



THE KIRWAN LAW FIRM

## **WARNING TO PHYSICIANS WITH FLORIDA LLCs The Florida Supreme Court Just Took Away Your Asset Protection**

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On June 24, 2010, the long awaited decision of Shaun Olmstead, et. al., v. Federal Trade Commission was issued by the Florida Supreme Court. The Court had been asked whether the owner of a single-member Florida Limited Liability Company ("LLC") could be forced by a court to surrender its ownership of the LLC (and all the assets held inside the LLC) to a creditor who had obtained a judgment against him or her. Unfortunately, the Court answered that question in the affirmative. More disturbing, however, was that in providing its reasoning for reaching that conclusion, it also destroyed the asset protection most people believed protected their ownership interests in multiple member LLCs.

In order to understand the damage this case has had on the asset protection benefits of Florida LLCs, it is helpful to understand what asset protection benefits are offered by this form of legal entity. Assume for a minute that you and a friend formed a corporation to hold an office building worth one million dollars (\$1,000,000.00) and that each of you own fifty percent (50%) of the corporation's stock. If you were sued for medical malpractice and the person suing you obtained a large judgement, the creditor could simply take your stock in the corporation and your friend would now be partners with your creditor. This is obviously not a desirable result for either you or your friend. If, on the other hand, you had formed an LLC to hold the office building (again each of you own fifty percent (50%) of the LLC), your creditor could NOT (i) take your fifty percent (50%) ownership interest in the LLC, (ii) vote your interest in the LLC, or (iii) reach the assets held inside the LLC (i.e., the real estate). Instead, they would be entitled to something called a "charging order." A charging order is akin to a lien against your LLC interest so that if the LLC ever distributed cash or other assets to its owners (called "Members"), the share of the distribution that would have been distributed to you instead goes to your creditor to help pay down your judgment debt. In this manner, neither the business of the LLC is interrupted nor is your friend affected by your judgment. Of course, if the LLC does not make any distributions, your creditor waits in the wings and collects nothing. If the LLC is properly structured (an important point because many are not), the creditor might never collect from you if (i) the LLC fails to make distributions for the length of the judgement (up to 20 years in Florida), or (ii) you die during that 20 year period. This obviously provides you with leverage to negotiate a favorable settlement with someone considering suing you.

Each state has different laws regarding whether or not a charging order is the only remedy a court is allowed to grant a creditor. Some states, like Delaware, provide in their LLC statues that the charging order is the *exclusive* remedy and that a court cannot order you to turn over your ownership

interest to a creditor. Other states, like Florida, do not expressly state in their statute whether the charging order remedy is the "exclusive" remedy a court is allowed to grant. In states with statutes similar to Florida, some courts have ruled that the charging order is the exclusive remedy and in other states, courts have ruled that the creditor has additional rights (including the right to take your LLC membership interest).

Another "charging order issue" which has arisen is whether a single-member LLC (i.e., a LLC owned 100% by one person), receives charging order protection. Other courts who have addressed this issue have typically focused on the fact that the charging order remedy is there not to protect the person being sued, but rather the innocent LLC members who are not being sued. Given this logic, it is easy to see how a court could hold that single-member LLC does not receive charging order protection while multi-member LLCs do. This, unfortunately, was not the approach adopted by the Florida Supreme Court in deciding whether Florida single-member LLCs receive the benefit of charging order protection. I actually warned people that Florida LLCs might not receive full charging order protection in my book, *The Asset Protection Guide for Florida Physicians*, originally published in 2003. Much to my dismay, the *Olmstead* decision proved my fears to be well founded.

Rather than follow the logic used by other courts (which actually is logical), our Supreme Court's analysis focused on whether the charging order provision of Florida's LLC Act provides the "exclusive remedy" a court is able to grant a judgment creditor with respect to a person who owns 100% of a Florida LLC. The Court reached the conclusion that it was NOT because Florida's LLC statute did not expressly use the word "exclusive" in describing the charging order remedy. It compared the Florida LLC charging order statute to Florida's *limited partnership* statute, which DOES expressly provide that the charging order protection is the exclusive remedy available to a creditor, and concluded that the drafters of the LLC statute must have intended their omission of the word "exclusive" to mean that the court was free to give a creditor other collection options. The Court conveniently failed to mention, however, that at the time the LLC charging order statute was originally passed (1993) the *limited partnership* charging order statute didn't contain the word "exclusive" either (the "exclusive" language was added twelve years later in 2005). They also failed to address the practical reality that the drafting committee of the 2005 limited partnership statute didn't change the LLC statute because doing so was not within the scope of what their drafting committee was permitted to do. Finally, the Court "mysteriously" omitted from its analysis that at least two Florida cases that were decided *prior* to 1993 regarding the charging order protection offered by the limited partnership statute (which did NOT contain the "exclusive" language at the time and which practically mirrored the LLC statute at the time it was drafted) held that the charging order remedy WAS the EXCLUSIVE remedy with respect to limited partnerships despite the missing "exclusive" language. So I guess the Supreme Court felt that the 1993 drafters of the LLC charging order statute must have (i) ignored the then current case law, (ii) peered twelve years into the future to witness the "exclusive" language being added to the limited partnership statute in 2005, and (iii) consciously omitted the "exclusive" language from the 1993 LLC legislation to send a loud and clear message that charging order protection was not the sole and exclusive remedy with respect to Florida LLCs. Really gives you confidence in our courts, doesn't it?

Since the Court's actual ruling only specifically addressed single-member LLCs, you might be wondering why people holding an interest in a Florida multi-member LLC should be concerned? Unfortunately, the LLC charging order statute does not distinguish between single-member and

multi-member LLCs. Therefore, in holding that the LLC charging order statute does not provide the sole and exclusive remedy with respect to Florida LLCs, the Court effectively eliminated this valuable protection for ALL Florida LLCs, single-member and multi-member alike. The dissenting opinion (i.e., the opinion written by the Justices who voted against the decision) contains this warning:

“[This decision] has far-reaching impact because the principles used to ignore the LLC statutory language under the current factual circumstances apply with equal force to multi-member 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 multi-member LLCs and render the assets of all LLCs vulnerable.”

If you are a member of a Florida LLC, whether single-member or multi-member, please understand that the charging order protection you thought you had probably does not exist. Fortunately, there are solutions to the problem caused by our state's highest court. Which solution is right for you will depend on a number of factors including, the manner in which your LLC is presently taxed, the tax "basis" of the LLC assets and of your LLC membership interest, the current provisions of your LLC's operating agreement, and certain facts regarding your personal situation. If you are interested in learning more about how to protect your Florida LLC, please feel free to contact me.

***About the author.*** Adam O. Kirwan, J.D., LL.M. is the founder of The Kirwan Law Firm and the author of the books, *The Asset Protection Guide for Florida Physicians*, and *The Asset Protection Guide for Florida Residents*. The attorneys at The Kirwan Law Firm focus their practice exclusively on asset protection planning, estate planning, and litigation related to protecting clients' assets. The firm has extensive experience in working with Florida physicians and understands the planning issues they face in effectively protecting their assets, not only from medical malpractice law suits but also from problems brought about by the collapse of the Florida real estate market. You can reach Mr. Kirwan at (407) 210-6622.