafting sessions were held as recently as August 5, 2010, in Palm Beach, FL.

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On the other hand, it is possible that the Florida banking lobby may attempt to interfere with efforts to resolve this mayhem, thus further hurting Florida's somewhat teetering business economy. Lenders were aware of the LLC charging order rules when they lent funds to thousands of LLC member borrowers in the past decade. A windfall based on a questionable Supreme Court ruling will just be another example of why Florida may have a long way to go before becoming a "top tier" sophisticated, business-friendly jurisdiction.

THE QUESTIONABLE NATURE OF THE COURT'S OPINION

Further evidence of the authors' view is found in the spirited dissent of Judge Lewis in the *Olmstead* case:

This Court does not possess the authority to judicially rewrite those operative statutes through a speculative inference not reflected in the legislation. The Legislature has the authority to amend Chapter 608 to provide any additional remedies or exceptions for judgment creditors, such as an exception to the application of the charging order provision to single-member LLCs, if that is the desired result. However, by basing its premise on principles of law with regard to voluntary transfers, the majority suggests a result that can only be achieved by rewriting the clear statutory provisions. In effect, the majority accomplishes its result by judicially legislating section 608.433(4) out of Florida law.

Further support for the premise that the Legislature intended the charging order to be a creditor's exclusive remedy lies in the fact that the Legislature chose to mention the availability of this remedy separate and apart from levy and sale under execution. Florida Statute § 56.061 provides remedies for creditors of an LLC member that are far superior to the remedy of a charging order. There would have been no reason for the Legislature to provide for the charging order as a remedy for creditors if creditors were instead able to levy upon interests in an LLC or limited partnership or to force a sale of an interest in an entity to the

creditor as the highest bidder. The authors have never met a collection attorney who would prefer a charging order to outright ownership and control of a debtor's membership interests.[17]

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[17] However, a creditor's ownership of a judgment debtor's membership causes the creditor to be taxed on any income allocated to such interest if the LLC is taxable as a partnership for federal income tax purposes. *See* Rev. Rul. 77-137, 1977-1 C.B. 178. Although not free from doubt, the creditor with a charging order is not likely to be taxed on the income allocated to such interest.

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Moreover, the 1993 LLC statute provided that an insolvent or bankrupt LLC member's interest would not have to be purchased by the Florida LLC if the Articles of Organization or Operating Agreement provided otherwise, and provided that the assignee of the member of a Florida LLC would not be able to participate in management or voting of LLC interests without consent of the other members. A charging order remedy would be consistent with these other 1993 statutory provisions, which are still applicable and are expected to be enhanced in the forthcoming 2011 Florida LLC statutory revisions described above.

The Florida Supreme Court further demonstrated its confusion by noting that the Florida general partnership statute also provides for charging orders to be the exclusive remedy of the judgment creditor of the general partner of a general partnership or a limited liability partnership (LLP). The Court apparently did not review the general partnership charging order statute, which specifically provides that the holder of a charging order against a general partnership or LLP interest can require foreclosure of the interest.[18]

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[18] Fla. Stat. § 620.8504 (2008).

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It is possible that DCAs could conclude that the Florida Supreme Court's multiple-member dicta was simply erroneous, as the Court fortunately made it clear throughout its decision that its holding only applied to single-member LLCs.

IN THE MEANTIME — TAKE ACTION TO PROTECT CLIENTS

Time will tell as to whether trial courts will conclude that the Florida Supreme Court's decision should apply to multiple-member LLCs and thus, allow the creditors of majority or managing members to seize LLC assets.

While we wait to see whether the Legislature re-drafts the applicable statute to clean up this area, clients and their advisors might consider the following:

1. Having the client own less than 50% of the LLC membership interests so that he or she does not have control over the LLC. Where the client owns less than 50% of the LLC, the creditor would typically be unable to obtain control of the LLC. Voting and non-voting membership interests may also be used so that the client does not own more than 50% of the voting interests.

Also, where LLC ownership certificates are issued and subject to restrictive endorsements that prevent transfer, such endorsements may prevent assignment, even to a creditor who would otherwise have "foreclosure rights" thereto.

Additionally, there may be instances where an irrevocable member mechanism has been put in place for valuable consideration paid by the manager, in which event ownership of the membership interests may not necessarily allow a creditor to control the entity or cause the debtor member's interest in the LLC to become non-voting or subject to forfeiture or redemption.

2. Having LLCs invest in limited partnerships, offshore LLCs, or other arrangements, so that even if a creditor were to seize majority control of the LLC, the creditor would be subject to the terms of lower-tier

protective arrangements. This may be an especially attractive solution for LLCs taxed as S corporations, because the S corporation second class of stock rules may prevent limited partnerships from being classified as S corporations for federal income tax purposes.[19]

3. Converting LLCs to limited partnerships, which in Florida requires payment of a limited partnership filing fee of $1,000, and an annual report fee of $500 per year, giving further reason to regard Florida as an inhospitable jurisdiction for investment and business entity planning.

If the entity does not do business in Florida, then an out-of-state entity can be used. Clients using LLCs for both tenancy by the entireties ownership and charging order features may consider Delaware and Wyoming, both of which have favorable limited partnership statutes, recognition of limited liability limited partnerships, and more reasonable filing fees and annual report costs.

4. Converting a Florida LLC into a limited partnership or a limited liability limited partnership in another state is specifically provided for under the Florida Statutes, and this option could be explored as a way to have more stable charging order law apply to clients' business entities.

5. Moving the Florida LLC's business assets and operations to states like Delaware, Wyoming or Texas, which are known for stable, non-controversial business law court decisions, and still provide charging order protection as the sole remedy for the judgment creditor with respect to a debtor's LLC interests.

Married couples residing in Florida often own LLC interests as tenants by the entireties, particularly where a creditor would likely obtain a judgment against only one spouse. Creditors of one spouse generally cannot reach tenancy by the entireties assets. Florida is one of the few states that allows married couple residing in Florida to own intangible assets as tenants by the entireties. Delaware and Wyoming do as well.

6. Converting a Florida LLC to a Delaware, Texas, or Wyoming LLC, using a state that has an LLC Act that provides that the charging order is the exclusive remedy of a creditor. Since the Florida Supreme Court based its holding on its interpretation of Florida Statute § 608.433 and the lack of “exclusive remedy” language, such holding may not apply to LLCs created pursuant to laws of another state.[20]

7. Having the client convey LLC membership interests to offshore or domestic asset protection trusts. A similar option involves selling the underlying LLC assets, liquidating, and investing the proceeds in other assets and/or vehicles that may be easier to protect. This includes having the client fund offshore or domestic asset protection trusts or purchase annuities or other assets that may be exempt under applicable law.

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[19] The IRS provided in Rev. Proc. 99-51, 1999-52 I.R.B. 760, that “given the factual difficulties involved in determining whether the differences between the rights and obligations of general and limited partnership interests give rise to a second class of stock, the issue of whether a state law limited partnership complies with the [S corporation] single class of stock requirement is under extensive study.” Further, the IRS will not provide advance rulings on the issue until it is resolved through publication of a revenue ruling, revenue procedure, regulations, or otherwise. However, if the conversion of an LLC to a limited partnership under state law is found to have terminated the entity's S Corporation election because of a violation of the second class of stock rules, 9100 relief may be available to have such termination classified as an “inadvertent termination” (see PLR 200409012).

[20] It is unsettled as to whether Florida law will continue to apply with respect to LLCs that have been moved to other jurisdictions, if the LLC continues to have significant contacts in the State of Florida. For a detailed discussion regarding conflict of law analysis in the context of trusts, see LISI Estate Planning Newsletter #1391 (Jan. 6, 2009) at http://www.leimbergservices.com/;Rothschild, Rubin, Blattmachr, “Few Bad Apples Should Not Spoil the Bunch,” 32 *Vand. L. Rev.* 763 (1999).

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CONCLUSION

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The *Olmstead* decision cemented the (expected but unconfirmed) notion that single-member Florida LLCs do not afford charging order protection. An unexpected consequence of the *Olmstead* opinion is that clients who own membership interests in multiple-member LLCs now face the possibility that a creditor receiving a judgment against them will be able to take over the client's membership interest, as opposed to the creditor being limited to only obtaining a charging order against such membership interest.

Nevertheless, the authors believe that it is unlikely that a court will allow a judgment creditor to attach the underlying assets of a Florida LLC because the Florida LLC Act restricts the rights afforded to an assignee of an LLC membership interest with respect to participation in the LLC's business and access to the LLC's assets. Furthermore, an assignee of an LLC membership interest should be subject to the provisions of the LLC's articles of organization and operating agreement, which may contain prohibitions on the assignability of an LLC interest, the admission of new members, and the management of LLC business and affairs.

However, time will tell as to whether a court will classify a creditor as an “assignee” for the purposes of Florida Statute § 608.433, or as a “member” with rights relating to the management of the LLC and its assets notwithstanding contrary provisions in the Florida LLC Act and/or the LLC's articles of organization and operating agreement.

In the interim, the Sunshine State will hopefully provide an appropriate legislative fix to a Supreme Court decision that has caught many planners and their clients by surprise, and has damaged Florida's reputation as a business-friendly jurisdiction.

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