

ADVERSE WITNESS ARTICLE
ASSET PROTECTION FOR LLC'S

Until last year, many Florida business lawyers believed that the assets owned by a Florida limited liability company (“LLC”) were safe from a creditor of an owner of an LLC membership interest, even if the LLC was owned by only one person. The basis for such belief was Florida Statute Section 608.433(4), which provided that a judgment creditor of a member of a Florida LLC could charge the LLC membership interest of the member with the payment of the unsatisfied amount of the creditor’s judgment and, to the extent so charged, the judgment creditor only had the rights to the profits and distributions to which such member was otherwise entitled. This statutory provision, which is commonly referred to as the “charging order” statute, did not state that the creditor may become a substitute member of the LLC and thereby have an interest in the assets of the LLC or have any management rights.

However, on June 24, 2010, the Florida Supreme Court, in the case of *Olmstead v. Federal Trade Commission*, 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 limited liability company to satisfy an outstanding judgment. The practical effect of this case was that a creditor of a person who is the sole member of a Florida LLC could take over the ownership of the LLC and thereby obtain effective ownership of the LLC’s assets. The Court determined that the Florida statutory provision cited above should not apply to single-member LLC’s, even though no distinction is made between single-member LLC’s and multiple-member LLC’s in the statute.

In light of this Florida Supreme Court case, many business lawyers advised their clients who owned and operated their businesses using single-member LLC’s to consider adding one or more additional members to the LLC, converting the LLC into a different type of business entity,

such as a limited partnership or limited liability limited partnership, or converting the LLC from a Florida LLC into an LLC in a state whose law is well-settled regarding charging order protection. It is also important to note that the Court's opinion left open the possibility that even creditors of members of multiple-member LLC's might be able to take over the ownership of the member's LLC interest. There clearly was a need for the Florida Legislature to address these important Florida business law issues as soon as possible.

I am pleased to advise that the Florida Legislature did, in fact, act quickly to partially overrule the *Olmstead* case and to provide guidance to the business community with respect to asset protection for both single-member and multiple-member LLC's. Effective May 31, 2011, Florida Statute §608.433 has been amended to provide as follows:

1. The holding in the *Olmstead* case does not apply to multiple-member LLC's. Rather, a charging order is the sole and exclusive remedy available to a judgment creditor of a member of a multiple-member LLC.
2. A charging order is the sole and exclusive remedy available to a judgment creditor of a single-member LLC, unless the judgment creditor establishes to the satisfaction of the court that distributions under a charging order will not satisfy the judgment within a reasonable time. If the judgment creditor successfully makes such a showing, the court may order the sale of the membership interest pursuant to a foreclosure sale.
3. The amendment does not limit (a) the rights of a creditor that has been granted a consensual security interest in an LLC membership interest to pursue its creditor's rights, (b) the principles of law and equity which affect fraudulent transfers, or (c) the availability of the equitable principles of alter ego, equitable lien, constructive trust or other equitable principles not inconsistent with the charging order statute.

In light of the new legislation, which confirms that charging order protection is available to members of multiple-member LLC's but is not available in certain circumstances to a member of a single-member LLC, it seems that adding one or more additional members to a single-member Florida LLC will often be the most practical approach for business owners who own and operate their businesses using single-member LLC's. It would appear to be very risky for a

single-member LLC to rely on the charging order protection set forth in paragraph #2 above. Because the member of a single-member LLC typically controls whether distributions will be made from the LLC, and, therefore, could prevent such distributions from being made to satisfy a charging order within a reasonable time, it is possible that a court could shift the burden of proof from the judgment creditor to the single-member LLC and require the single-member LLC to establish that distributions will be made from the LLC to satisfy the judgment within a reasonable time in order to qualify for charging order protection. Regardless of whether a court places the burden of proof on the judgment creditor or the single-member LLC, a single-member LLC may have a difficult time persuading the court not to order the sale of the membership interest pursuant to a foreclosure sale. If one or more additional members are added to a single-member LLC, the charging order protection will be available without the risk of costly and possibly unsuccessful litigation.

An analysis of the alternatives and legal and tax consequences of making changes to a single-member LLC is beyond the scope of this article. A key aspect of such analysis is how important it is to the business owner to protect the assets of the business from the owner's potential creditors. Business owners should consult with their legal and tax advisors to discuss their particular situations in order to make an informed decision on whether to make any changes to their existing LLC's or on how to structure their new business.