



Client Alert

MACDONALD, ILLIG, JONES AND BRITTON LLP

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FLORIDA SUPREME COURT RULES CHARGING ORDER IS NOT THE EXCLUSIVE REMEDY FOR THE CREDITOR OF A MEMBER OF A SINGLE-MEMBER LLC

When the single-member Limited Liability Company ("LLC") became available under many state LLC statutes, it was envisioned that the owners/members would enjoy limited liability but have the ability to tax earnings like a proprietorship (as a Form 1040 Schedule C business). Based on these facts, single-member LLCs became an attractive option for individuals who wanted to start a business, but did not want the risk of doing business as a sole proprietor or the expense or formality of creating and operating a multi-member LLC or corporation.

The recent case of Olmstead v. Federal Trade Commission, (decided on June 24, 2010) has sent "shockwaves" to many single-member LLC owners and advocates by dramatically enhancing the remedy available to an owner's creditors. This alert will briefly describe a traditional charging order remedy, the remedy determined by the Olmstead Court, and finally, the potential consequences of the decision on Pennsylvania single-member LLCs.

CHARGING ORDERS

A charging order is a remedy borrowed from partnership law. It is a way of protecting the assets of the partnership, while at the same time protecting partners from being forced to admit a creditor of a partner to the partnership. Essentially, a charging order provides that if a partner has an individual creditor, the partner cannot be forced to assign his interest in the partnership in order to satisfy his personal debt. Rather, the creditor is only entitled to any distributions the partner may receive from the partnership. This remedy has been incorporated into LLC statutes for the same reasons (i.e., to protect the assets of the business as well as the other members from being forced to do business with someone they did not plan on being a member.)

OLMSTEAD

The Olmstead Court recognized that a charging order is the traditional method by which the creditor of a member collects on the debt. However, it found nothing in the Florida statutes that stated a charging order was the exclusive remedy of such creditors. Rather, the Court noted that traditionally creditors can levy any assets that the debtor owns. In the context of single-member LLCs, a charging order is not furthering the dual purpose (i.e. protecting the assets of the LLC as well as the other members of the LLC). Therefore, the Court held that the creditor should be entitled to an assignment of the interest in accordance with other state laws, effectively removing the member/owner from the LLC and control of all its assets.

EFFECT ON PENNSYLVANIA LAW

Currently, Pennsylvania law is structured in much the same way as Florida law. It is important to monitor whether Courts in other states begin to follow the Florida Supreme Court, or if legislatures act quickly to affirmatively state that a charging order is the sole remedy of a creditor of an individual member of an LLC, regardless of whether there are other members. If other states begin to follow the reasoning in Olmstead, single-member LLC owners will want to reevaluate if the reasons for creating an LLC, including, in particular, limiting the liability of the owner for the activities of the entity, are still justified by the new potential risks created by the Olmstead decision, or if another business structure, such as an S corporation, would better meet his/her needs.

We will continue to monitor this decision closely and will keep you informed on any changes to Pennsylvania law.

For more information, please contact the author of this article, any member of the Business Transactions Group, or any MacDonald Illig attorney with whom you have worked.

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