

Florida Legislature Clarifies Remedies Available to Judgment Creditors of Members of Florida Limited Liability Companies



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On May 31, 2011, Governor Rick Scott signed into law House Bill 253, which clarifies that a charging order is the “sole and exclusive” remedy available to judgment creditors of members of multi-member Florida limited liability companies. It is believed that this legislation will put an end to the uncertainty generated by the Florida Supreme Court’s ruling in *Olmstead vs. Federal Trade Commission*, 44 So. 3d 76 (Fla. 2010) (hereinafter referred to as “*Olmstead*”). This legislation solidifies Florida’s reputation as one of the most debtor friendly states in the country by limiting the collection remedies available to lenders and thus, may make it more difficult for limited liability companies to obtain financing. It should also lead to even more conversions of corporations into LLCs, which can be done quite inexpensively and without tax consequences.

As a brief overview, a limited liability company (“LLC”) is a hybrid business entity that has corporate-like protection against personal liability for its owners (known as “members”) and may elect the tax benefits of a partnership or S corporation. This personal liability protection and beneficial tax structure make it a popular business vehicle among American business owners. LLCs are a relatively new business structure in the United States. In 1977, Wyoming became the first state to enact LLC legislation, with Florida following soon thereafter. Many other states chose not to adopt LLC legislation until 1988 when the Internal Revenue Service issued a ruling allowing LLCs to be treated as partnerships for tax purposes.

Prior to the ruling in *Olmstead*, it was believed that charging orders were the exclusive remedy available to judgment creditors of partners of limited partnerships and members of LLCs. Under a charging order, the creditor has only the rights of an assignee of the partnership or membership interest. As an assignee, a creditor has the right to receive distributions to which the debtor partner or member would have been entitled (this remedy is analogous to wage garnishment). However, the charging order does not entitle the creditor to become or to exercise any right of a partner or member. The concept of charging orders was developed in order to protect

non-debtor partners or members from having to involuntarily share the management of the entity with someone they did not choose. This protects the autonomy of the original partners or members and allows them to continue to manage their enterprise without creditor intervention.

The belief that a charging order was the exclusive remedy for judgment creditors of a member of a Florida LLC came into question after *Olmstead*. In *Olmstead*, defendants Shaun Olmstead and Julie Connell operated an advance-fee credit card scam. In response to this scam, the Florida Trade Commission (“FTC”) sued the defendants and their corporate entities for unfair or deceptive trade practices. The FTC was awarded injunctive relief and a judgment for more than \$10 million. To satisfy this judgment, the FTC obtained an order compelling the defendants to endorse and surrender all of their right, title, and interest in several single member Florida LLCs. The defendants appealed the judgment arguing that the only remedy available against their ownership interests was a charging order pursuant to the language of section 608.433(4), Florida Statutes. Section 608.433(4) provides, in relevant part, that “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.”

To understand the issue concerning the remedies available to judgment creditors it is helpful to compare and contrast the evolution of the law with respect to limited partnerships and LLCs. The Florida Legislature enacted the Florida Revised Uniform Limited Partnership Act in 2005 and implemented Section 620.1703, Florida Statutes, which provides that the charging order is the “exclusive remedy” a judgment creditor of a partner of a Florida limited partnership may use to satisfy a judgment, but left unchanged the corresponding LLC statute, which did not contain the same “exclusive remedy” language. Chief Justice Canady interpreted the inaction of the Florida Legislature with respect to LLCs as an indication of legislative intent that a charging order is not the exclusive remedy available to the judgment creditor of a member of a Florida LLC. He wrote

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that “the language of this subsection [608.433(4)] ... limits the rights of a judgment creditor to the rights of an assignee but ... does not expressly establish the charging order as an exclusive remedy.” Based on this reasoning, *Olmstead* held that the charging order was not the exclusive remedy available to creditors holding a judgment against the sole member of a Florida single-member LLC and ordered the defendants to surrender all right, title and interest to the LLCs to satisfy the outstanding judgment.

The *Olmstead* decision led to a great deal of uncertainty with respect to the rights of judgment creditors of members of Florida multi member LLCs. This is because the *Olmstead* holding was issued with respect to a single-member LLC, but the reasoning stated in the majority opinion was not expressly limited to single-member LLCs. This created concerns that multi-member LLCs in Florida might have lost their charging order protection. These concerns were voiced by the dissenting justices in *Olmstead* when they criticized the majority’s holding, arguing that it was not limited to single member LLCs and asking the Florida Legislature to clarify the law in this area.

The Florida Legislature heeded the call of the dissenting justices in *Olmstead* and drafted House Bill 253 to clarify the uncertainty created after the *Olmstead* decision. House Bill 253 amends section 608.433 in several ways, the most noteworthy of which are the following:

- Subsection 5 was added to expressly provide that “[e]xcept as provided in Subsections (6) and (7), 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 the judgment debtor’s interest in a limited liability company or rights to distributions from a limited liability company.” Subsections (6) and (7) are only applicable to single-member LLCs. Therefore, House Bill 253 puts multi member LLCs on par with limited partnerships and expressly provides that a charging order is the only remedy available to a judgment creditor of a member or member’s assignee of a multi-member LLC.
- Subsection 6 was added to provide that judgment creditors of the sole member of a LLC who can establish that distributions under a charging order will not satisfy a judgment within a reasonable time, are not limited to a charging order as the “sole and

exclusive remedy by which the judgment creditor may satisfy the judgment against a judgment debtor who is the sole member of a limited liability company or the assignee of the sole member.” This Subsection allows judgment creditors of the sole member of a Florida LLC to pursue additional remedies in limited situations.

- Subsection (7) was added to provide that with respect to single-member LLCs where the court orders a foreclosure sale of a debtor’s LLC interest or a charging order lien against the sole member of the LLC pursuant to Subsection (6), then (a) the purchaser at the foreclosure sale obtains the member’s entire LLC interest, (b) the purchaser at the sale becomes the member of the LLC, and (c) the debtor ceases to be a member of the LLC.
- To address any possible ambiguity regarding Subsection (7), Subsection (8) was added to expressly limit the remedy of foreclosure on a judgment debtor’s interest to single-member LLCs.
- Finally, House Bill 253 also included a Section 2, which stated the Legislature’s intention that the amendments to Section 608.433 were to clarify prior law, and would apply retroactively.

With these changes, the Florida Legislature and Governor Rick Scott have taken steps to restore confidence lost by members of Florida LLCs due to the *Olmstead* decision. Three issues to keep in mind, however. First, charging order protection will not apply in situations where the members’ transfer of property to the LLC constitutes a fraudulent conveyance or where the facts show such disregard of legal formalities that a successful “pierce the veil” argument can be made. Second, this legislation raises concerns for those of us who represent banking institutions and other lenders contemplating loans to multi-member LLCs. As the charging order limitation impedes the collection efforts of such lenders, such limitations may create a more stringent underwriting environment. Finally, an existing corporate entity wishing to take advantage of charging order protection can be converted to a LLC under Florida Statute 608.439 and such conversion is not a taxable event under the Treasury’s “check the box” regulations.

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