

FINAL BILL ANALYSIS

BILL #: CS/HB 253

FINAL HOUSE FLOOR ACTION:

112 Y's 1 N's

SPONSOR: Rep. Stargel and Rep. McBurney

GOVERNOR'S ACTION: Approved

COMPANION BILLS: CS/SB 1152

SUMMARY ANALYSIS

This bill passed the House on April 15, 2011, and subsequently passed the Senate on April 29, 2011. The bill was approved by the Governor on May 31, 2011, chapter 2011-77, and became effective on that date.

A limited liability company is a form of business entity where owners have limited personal liability for the debts and actions of the limited liability company, similar to a corporation, but management and tax flexibility, similar to a partnership. When a monetary judgment is entered against a member of a limited liability company, Florida law provides for a "charging order" that directs the limited liability company to pay profits and distributions intended for the judgment debtor to the judgment creditor. By entering a charging order, the judgment creditor is paid without disrupting management of the limited liability company.

The Florida Supreme Court recently held that Florida's statutory charging order provision is not the exclusive means by which a judgment creditor can execute a judgment against a debtor owning all of the interest in a single-member limited liability company. The court ordered the judgment debtor to surrender all right, title, and interest in the member's single-member limited liability company to satisfy an outstanding judgment.

This bill provides, with one exception, that a charging order is the "sole and exclusive remedy" by which a judgment creditor may satisfy a judgment from a judgment debtor's interest in a limited liability company. The exception arises in situations where a limited liability company has only one member. The bill provides that the court may order the sale of a member's interest in a single member limited liability company if distributions under a charging order will not satisfy the judgment in a reasonable time.

The fiscal impact of the bill on state and local governments is speculative. See II.D. Fiscal Comments.

The provisions of this bill are intended to apply retroactively.

I. SUBSTANTIVE INFORMATION

A. EFFECT OF CHANGES:

Limited Liability Companies

Sections 608.401-608.705, F.S., comprise the Florida Limited Liability Company Act (“LLC Act”). A limited liability company (“LLC”) is a business entity where owners have limited personal liability for the debts and actions of the LLC, similar to a corporation, but management and tax flexibility, similar to a partnership. Owners of a LLC are called members. Florida law allows a single-member LLC. Ownership shares, often called “membership interests,” “member’s interest,” or “interest,” are considered personal property. A member’s interest in a LLC may be assigned but the assignee’s interest is generally limited to sharing in the profits and losses and receiving distributions from the LLC.¹ Generally, an assignee does not receive any rights relating to management of the LLC.² Section 608.433(1), F.S., provides that an assignee may become a member only if the other members consent, unless the operating agreement or articles of organization provide otherwise. A LLC may file as a corporation, a partnership, or a sole proprietorship for federal income tax purposes, so the LLC business entity provides tax flexibility.³

According to the Florida Division of Corporations, there are 548,893 active LLCs in Florida.⁴ The number of LLC filings has generally increased over the last ten years. In 2000, 19,186 documents related to LLCs were filed with the Division of Corporations. In 2010, 138,287 such documents were filed with the Division.⁵

Enforcement of Judgments and Charging Orders

A judgment is an order of the court creating an obligation, such as a debt. Chapter 56, F.S., provides mechanisms for execution of judgments. Section 56.061, F.S., provides that “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 upon execution.” The statute allows a judgment creditor to take stock held by a judgment debtor to satisfy the judgment.

A charging order is a court order directing the members of a LLC to pay a judgment debtor’s share of the LLC profits or distributions to a judgment creditor. The judgment creditor is not involved in the management decisions of the LLC but merely collects the judgment debtor’s share of profits or

¹ The provisions related to assignments are the same as provisions related to partnerships, whereby if a partner transfers his or her interest, the remaining partners are not required to accept the new partner as an equal for management and voting purposes.

² See, generally, *Olmstead v. Federal Trade Commission*, 44 So.3d. 76, 77-81 (Fla. 2010)(providing background information on LLCs under Florida law).

³ See, <http://www.irs.gov/businesses/small/article/0,,id=98277,00.html> (accessed January 27, 2011).

⁴ http://www.sunbiz.org/corp_stat.html (accessed January 28, 2011).

⁵ *Id.*

distributions.⁶ Florida has codified the charging order in the LLC Act. Section 608.433(4), F.S., provides:

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.

The theory behind 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 the business, or portions of it, was sold to pay the judgment creditor.⁷ As a federal court has explained, “a charging order protects the autonomy of the original members, and their ability to manage their own enterprise.”⁸ A limitation of the charging order remedy is that a creditor cannot recover unless the voting members of the LLC distribute profits. If the LLC does not make a distribution, the judgment creditor is not paid.

The charging order is not unique to the LLC business structure. Florida's Revised Uniform Partnership Act of 1995, ss. 620.8100 - 620.9902, F.S., and Florida's Revised Uniform Limited Partnership Act of 2005, ss. 620.1101-620.2205, F.S., similarly provide charging order remedies in partnership and limited partnership law.

The *Olmstead* Decision

In *Olmstead*, a federal court asked the Florida Supreme Court whether, under Florida law, a court may order a judgment debtor to surrender all “right, title, and interest” in the debtor's single-member LLC to satisfy an outstanding judgment. In *Olmstead*, the Federal Trade Commission (“FTC”) alleged Olmstead was operating an “advance-fee credit card scam” and sued for unfair and deceptive trade practices.⁹ The FTC prevailed and obtained an order directing Olmstead to surrender all right, title, and interest in his LLC. Olmstead, the judgment debtor and sole member of a LLC, argued that a charging order under s. 608.433(4), F.S., was the sole and exclusive remedy available against his ownership interest in the LLC. He argued that no other remedy was applicable. The FTC argued that other remedies were available under Florida law and that the statutory charging order was not the sole remedy.¹⁰

The court held that a charging order under s. 608.433(4), F.S., was not the exclusive remedy. The court noted that s. 56.061, F.S., provides that stock in corporations is subject to sale and execution to satisfy a judgment and that because a LLC is a “type of corporate entity,” an ownership interest in a

⁶ See *City of Arkansas City v. Anderson*, 752 P.2d 673, 681-84 (Kan. 1988)(discussing the charging order at common law and under the Uniform Partnership Act).

⁷ See, generally, *City of Arkansas City*, 752 P.2d at 682.

⁸ *In re: First Protection, Inc.*, 2010 WL 5059589 (9th Cir. BAP (Ariz.)) at 6.

⁹ *Olmstead*, 44 So. 3d at 78.

¹⁰ *Olmstead*, 44 So.3d at 77-78.

LLC is reasonably understood to be corporate stock and subject to execution under the statute.¹¹ The court rejected arguments that s. 608.433(4), F.S., displaced s. 56.061, F.S. It noted that Florida's partnership and limited partnership statutes contain similar charging order provisions but those provisions provide that the charging order is the exclusive remedy and that specific language relating to an exclusive remedy is not present in the LLC statute.¹² Accordingly, the court said:

Specifically, we conclude that there is no reasonable basis for inferring that the provision authorizing the use of charging orders under section 608.433(4) establishes the sole remedy for a judgment creditor against a judgment debtor's interest in a single-member LLC... Section 608.433(4) does not displace the creditor's remedy available under section 56.061 with respect to a debtor's ownership interest in a single-member LLC.¹³

Criticism of *Olmstead*

In dissent, Justice Lewis argued that the majority opinion was rewriting the LLC Act to create a remedy not contemplated by the Legislature. He said that a reading of all of ch. 608, F.S., and not merely the provisions cited by the majority, makes clear that the LLC Act displaces ch. 56, F.S.¹⁴ Justice Lewis warned:

This is extremely important and has far-reaching impact because the principles used 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.¹⁵

Commenters have explained the concern of some business law practitioners:

As a result of the dissenting opinion, many practitioners are concerned that a multiple-member Florida LLC arrangement may not provide charging order protection, although that is not what the majority held. As discussed below, there is a good chance that there will be legislative clarification of this court-created "uncertainty by implication." In the interim, advisors should alert their clients to the exposure and consider bifurcating Florida LLC membership interests into voting and nonvoting interests, converting Florida LLCs to limited partnerships or limited liability limited partnerships, moving Florida LLCs to jurisdictions that have

¹¹ *Olmstead*, 44 So.3d at 80.

¹² *Olmstead*, 44 So.3d at 81-82.

¹³ *Olmstead*, 44 So.3d at 83.

¹⁴ *Olmstead*, 44 So.3d at 83-84 (Lewis dissenting).

¹⁵ *Olmstead*, 44 So.3d at 84 (Lewis dissenting).

a more stable charging order protection law, or implementing other divestment of management control strategies.¹⁶

Effect of this Bill

This bill contains “whereas” clauses to express the Legislature’s intent that *Olmstead* not apply to multimember LLCs. The bill defines charging order as “a lien on the judgment debtor's limited liability company interest or assignee rights.” It provides that a judgment creditor has only the rights of an assignee of a LLC interest to receive distributions to which the judgment debtor would have otherwise been entitled from the LLC.

This bill provides, with one exception, that 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 a LLC or rights to distributions from a LLC.

The exception arises in situations where a LLC has only one member. The bill provides that the court may order the sale of a member's interest in a LLC if the judgment creditor establishes that distributions under a charging order will not satisfy the judgment in a reasonable time. Upon such a showing, the court may order the sale of the interest in the LLC pursuant to a foreclosure sale. The bill provides that the judgment creditor may make such a showing within a reasonable time after entry of the judgment and at the time the judgment creditor applies for entry of the charging order. If the court orders a foreclosure sale, the purchaser at the sale obtains the member's entire interest in the LLC, the purchaser becomes the member of the LLC, and the person whose interest is sold ceases to be a member of the LLC.

This bill provides that it does not limit:

- The rights of creditors that have been granted a consensual security interest in a LLC;
- The principles of law and equity which affect fraudulent transfers;
- The availability of equitable principles such as alter ego, equitable lien, or constructive trust; or
- The jurisdiction of the court to enforce a charging order.

The bill contains language indicating that its provisions are clarifying and apply retroactively.

II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT

A. FISCAL IMPACT ON STATE GOVERNMENT:

1. Revenues:

See "Fiscal Comments."

¹⁶ Gassman, Denicolo, Koche, and Wells, *After Olmstead: Will a Multiple-member LLC Continue to Have Charging Order Protection*, The Florida Bar Journal, Vol. 84, No. 10, December, 2010. (accessed at <http://www.floridabar.org/DIVCOM/JN/JNJournal01.nsf/8c9f13012b96736985256aa900624829/f3631c387f59325c852577ea0060b5e6!OpenDocument>).

2. Expenditures:

See "Fiscal Comments."

B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

1. Revenues:

None.

2. Expenditures:

None.

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

The fiscal impact on Florida LLCs is not known. It is not known how many, if any, LLCs would relocate or not locate in Florida because of *Olmstead* and it is not known how many LLCs will locate or remain in Florida due to this bill. It is not known how many LLCs, if any, would incur additional costs due to changing legal status in response to *Olmstead*.

D. FISCAL COMMENTS:

The fiscal impact of this bill is unknown and speculative. Some have commented that the *Olmstead* decision would lead to businesses leaving the state and hurting Florida's economy and state revenues by reducing tax collections and LLC filing fees from these businesses. This bill should head off any negative impact from the *Olmstead* decision. The Department of State does not anticipate a fiscal impact on state governments over the next three fiscal years.