

WEALTH PRESERVATION AND TAX PLANNING ALERT

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May 2011

**Olmstead “Charging Order” Patch Bill Passed by Florida Legislature
-- Awaiting Signature by Governor**

On April 29, 2011, the Florida Senate passed legislation (HB 253) which was previously passed by the House of Representatives two weeks earlier. This legislation is designed to “fix” the uncertainty and confusion created by the *Olmstead* case with respect to “charging order” protection for members of Florida LLCs. This new legislation, which is discussed below, is being sent to the Governor for his signature.

Olmstead Case and Charging Order Protection

Last June, the Florida Supreme Court in *Olmstead v. Federal Trade Commission* held that the statutory charging order protection in Florida under § 608.433(4), Florida Statutes (“F.S.”), is not available to the sole member of a Florida single-member LLC. The Court concluded that a court may order a judgment debtor to surrender all right, title and interest in that debtor’s single-member Florida LLC to the judgment creditor to satisfy that judgment creditor’s claims against the debtor.

The “charging order” remedy set forth in § 608.433(4), F.S., provides that a judgment creditor of a member in a Florida LLC may apply to a court for an order (charging order) charging the membership interest of the debtor member with payment of the unsatisfied amount of the judgment owed to the judgment creditor. To the extent so charged, the judgment creditor has only the rights of an assignee of such interest which means, as a general rule, that the assignee has no right to participate in the management of the business and affairs of the LLC, but rather is only entitled to share in profits and losses and to receive such distributions to which the assignor was entitled.

The charging order remedy originated in common law to protect non-debtor partners from being forced into partnership with the creditor of a debtor-partner. The underlying theory of the charging order is that a judgment creditor can be paid from the profits or distributions from the LLC without the disruption of the business caused by inserting another member into the group or the damage caused to other members if all or any portion of the business was sold to pay the judgment creditor.

Thus, while the underlying theory/justification for the charging order remedy seemingly falls apart in the context of a single-member LLC – after all, there is no non-debtor member to

protect in a single-member LLC – the rationale for applying charging order remedy in a multi-member LLC context appears to be well-founded. At least that is what most of us thought prior to the *Olmstead* decision.

The Supreme Court, in its majority opinion, in *Olmstead* placed significant emphasis on the language of the “charging order” statute for Florida LLCs which, unlike the “charging order” statute for partnerships, does not expressly state that it is the “sole and exclusive” remedy that can be utilized by a judgment creditor with respect to a judgment debtor’s membership interest in a Florida LLC. The Court concluded that there is no reasonable basis for inferring that the Florida LLC charging order statute establishes the sole remedy for a judgment creditor against a judgment debtor’s interest in a single-member Florida LLC.

The majority’s analysis in *Olmstead* was criticized by Justice Lewis in his lengthy dissenting opinion in which he articulated the potential negative implications of the majority’s decision on multiple-member LLCs by expressly noting the following:

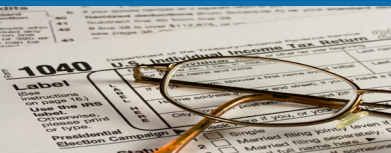
An adequate remedy is available without the extreme step taken by the majority in rewriting the plain and unambiguous language of [the LLC statute]. This is extremely important and has far-reaching impact because the principles used [by the majority] to ignore the LLC statutory language under the current factual circumstances apply with equal force to multimember LLC entities and, in essence, today’s decision crushes a very important element for all LLCs in Florida. If the remedies available under the LLC Act do not apply here because the phrase “exclusive remedy” is not present, **the same theories apply to multimember LLCs and render the assets of all LLCs vulnerable.** (Emphasis added.)

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Justice Lewis further noted in his dissent:

To support its conclusion that charging orders are inapplicable to single-member LLCs, the majority compares the provision in the partnership statute that mandates a charging order as an exclusive remedy to the non-exclusive provision in the LLC Act. The exclusivity of the remedy is irrelevant to this analysis. By relying on an inapplicable statute, the majority ignores the plan language of the LLC Act and the other restrictions of the statute, which universally apply the use of the charging order to judgment creditors of all LLCs, regardless of the composition of the membership. **The majority opinion now eliminates the charging order remedy for multimember LLCs** under its theory of “nonexclusivity” **which is a disaster for those entities.** (Emphasis added.)

Thus, while the holding of the Supreme Court in the *Olmstead* case can be rationalized based on the intended purpose of the charging order remedy (i.e., to protect non-debtor partners from being forced into partnership with the creditor of a debtor partner), the majority’s focus, and perhaps undue reliance, on the difference between the charging order statutes for LLCs and partnerships, as a primary basis for its holding, was somewhat surprising. Justice Lewis’ detailed dissent brought into sharp focus the negative implications and exposure of the majority’s rationale to multiple-member LLCs in Florida.

Florida Legislature to the Rescue – HB 253

Earlier this year, new legislation was introduced in both the House of Representatives and the Florida Senate to rewrite the Florida LLC charging order statute to provide that the charging order shall be the “sole and exclusive” remedy available for judgment creditors of a debtor-member of a Florida LLC in order to deal with the uncertainty created by the *Olmstead* case.

This new “charging order” legislation (HB 253) was passed by the House of Representatives on April 15, 2011. On April 29, 2011, the Florida Senate also passed HB 253 paving the way for this new legislation to be sent to the Governor for his signature.

This new legislation, once signed by the Governor, will make the following changes and clarification to the Florida LLC charging order statute:

1. It clarifies that the general application of the *Olmstead* case to single-member LLCs does not extend to multiple-member LLCs.
2. It provides that with respect to a **multiple-member** LLC, a charging order is the “sole and exclusive remedy” by which a judgment creditor of a member or member’s assignee may satisfy a judgment from a judgment debtor’s interest in an LLC or rights to distributions from an LLC, and that the remedy of foreclosure on a judgment debtor’s membership interest in the LLC is not available to the judgment creditor attempting to satisfy the judgment.
3. It provides that with respect to a **single-member** LLC, a charging order is the “sole and exclusive remedy” by which a judgment creditor of a member or member’s assignee may satisfy a judgment from a judgment debtor’s interest in an LLC or rights to distributions from an LLC, **unless** the judgment creditor of a member or member’s assignee establishes to the satisfaction of the court that distributions under a charging order will not satisfy the judgment within a reasonable time, in which case a charging order will not be the sole and exclusive remedy available to the judgment creditor. Upon such a showing, the court may order the sale of a member’s or assignee’s interest in the LLC pursuant to a foreclosure sale. The judgment creditor may make such a showing within a reasonable time at any time after entry of the judgment and may do so at the same time the judgment creditor applies for entry of a charging order. If the court orders a foreclosure sale, the purchaser at the sale obtains the member’s entire interest in the LLC and becomes the member of the LLC, and the person whose interest is sold ceases to be a member of the LLC.
4. It provides that nothing in this new charging order statute shall limit: (i) the rights of a secured creditor who has been granted a consensual security interest in the LLC interest; (ii) the principles of law and equity which affect fraudulent transfers; (iii) the

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availability of equitable principles of alter ego, equitable lien, or constructive trust, or other equitable principles not inconsistent with this charging order statute; or (iv) the continuing jurisdiction of the court to enforce its charging order in a manner consistent with this charging order statute.

5. This new legislation is intended to be clarifying and remedial in nature and, thus, **will apply retroactively**.

Once this new legislation is signed by the Governor and becomes law, it should provide comfort for both existing and new multiple-member LLCs formed in Florida that, barring the presence of any of the exceptions noted in paragraph 4, above, “charging order” protection will be the “sole and exclusive” remedy available to a judgment creditor of a debtor member of such LLCs. By contrast, the “charging order” protection for single-member LLCs under this new legislation is somewhat

illusory since a judgment creditor can still seek to foreclose on the debtor member’s interest in the LLC by establishing to the satisfaction of a court that distributions under the charging order will not satisfy the judgment within a reasonable period of time. ■

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