

ASSET PROTECTION VIA LLC IN LIGHT OF *OLMSTEAD*

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CASE LAW REVIEW

In re Albright, 291 B.R. 538 (Bankr. D. Colo. 2003)

Upon filing Chapter 7 bankruptcy petition, single member of LLC effectively assigned entire membership interest to bankruptcy trustee (including management rights), enabling trustee to liquidate assets of LLC.

In re Ehmann, 319 B.R. 200 (Bankr. D. Ariz. 2005)

Where LLC operating agreement was not an “executory contract,” membership interest in a multi-member LLC became property of the Chapter 7 bankruptcy trustee.

In re Modanlo, 412 B.R. 715 (Bankr. D. Md. 2006)

Chapter 11 bankruptcy trustee of a single member of an LLC may exercise economic and governance rights in the single-member LLC, including the rights to file a bankruptcy petition for the LLC and exercise voting rights held by the LLC.

In re A-Z Electronics, LLC, 350 B.R. 886 (Bankr. D. Idaho 2006)

Upon filing Chapter 7 bankruptcy petition, single member of LLC effectively assigned entire membership interest to bankruptcy trustee, including the right to file a petition for bankruptcy for the LLC.

Other cases of interest:

In re Lahood, 2010 WL 3842429, 2 (C.D. Ill. 2010); Cognex Corporation v. VCode Holdings, Inc. (U.S. Dist. LEXIS 81242 (Bankr. D. Minn. 2006); In re Schwab, 378 B.R. 854 (Bankr. D. Minn. 2007); General Electric Capital Corp v. JLT Aircraft Holding Co., 2010 U.S. LEXIS 76384 (Bankr. D. Minn. 2010); U.S. v. Surgent, 2008 U.S. Dist. LEXIS (E.D.N.Y. 2008); In re Desmond, 316 B.R. 593 (Bankr. D. N.H. 2005); In re Desmond, 2005 WL 1244842 (Bankr. D. N.H. 2005); In the Matter of Pischke, 11 B.R. 913 (Bankr. E.D. Vir. 1981); Baldwin, 2006 WL 2034217 (10th Cir. B.A.P. Okl. 2006)

OLMSTEAD

Fed. Trade Comm'n v. Olmstead, 528 F.3d 1310 (11th Cir. 2008); Olmstead v. Fed. Trade Comm'n, --So. 3d-- (Fla. 2010) 2010 WL 2518106

Majority Opinion

Florida law permits a court to order a judgment debtor to surrender all right, title and interest in and to the debtor's single-member LLC to satisfy an outstanding judgment because there is no reasonable basis for inferring that the charging order remedy is the sole remedy for a judgment creditor of an LLC member.

Justice Lewis' Dissenting Opinion

The LLC Act inherently displaces the availability of the execution provisions in chapter 56 by providing a remedy that is intended to prevent judgment creditors from seizing ownership of the membership interests and liquidating the assets of the LLC.

FLORIDA STATUTES

Fla. Stat. § 56.061

Fla. Stat. § 56.061 - Property subject to execution.

Lands and tenements, goods and chattels, equities of redemption in real and personal property, and stock in corporations, shall be subject to levy and sale under execution. Likewise, the interest in personal property in possession of a vendee under a retained title contract or conditional sale contract shall be subject to levy and sale under execution to satisfy a judgment against the vendee. This shall be done by making the levy on such personal property.

Olmstead Court compared LLCs to Corporations.

Lott v. Padgett, 153 Fla. 308 (Fla. 1943); Street v. Sugarman, 202 So.2d 749 (Fla. 1967); Icardi v. Nat'l Equipment Rental, Inc., 378 So.2d 113 (Fla. 5th DCA 1980)

Chapter 608, Florida Statutes

Fla. Stat. § 608.433 - Right of assignee to become member.

(1) 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.

(2) An assignee who has become a member has, to the extent assigned, the rights and powers, and is subject to the restrictions and liabilities, of the assigning member under the articles of organization, the operating agreement, and this chapter. An assignee who becomes a member also is liable for the obligations of the assignee's assignor to make and return contributions as provided in s. 608.4211 and wrongful distributions as provided in s. 608.428. However, the assignee is not obligated for liabilities which are

unknown to the assignee at the time the assignee became a member and which could not be ascertained from the articles of organization or the operating agreement.

(3) If an assignee of a limited liability company interest becomes a member, the assignor is not released from liability to the limited liability company under ss. 608.4211, 608.4228, and 608.426.

(4) 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.

Legislative proposals seeking to enact exclusive remedy language and explicitly disallow foreclosure failed to reach the Florida Legislature.

Chapter 620, Florida Statutes / Florida Revised Uniform Limited Partnership Act of 2005

Fla. Stat. § 620.1703 - Rights of creditor of partner or transferee.

(1) On application to a court of competent jurisdiction by any judgment creditor of a partner or transferee, the court may charge the partnership interest of the partner or transferable interest of a transferee with payment of the unsatisfied amount of the judgment with interest. To the extent so charged, the judgment creditor has only the rights of a transferee of the partnership interest.

(2) This act shall not deprive any partner or transferee of the benefit of an exemption law applicable to the partner's partnership or transferee's transferable interest.

(3) This section provides 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. **Other remedies, including foreclosure on the partner's interest in the limited partnership or a transferee's transferable interest and a court order for directions, accounts, and inquiries that the debtor general or limited partner might have made, are not available** to the judgment creditor attempting to satisfy the judgment out of the judgment debtor's interest in the limited partnership and may not be ordered by a court.

Even before the 2005 enactment of FRULPA, several Florida cases in the partnership context *clarified* that the charging order was a creditor's sole remedy:

- Myrick v. Second National Bank of Clearwater, 335 So.2d 343 (Fla. 2nd DCA 1976)
- Krauth v. First Continental Dev-Con, Inc., 351 So.2d 1106 (Fla. 4th DCA 1977)
- In re Jam Fine Furniture, Inc., 19 B.R. 578 (Bankr. S.D. Fla. 1982)
- Atlantic Mobile Homes, Inc. v. LeFever, 481 So.2d 1002 (Fla. 4th DCA 1986)
- In re Canto, 84 B.R. 773 (Bankr. N.D. Fla. 1988)
- In re Stocks, 110 B.R. 65 (Bankr. N.D. Fla. 1989)
- Anderson v. Potential Enterprises, Ltd., 596 So.2d 488 (Fla. 5th DCA 1992)
- Schiller v. Schiller, 625 So.2d 856 (Fla. 5th DCA 1993)
- Givens v. National Loan Investors L.P., 724 So.2d 610 (Fla. 5th DCA 1998)

After Olmstead, in Florida, assets in single-member LLCs are not insulated from the outside creditors of its sole member.

POSSIBLE WAYS TO ADDRESS EXISTING FLORIDA SMLLCs AND MMLLCs

1. Add a member
 - a. What percentage ownership?
 - i. Albright peppercorn.
 - b. Who should the members be?
 - i. Family members
 - ii. Trusts
 1. Revocable Trust
 2. Irrevocable Trust
 - a. Grantor Trust
 - iii. Other entities
 1. LLC
 2. Partnership
 3. Corporation
 - iv. Joint Title
 1. T by E
 2. JTWROS
 3. TIC
 - c. Tax Consequences
 - i. Taxable gifts
 - ii. New member contribute property
2. Member-managed vs. Manager-managed
3. Operating Agreement Provisions
4. Conversion
 - a. Convert to LP or LLLP - Fla. Stat. § 608.4401
 - i. A general partner of an LP is liable for the debts and obligations of the LP while a general partner of an LLLP is not liable for the debts and obligations of the LLLP. Fla. Stat. § 620.1404.

- ii. A limited partner of an LP or an LLLP is not liable for an obligation of the partnership even if the limited partner participates in the management and control of the partnership. Fla. Stat. § 620.1303.
- b. Limited Liability vs. Asset Preservation
 - i. Fla. Stat. § 608.701
 - 1. 608.701 - Application of corporation case law to set aside limited liability: In any case in which a party seeks to hold the members of a limited liability company personally responsible for the liabilities or alleged improper actions of the limited liability company, the court shall apply the case law which interprets the conditions and circumstances under which the corporate veil of a corporation may be pierced under the law of this state.
 - ii. Court shall apply corporate case law for piecing the LLC veil actions
 - 1. Dania Jai-Alai Palace, Inc. v. Sykes, 450 So.2d 1114 (Fla. 1984)
 - iii. Do partnerships have the Dania Jai-Alai standard for piercing the veil?
- c. Convert to LLC in Another Jurisdiction
 - i. Jurisdictions where the charging order is the exclusive remedy:

AL, AK, AZ, CA, DE, HI, ID, IL, IA, KS, KY, ME [Eff. 7-1-11], MN, MS, MT, NE, NV, NJ, ND, OK, SC, SD, TN, TX, UT, VT, VA, WV, WY
 - ii. Jurisdictions where foreclosure is prohibited **expressly** or by implication:

AK, DE, GA, ME [Eff. 7-1-11], NV, **NJ, SD, TX, VA**
 - iii. Jurisdictions where charging order is exclusive remedy and foreclosure is expressly prohibited:

AK, ME [Eff. 7-1-11], NJ, SD, TX
 - iv. May be able to form a series LLC to add additional layer of inside creditor protection
 - 1. Series LLC jurisdictions

DE, IL, IA, NV, OK, TN, TX, UT, WI
 - 2. New Prop. Regs. on tax classification of series LLCs. Prop. Treas. Reg. § 301.7701-1.
- d. Convert to a Corporation
- e. Convert to a Foreign Entity
- f. Tax Consequences to Conversion
 - i. Employment Tax Status and Filing Issues

1. SM LLC treated as a corporation for employment tax purposes and must file and pay under a separate EIN. Treas. Reg. § 301.7701-2(c). Single member treated as self employed and must pay SE tax.
2. MM LLCs generally apply partnership rules. Prop. Reg. § 1.1402(a)-2.
 - a. Member managed vs. manager managed
- ii. Check-The-Box Status
 1. Potential conversion to new tax entity
 2. K-1s to the new owners as opposed to disregarded entity status
- iii. Grantor trust as other owner
- iv. Corporate or partnership tax laws may apply
- v. International tax law may apply if foreign entity

CHARGING ORDERS AND “PHANTOM INCOME”

Rev. Rul. 77-137; Evans v. Comm’r, 447 F.2d 547 (7th Cir. 1971)

OTHER AVAILABLE REMEDIES

Bankruptcy (involuntary or voluntary)

Make operating agreement an executory contract

Dissociation or liquidation event

Piercing and reverse piercing theories

Dania Jai-Alai Palace, Inc. v. Sykes, 450 So.2d 1114 (Fla. 1984)

Litchfield Asset Management Corp. v. Howell, 799 A2d 298 (Conn. 2001)

Receiver appointment

Foreclosure

Other remedies to creditors

STATUTORY REVISION

Will Olmstead be a death rattle for SM LLC asset preservation or a battle cry?

Will legislation be passed to include “exclusive remedy” language? If so, might Olmstead still apply to SM and MM LLCs? Should legislation concede SM LLCs and protect MM LLCs?

JUDICIAL INTERPRETATION

Was opinion flawed enough, if at all, to justify repudiation?

RELY ON OTHER ASSET PRESERVATION TECHNIQUES

Domestic and foreign asset protection trusts, insurance policies, annuities, homestead, tenancy by the entirety property, exempt wages, pensions, retirement accounts, qualified tuition accounts, personal property and automobiles, etc.

QUESTIONS