

MEMORADUM

CHARGING ORDERS

TO: Drafting Committee on the Harmonization of Business Entity Statutes
FROM: Carter G. Bishop, Co-Reporter
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This memo has four sections:

- The consistent pattern of the charging order statute in uniform acts since 1914;
- The inconsistent language of state LLC charging order statutes;
- The unique relationship problem between charging order statutes in the context of a SMLLC and the Florida Supreme Court judicial resolution under the *Olmstead* case; and
- A revision to RULLCA § 503 that shows the effects of eliminating (i) exclusivity, (ii) other permissible orders, (iii) foreclosure, and (iv) adding a new subsection to allow the purchaser in a foreclosure sale to acquire all the rights of the only member.

Uniform Law Background

The Uniform Partnership Act of 1914 § 28 (UPA) stated the first charging order statute in a NCCUSL uniform law. The provision was borrowed nearly verbatim from a similar charging order statute reflected in the English Partnership Act of 1895. The Uniform Limited Partnership Act of 1916 § 22 (ULPA) stated a similar charging order statute. Both statutes adopted a similar approach: (1) the judgment creditor of a partner but not the partnership, (2) applied for a court order directing the partnership to pay all monies due the debtor partner to the creditor until the judgment was satisfied, (3) make all other orders or inquiries which the debtor partner might have made or the circumstances required, and (4) the charging order could be foreclosed through a sale of the interest. The Uniform Limited Partnership Act of 1976/1985 § 703 (RULPA) continued the same essential theme.

The Revised Uniform Partnership Act of 1997 § 504 (RUPA) added several clarifying revisions including (1) the court could only charge the judgment partner's transferrable interest and (2) the charging order and foreclosure remedies were the creditor's "exclusive remedies." The Uniform Limited Liability Company Act of 1996 § 504 (ULLCA) repeated RUPA precisely as did the Uniform Limited Partnership Act of 2001 § 703 (ULPA 2001) (except providing that a transferee's interest could also

be charged). The Revised Uniform Limited Liability Company Act of 2006 § 503 (RULLCA) added several refinements and altered the wording somewhat to clarify but not change the basic nature of the provisions.

The English Partnership Act included a charging order statute to make clear that a judgment creditor of a partner could not execute against any partnership assets. Presumably, UPA already made this clear by stating that a partner's interest in partnership assets was not subject to attachment or execution except on a claim against the partnership (not a partner) (UPA § 25(2)(c)). All later uniform acts included a specific statement that the partnership, limited partnership or LLC is an entity separate and distinct from its owners. See, RULLCA § 104.

State LLC Law Background

Every state has a charging order statute in all partnership and LLC acts but the language varies. The most common variances concern (1) whether the charging order procedure is the exclusive remedy of a judgment creditor and (2) whether foreclosure is permitted.

Twelve (12) state LLC acts expressly permit foreclosure of the charging order lien. Thirty states (30) and the District of Columbia (DC) simply do not mention foreclosure in any way. Eight (8) states that either expressly preclude foreclosure by statute (Alaska, Georgia, New Jersey, South Dakota and Texas) or by implication after amending the statute to remove foreclosure by making the statute silent (Delaware, Nevada and Virginia).

Twenty-eight states (28) indicate the charging order is exclusive. Twenty-two (22) states and the (DC) indicate the charging order is not exclusive by silence.

Florida, *Olmstead* and the SMLLC Charging Order Problem

After the check-the-box regulations were adopted in 1997, all states permitted an LLC to be formed with one member. In nearly all cases, the SMLLC option was simply added to the existing multi-member LLC legislation without further thought regarding its interaction with the charging order provisions.

As a consequence, in those 12 states that expressly permit foreclosure and the 31 states that permit foreclosure by silence, the normal charging order and multi-member LLC transfer restrictions exist. The choose-your-partner and charging order rules worked together to protect other owners from being forced to accept a foreclosing creditor as a member without the consent of the other members. Of course, in a SMLLC, there are no other members to protect.

In the recent *Olmstead* case, the Florida Supreme Court interpreted the rights of the FTC foreclosing on a charging order against the only owner. Referencing a corporation, the Court determined it could order the SMLLC owner to transfer the

entire right and interest in the SMLLC to the FTC. The Florida statute was (1) silent regarding foreclosure and (2) did not state it was the exclusive remedy. The case has drawn even more attention to whether a SMLLC may be used as an asset protection vehicle.

Change The Uniform Acts?

While the states are not uniform in the LLC acts and not uniform among partnership and LLC acts, the questions are twofold for uniform acts:

- Should all uniform acts be modified to eliminate either (1) foreclosure (2) exclusivity, or (3) "other orders"; and
- If not, should RULLCA be modified to expand the right of a judgment creditor of the only member of a SMLLC to obtain in foreclosure the entire membership interest of the only member thereby allowing the creditor to liquidate the SMLLC and sell its assets to pay the judgment.

RULLCA § 503 below reflects all three approaches.

- Striking RULLCA § 503(b) eliminates the "other orders" issue;
- Striking RULLCA §§ 503(c), (d) and (e) eliminates foreclosure by silence (only 5 states expressly preclude);
- Striking RULLCA § 503(g) eliminates exclusivity and allows other state law remedies (28 states are silent on exclusivity); and
- Adding something like RULLCA § 503(h) would allow the purchaser at the foreclosure sale of the only member's interest in a SMLLC to acquire all that member's interest (not just the transferrable interest) provided there are no transferees or dissociated members. No state has adopted this approach except Florida in the *Olmstead* case and it was by judicial interpretation.

RULLCA Draft

§ 503. Charging Order.

(a) On application by a judgment creditor of a member or transferee, a court may enter a charging order against the transferable interest of the judgment debtor for the unsatisfied amount of the judgment. A charging order constitutes a lien on a judgment debtor's transferable interest and requires the limited liability company to pay over to the person to which the charging order was issued any distribution that would otherwise be paid to the judgment debtor.

~~(b) To the extent necessary to effectuate the collection of distributions pursuant to a charging order in effect under subsection (a), the court may:~~

~~{1} appoint a receiver of the distributions subject to the charging order, with the power to make all inquiries the judgment debtor might have made; and~~

~~{2} make all other orders necessary to give effect to the charging order.~~

~~(c) Upon a showing that distributions under a charging order will not pay the judgment debt within a reasonable time, the court may foreclose the lien and order the sale of the transferable interest. The purchaser at the foreclosure sale only obtains the transferable interest, does not thereby become a member, and is subject to Section 502.~~

~~(d) At any time before foreclosure under subsection (c), the member or transferee whose transferable interest is subject to a charging order under subsection (a) may extinguish the charging order by satisfying the judgment and filing a certified copy of the satisfaction with the court that issued the charging order.~~

~~(e) At any time before foreclosure under subsection (c), a limited liability company or one or more members whose transferable interests are not subject to the charging order may pay to the judgment creditor the full amount due under the judgment and thereby succeed to the rights of the judgment creditor, including the charging order.~~

(f) This [act] does not deprive any member or transferee of the benefit of any exemption laws applicable to the member's or transferee's transferable interest.

(g) This section provides the exclusive remedy by which a person seeking to enforce a judgment against a member or transferee may, in the capacity of judgment creditor, satisfy the judgment from the judgment debtor's transferable interest.

(h) The purchaser at a court ordered sale of the charging order lien against the only member of a limited liability company obtains not only the transferable interest but the entire interest of the only member, provided there are no transferees or dissociated members.