

Real Property, Probate and Trust Law Section of The Florida Bar

White Paper on Proposed Enactment of Revisions to Section 608.433, Florida Statutes

I. SUMMARY

The proposal, if adopted, will restore certainty to an important aspect of the law of limited liability companies, ensuring that Florida LLCs will again be a viable business choice. Uncertainty exists because of the reasoning of the Supreme Court of Florida's decision in *Olmstead v. Federal Trade Comm.*, Case No. SC08-1009 (June 24, 2010), holding that the remedy of a judgment creditor of an owner of an interest in a single-member LLC is not limited to a charging order and that, instead, a court may enter an order directing the judgment debtor to surrender all right, title and interest in the debtor's membership interest to satisfy an outstanding judgment. The proposal to amend the Florida Limited Liability Company Act, F. S. §§608.401 – 608.705, confirms that a charging order lien is the exclusive remedy available to a judgment creditor seeking to attach the membership interest of a member in a multiple-member LLC.

II. CURRENT SITUATION

A. Background: Creditors' Rights in LLC Membership Interests in General.

(1) Increasingly Widespread Use of LLCs.

LLCs first became available in Florida in 1982, but were rarely used primarily because LLCs were subject to Florida corporate income tax. By contrast, partnerships and S corporations were not subject to Florida corporate income tax.

In 1999 LLCs were exempted from the Florida corporate income tax. This change in the law caused LLCs to become popular and, according to statistics published by the Secretary of State on Sunbiz.org, by 2007 there were more LLCs created than any other form of business organization, including corporations. Although the number of new corporations created in Florida has declined slightly since 2000 (from 119,282 in 2000 to 103,113 in 2009, a decrease of 16,169), the number of new LLCs has exploded (from 19,186 in 2000 to 128,548 in 2009, an increase of 109,362).

(2) Assignee of Membership Interest Must Receive Consent of Other Members to Become Member.

Florida Statutes Section 608.433(1) provides as follows:

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.

Accordingly, at least in the context of a multiple-member LLC, an assignee of a membership

interest would not become a member of the LLC without the consent of the other members. This concept is derived from partnership law, where it is often referred to as the “know your partner” rule.

(3) Charging Order Remedy for LLCs.

Florida Statutes Section 608.433(4) (which has essentially been unchanged since its enactment in 1993) provides as follows:

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.

Florida Statutes Section 608.433(4) provides that a court may grant a judgment creditor of an LLC member a charging order. If a judgment creditor of an LLC member does obtain a charging order, then to the extent that distributions are made from the LLC, the creditor would be entitled to distributions allocable to the membership interest in which it has obtained the charging order. However, a charging order does not grant management rights to the creditor or cause the creditor to be admitted as a member.

(4) Florida Cases Interpreting Partnership Charging Order Remedy Prior to *Olmstead*.

In *Myrick v. Second National Bank*, 335 So.2d 343 (Fla. 2d DCA 1976), a creditor attempted to levy upon the debtor’s interest in a partnership. The court considered whether the charging order statute in effect at that time, which was substantially similar to current Florida Statutes Section Florida 608.433(4), merely furnished the creditor with an additional remedy or whether it limited the remedy to a charging order. The court concluded that the judgment debtor's rights in the partnership were not subject to levy but could only be reached by the judgment creditor through a charging order.

The courts in *Atlantic Mobile Homes, Inc. v. LeFever*, 481 So.2d 1002 (Fla 4th DCA 1986) and *Givens v. National Loan Investors L.P.*, 724 So.2d 610 (Fla 5th DCA 1999) reached similar results, concluding that the charging order remedy was the sole remedy available to a judgment creditor.

(5) Statutory Charging Order Provision for Limited Partnerships Revised in 2005: Florida Makes a Charging Order the Exclusive Remedy.

In 2005, Florida Statutes Section 620.1703, which provides for a charging order remedy in connection with partnership interests of a limited partnership, was revised to indicate that the charging order remedy "was 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." The statutory change codified the results of the decisions discussed in the preceding subsection (4).

(6) Other States Make the Charging Order the Exclusive Remedy Available to Judgment Creditors of LLC Members.

A number of states prohibit foreclosure of LLC interests, including Alabama, Alaska, Arizona (but see *Ehmann*, discussed below), Delaware, Minnesota, Mississippi, New Jersey, North Carolina, North Dakota, Oklahoma, South Dakota, Tennessee, Texas, Virginia and Wyoming.

(7) Bankruptcy Cases Addressing Charging Orders are Instructive

Florida is a so-called “opt out” state, meaning that a Florida debtor in bankruptcy can only use state law exemptions. For bankruptcies in other states, depending on applicable state and federal law, a debtor might be able to choose between state and federal exemptions, or might be required to use the federal exemptions. Regardless of what law the Bankruptcy Courts apply in a particular case, the analysis of the exclusivity of the charging order remedy by those Courts is instructive to state legislatures and courts addressing the question.

In *Albright*, 291 B.R. 538 (Bankr. D. Colorado, 2003), the debtor was the sole member and manager of a Colorado LLC. The bankruptcy trustee argued that because the debtor was the sole member and manager of the LLC at the time she filed bankruptcy, the trustee controlled the LLC and could cause the LLC to sell the assets owned by the LLC and distribute the sale proceeds to the bankruptcy estate. The debtor argued that the bankruptcy trustee was only entitled to a charging order and could not assume management of the LLC or cause the LLC to sell the assets of the LLC. The court concluded that, where the debtor, on the date her Chapter 7 petition was filed, was the only member of the LLC, the debtor's bankruptcy filing effectively assigned her entire membership interest in the LLC to the bankruptcy estate, and the trustee obtained all of her rights, including the right to control management of the LLC.

On the other hand, the court in *Albright* stated that if the debtor's interest were in a multiple-member LLC, and if other members had not consented to substitute member status for the Chapter 7 trustee, the bankruptcy estate would have been entitled only to receive a share of the profits or other compensation from the LLC, and would not have had the right to participate in the management of the LLC.

In *Ehmann*, 319 B.R. 200 (Bankr. D. Arizona, 2005), the debtor owned an interest in an Arizona multiple-member LLC that held two investments, one of which was converted to cash shortly after the bankruptcy case was filed. Distributions were made from the LLC to other members but not to the bankruptcy trustee. The court concluded that the operating agreement was not an “executory contract” because the members had no material obligations. The court held that where the operating agreement of the LLC was not an “executory contract,” the bankrupt member's interest in the LLC became property of the bankruptcy estate, notwithstanding any language in the operating agreement otherwise restricting or conditioning the transfer of the bankrupt member's interest. Accordingly, the bankruptcy trustee had all the rights and powers with respect to the LLC that the debtor held as of the commencement of the bankruptcy.

In *Modanlo*, 412 B.R. 715 (Bankr. D. Maryland, 2006), the bankruptcy trustee moved for leave to cause the debtor's single-member LLC to call a meeting of the shareholders of a corporation in which it was the largest shareholder and held control. The court held that the trustee was authorized to exercise management and governance rights in the LLC.

In *A-Z Electronics, LLC*, 350 B.R. 886 (Bankr. D. Idaho, 2006), the court held that the bankruptcy trustee exercised the sole and exclusive management of the debtor's single-member LLC.

B. The Olmstead Case.

(1) Facts.

The Federal Trade Commission sued Mr. Olmstead and others for unfair and deceptive trade practices. Assets of the defendants were frozen and placed in receivership. Among the assets were several single-member LLCs.

The United States Court of Appeals for the Eleventh Circuit certified the following question to the Florida Supreme Court: “Whether, pursuant to Fla. Stat. Section 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.” *Fed. Trade Comm'n v. Olmstead*, 528 F.3d 1310, 1314 (11th Cir. 2008).

(2) Majority Opinion.

The Florida Supreme Court, in an opinion written by Justice Canady, concluded that Florida law permits a court to order a judgment debtor to surrender all right, title, and interest in the debtor's membership interest in a single-member LLC to satisfy an outstanding judgment. The Court stated that it based its conclusion on (i) the uncontested right of the owner of the single-member LLC to transfer the owner's full interest in the LLC; and (ii) the absence of any basis in the Florida LLC Act for not allowing the long-standing creditor's remedy of levy and sale under execution.

The Court reasoned that (i) the limitation on assignee rights set forth in Florida Statutes Section 608.433(1) has no application to the transfer of rights in a single-member LLC; (ii) an assignee of the membership interest of the sole member in a single-member LLC becomes a member and takes the full right, title, and interest of the transferor without the consent of anyone other than the transferor; and (iii) the charging order provision of the Florida LLC Act does not give a judgment creditor of the sole owner of an LLC less extensive rights than the rights that are freely assignable by the judgment debtor.

The Court noted that the statutory charging order provision applicable to limited partnerships is explicitly stated to be a creditor's “exclusive remedy,” and that such a provision is absent from the Florida Limited Liability Company Act. Thus, the Court reasoned that the Florida legislature must have intended to not make the charging order remedy the exclusive remedy for LLCs when it failed to amend the Florida Limited Liability Company Act when changes to the Florida Revised Uniform Limited Partnership Act of 2005 were made.

(3) Dissenting Opinion.

The dissenting opinion in *Olmstead* was written by Justice Lewis, who was joined by Justice Polston.

Justice Lewis concluded Florida law does not permit a court to order a judicial foreclosure of an LLC membership interest without first proceeding through the statutory requirements created by the Florida Limited Liability Company Act. Justice Lewis pointed out that, based on *Givens* and *Myrick*, Florida courts have determined in the partnership context that a charging order is the exclusive remedy for judgment creditors based on the “straightforward language of the statute.”

Justice Lewis also observed that the Court's rationale applies equally to multiple-member LLCs.

He argued that “the actual language of the statute does not distinguish between the number of members in the LLC” and that the holding of the Court” is premised on a limited application of a charging order without express language in the statutory scheme to support this assertion.”

Justice Lewis concluded that the restraint on transferability provided for in Florida Statutes Section 608.433(1) has applicability to single-member LLCs, and that a member of a single-member LLC continues to be a member unless all of the member's economic interest is transferred to the judgment creditor by the charging order. He continued by noting that alternative remedies are available to judgment creditors of an LLC member, including (i) dissolution of the LLC if the charging order requires the surrender of all of the member's economic interest; (ii) an order of insolvency against the judgment debtor, in which case that member's interest would become part of judgment debtor's bankruptcy estate; or (iii) “reverse piercing” of the LLC veil by a court to allow a judgment creditor to reach the assets of the LLC.

C. The Practical Consequences of *Olmstead*: Prompt Action is Required.

The rationale for the result reached by the Florida Supreme Court in *Olmstead* – that Florida law permits a court to order a judgment debtor to surrender all right, title, and interest in the debtor's single-member LLC to satisfy an outstanding judgment against the member – could apply with equal force to membership interests in multiple-member LLCs. Although *Olmstead* dealt only with a single-member LLC, the Court's reasoning will create substantial uncertainty as to the remedies available to a judgment creditor of a member of a multi-member LLC.

The continued general use of LLCs organized in Florida will decline if the uncertainty created by *Olmstead* is allowed to continue. Businesses will have an incentive to create an LLC in another jurisdiction where certainty exists, such as Delaware, or to re-locate existing Florida LLCs to those jurisdictions.

The Florida Limited Liability Company Act should be amended as soon as possible to provide that, consistent with the law applicable to limited partnerships, as to multiple-member LLCs, a charging order is the exclusive remedy which a judgment creditor of a member may use to satisfy a judgment out of the judgment debtor's membership interest in the multiple-member LLC.

III. EFFECT OF PROPOSED CHANGES

Through a modification of Section 608.433, Florida Statutes, the proposed legislative changes will make clear that the sole remedy of a creditor seeking to enforce a judgment against the interest owned by a member of a multiple-member LLC is a charging order against the member's transferable interest in the LLC. Foreclosure on the judgment debtor's interest and all other remedies a creditor could have are not available and may not be ordered by a court.

The proposed statute is intended to clarify existing law. The Court's decision in *Olmstead* applies only to single-member LLCs. The proposed legislative changes do not attempt to supersede *Olmstead* and will not apply to single-member LLCs. Instead, these changes are only to make clear that the law in Florida is now and continues to be that a charging order is the exclusive remedy of a judgment creditor as against a member's transferable interest in a multiple-member LLC.

IV. FISCAL IMPACT ON STATE AND LOCAL GOVERNMENTS

The proposal, if adopted, should increase revenue because existing LLCs will continue to pay fees to the State in order to remain in good standing in Florida, and additional LLCs will pay the fees required by the State for the LLC to be validly formed here.

V. DIRECT IMPACT ON PRIVATE SECTOR

The proposed statute will benefit the private sector by providing certainty and predictability to those establishing and maintaining multiple-member LLCs under Florida law. Without the proposed statutory revision, LLCs will no longer be a viable option for doing business in Florida and business formation and operation will be removed to other states that provide the protection that the revision is designed to achieve.

VI. CONSTITUTIONAL ISSUES

No constitutional issues are anticipated.

VII. OTHER INTERESTED PARTIES

Other groups that may have an interest in the legislative proposal include the Tax and Business Law Sections of The Florida Bar, and the Florida Bankers Association. The Tax Section is a co-sponsor of this proposal.