

NATIONAL BUSINESS INSTITUTE
CHARGING ORDER PROTECTIONS—THE SECRET WEAPON OF LLC
ASSET PROTECTION PRACTICE

Instructor: John M. Cunningham, Esq.¹

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- EXHIBIT A Table of U.S. LLC acts showing which of them arguably bar creditor foreclosures on the LLC interests and other membership rights of LLC member-debtors-in-default and which arguably do not
- EXHIBIT B Self-Test for Seminar Attendees Concerning LLC Charging Order Protections

¹ Biography and contact information of John M. Cunningham. Attorney John M. Cunningham is of counsel to McLane, Graf, Raulerson & Middleton, P.A., Manchester, NH, www.mclane.com. His e-mail address is john.cunningham@mclane.com. His phone number is (603) 628-1315. He is licensed to practice law in New Hampshire and Massachusetts. His practice is focused on LLC formations and conversions. Mr. Cunningham publishes a weekly blog on how to draft LLC operating agreements. The link is <http://www.cunninghamoperatingagreements.com/>. His general LLC formation website is www.llcformations.com.

Mr. Cunningham is the author of *Drafting Limited Liability Company Operating Agreements*, the leading U.S. general (i.e., non-state-specific) LLC practice manual and formbook. With Vernon R. Proctor of the Delaware bar, he is the co-author of *Drafting Delaware LLC Agreements*, a practice manual and formbook under the Delaware Limited Liability Company Act. Both books are published by Wolters Kluwer Law & Business, a global publisher of professional treatises and manuals.

I. INTRODUCTION TO THE SEMINAR

- 1) Welcome to the seminar
- 2) Subject matter of the seminar. This seminar is about LLC charging order protections. Charging order protections are among the most important business organization law feature of LLCs under all U.S. LLC statutes. In Part II of this outline, I'll briefly summarize the key ideas in the seminar.
- 3) My background as relevant to the seminar
 - a) The McLane firm. I am of counsel to McLane, Graf, Raulerson & Middleton, P.A., a New England law firm based in Manchester, NH. I am licensed to practice law in New Hampshire and Massachusetts.
 - b) My practice. My law practice is focused on forming LLCs and converting corporations and other non-LLC entities to LLCs. Charging order protections are a central business organization law consideration in my practice.
 - c) My writings and seminars about charging order protections
 - i) I am the author of the leading “general” (i.e., non-state-specific) LLC formbook and practice manual, and, with Vernon R. Proctor of the Delaware bar, I am the co-author of an LLC formbook and practice manual under the Delaware Limited Liability Company Act (the “DLLC Act”).
 - ii) In both books, I write extensively about charging order protections.
 - iii) I have taught scores of LLC seminars nationwide to bar associations, CPA societies, law firms and CPA firms. In all of these seminars, I give substantial attention to LLC charging order protections.
- 4) Seminar materials
 - a) The NBI. The materials in this seminar made available to registrants online by NBI consist of a sentence outline and one exhibit, consisting of a self-test on the material in the outline. You have perhaps downloaded these materials from the NBI in connection with registering for this seminar.
 - b) The revised materials
 - i) Revised outline. Since submitting the above outline to NBI in approximately April 2010, I have made significant revisions of the outline—particularly to take account of an important decision concerning LLC charging order protections handed down by the Florida Supreme Court on June 24, 2010. The name of the case is *FTC v. Olmstead*. A link and Westlaw citation to the case are below.
 - ii) Exhibits. The revised outline contains two exhibits. Exhibit A is a table that shows which state LLC acts bar creditors from levying on an LLC's members' membership rights and which do not. Exhibit B consists of the above self-test. You can obtain the most current version of the outline by downloading

it from my blog. The URL for this blog is
<http://www.cunninghamoperatingagreements.com/>.

5) Seminar format; questions

- a) I will follow the revised outline. In this seminar, I will follow the revised sentence outline closely. The revised outline is consistent with the original outline but is more detailed and, as noted, addresses the *Olmstead* decision.
- b) Questions. If, during the seminar, you have questions relating to the subject matter of the seminar, you can submit them by e-mail at any time if you have registered for the seminar via Westlaw or, at the end of the seminar, by phone if you have registered via NBI.
- c) Post-seminar contacts. After the seminar, please feel free to call me or e-mail me with questions relating to the seminar. I do not charge for brief consultations. My contact information is in footnote 1 of this outline.

6) Bibliography. There is an extensive legal literature concerning LLC statutory charging order protections and LLC charging order case law. If you want to review this literature, I particularly recommend the following links:

- a) <http://ssrn.com/abstract=1542244>. This is a link to a comprehensive and regularly updated table prepared by law professor Carter Bishop concerning charging order provisions in the 51 U.S. LLC acts (plus some model acts).
- b) <http://ssrn.com/abstract=1565595>. This is a link to a comprehensive and regularly updated table prepared by Professor Bishop concerning charging order case law.
- c) http://www.assetprotectionbook.com/#_State-by-State_Chart_of_Exemptions. This link is to a site that covers not only charging order protections but many other critical asset protection issues.
- d) <http://www.riserlaw.com/publications/ap/credtax.htm>. This is a link to an excellent article about the federal income tax treatment of creditors and LLC members against whom creditors have unsatisfied judgments (“member-debtors-in-default”) when charging orders are in effect. In essence, the article demonstrates that creditors who obtain charging orders against LLC member-debtors-in-default are not subject to federal income tax on LLC allocations of profits to these members.
- e) http://www.bestarticle.org/legal/all-about-charging-orders-a-comprehensive-review-of-how-llcs-and-flps-protect-your-assets/?expert=Jacob_Stein. This is a good introductory article about charging order protections by a lawyer who specializes in asset protection.
- f) http://law.baylor.edu/pdf/faculty/faculty_CLE/Miller_LLC_LLP_CumulativeCaseLawSurvey07.pdf. This is a link to a comprehensive list of charging order cases and other cases collected and excellently briefed and indexed by Elizabeth S. Miller, Professor of Law at Baylor University Law School.

II. THE BASIC IDEAS IN THE SEMINAR—BRIEF SUMMARY

- 1) Charging order protections—overview. In essence, charging order provisions provide as follows:
 - a) When members of LLC (“member-debtors-in-default”) incur unsatisfied judgments for conduct unrelated to the business of their LLCs, the credits of these LLC members may obtain “charging orders” against these LLCs. These orders require these LLCs to pay to these creditors any distributions otherwise payable by the LLC to these members.
 - b) However, with respect to the member-debtor-in-default, the other members and the LLC, these charging orders are (subject to exceptions in certain jurisdictions) the creditors’ *only* remedy. In particular, the creditors cannot obtain—e.g., by levy and attachment—any of the members’ other rights, including voting rights.
- 2) Origin and intent of charging order protections. LLC charging order protections have their origins in English limited partnership law. The intent of charging order protections is:
 - a) To protect innocent non-debtor members of an LLC from losing the going-concern value of their LLC because of misconduct of debtor-members unrelated to the LLC’s business; and
 - b) To implement the classic partnership “partner compatibility” policy sometimes called the “pick-your-partner” principle.
- 3) Value of charging order protections. As we’ll see in greater detail below, charging order protections can provide powerful business asset protection to *multi*-member LLCs and their members. (As discussed further below, *single*-member LLCs and their members probably cannot qualify for charging order protections.)
 - a) Thus, if LLC formation clients need or can benefit from charging order protections, you should form their LLCs as multi-member LLCs that have at least two members. The founder’s spouse is often the ideal second member, since:
 - i) An LLC deal between spouses is usually a friendly deal for which a relatively brief operating agreement will suffice; and
 - ii) Spouses normally form a single economic unit.
- 4) Charging order protections vs. limited liability. As also discussed further below, charging order protections are very different from limited liability protections.
- 5) All LLC acts provide for charging order protections. As noted, charging order protections are provided by all U.S. LLC acts, either by statute or, in the case of the Pennsylvania LLC Act, under the relevant case law.
- 6) Charging order protections are little known. In my experience, charging order protections are little known and little appreciated even by lawyers who consider themselves reasonably competent in handling LLC matters. But this picture is changing.
- 7) Corporations do *not* provide charging order protections.
 - a) The only corporate act that contains provisions allowing for charging order

- protections is that of Nevada. I think this situation is unlikely to change.
- b) The fact that LLC acts do provide for charging order protections and that most corporate acts do not is perhaps the single most important business organization law difference between these statutes.
 - c) The fact that multi-member LLCs *do* provide charging order protections and that single- and that multi-shareholder corporations do *not* provide them constitutes a major business organization law factor in choosing multi-member LLCs over single- or multi-shareholder corporations for business start-ups.
- 8) Charging order protections and malpractice. As discussed in greater detail below, the fact that corporations do *not* provide charging order protections and that LLCs *do* provide these protections may, in some cases, mean that forming an entity for a client as a corporation without advising the client about the potential benefits of LLC charging order protections may constitute legal malpractice.
- 9) Statutory conversions of corporations to LLC. The fact that LLCs do provide charging order protections and that corporations do not means that many corporations—perhaps hundreds of thousands of them—should convert to LLCs to obtain charging order protections. Under the laws of many states, there is a process called “statutory conversion” that makes these conversions easier. If properly structured, these conversions are “F reorganizations” under the Internal Revenue Code (the “IRC”) under IRC § 361(a)(1)(F) and are tax-free. (See PLRs 2005248021) and 200548021).
- 10) The *Olmstead* decision.
- a) Introduction. On June 24, 2010, the Florida Supreme Court handed down its decision in *FTC v. Olmstead*. The link to a PDF version of the decision is <http://www.floridasupremecourt.org/decisions/2010/sc08-1009.pdf>. The Westlaw citation is 2010 WL 2518106. The Florida LLC Act charging order provision does not by its terms limit these protections to multi-member LLCs. The issue in *Olmstead* was whether creditors of persons that are members of Florida *single-member* LLCs may obtain possession of the membership rights of these members, including their voting rights, under the Florida levy statute.
 - b) Decision. The basis for the Court’s decision was a provision of the Florida Act that provides that assignees (i.e., transferees) of the economic rights of these members may be admitted as members only upon the vote of all of the other members. The Court held that this provision was meaningless in the case of *single-member* LLCs and that, accordingly, the FTC could obtain the defendants’ membership rights in the relevant Florida single-member LLCs under the above levy statute.
 - c) Implications. With respect to single-member LLCs, the *Olmstead* decision is likely to be persuasive in many other jurisdictions. However, in light of the above rationale for the decision, I doubt that either in Florida or in other jurisdictions, the courts will apply *Olmstead* to multi-member LLCs. But the matter is not without doubt.

III. LLC CHARGING ORDER PROTECTIONS—KEY ISSUES AND CONCEPTS

A. INTRODUCTION

- 1) The Delaware Limited Liability Company Act as the reference LLC act in the seminar.
 - a) DLLC Act § 18-703. LLC charging order law is state business organization law. In this seminar, I will focus primarily on statutory charging order protections under § 18-703 of the Delaware Limited Liability Company Act (the “DLLC Act”). This is because:
 - i) It is useful to focus on charging orders in the context of actual statutory charging order provisions rather than in the abstract.
 - ii) The DLLC Act is the preeminent U.S. LLC act.
 - iii) The DLLC Act has strongly influenced many other LLC acts.
 - iv) Many non-Delaware charging order provisions generally resemble DLLC Act § 18-703.
 - b) Non-Delaware cases. However, during the seminar, I will refer to charging order cases from several non-Delaware states, since I believe that these cases, to the extent they deal with general charging order issues, are likely to be persuasive to courts in many other jurisdictions besides those in which they were issued.
- 2) Overview of DLLC Act § 18-703. DLLC Act § 18-703 provides, in brief summary, as follows:²

² Section 18-703 provides in its entirety as set forth below.

§ 18-703. Member's limited liability company interest subject to charging order

- a) On application by a judgment creditor of a member or of a member's assignee, a court having jurisdiction may charge the limited liability company interest of the judgment debtor to satisfy the judgment. To the extent so charged, the judgment creditor has only the right to receive any distribution or distributions to which the judgment debtor would otherwise have been entitled in respect of such limited liability company interest.
- b) A charging order constitutes a lien on the judgment debtor's limited liability company interest.
- c) This chapter does not deprive a member or member's assignee of a right under exemption laws with respect to the judgment debtor's limited liability company interest.
- d) The entry of a charging order is the exclusive remedy by which a judgment creditor of a member or of a member's assignee may satisfy a judgment out of the judgment debtor's limited liability company interest.
- e) No creditor of a member or of a member's assignee shall have any right to obtain possession of, or otherwise exercise legal or equitable remedies with respect to, the property of the limited liability company.

- a) Definitions—“LLC interest”; “membership rights.”
- i) Under § 18-101(8), the DLLC Act, a member’s “limited liability company interest” is the right of the member to receive allocations of LLC profits and losses and distributions of LLC cash and other assets.
 - ii) In this outline:
 - (1) An LLC member’s “membership rights” means the totality of the member’s rights as a member, including both economic and non-economic rights.
 - (2) Non-economic rights include voting rights, information rights, fiduciary rights and dispute resolution rights.
- b) Charging orders as creditors’ remedies against LLC member-debtors-in-default.
- i) A creditor (a “judgment creditor”) that holds an unsatisfied judgment against a member of a Delaware LLC who is a member-debtor-in-default may obtain from a court of competent jurisdiction a “charging order” against the LLC. Section 18-703(a) (first sentence).
 - ii) This order will require that the LLC distribute to the creditor, to the extent of the judgment, any assets, including cash, which it would otherwise distribute to the member. Section 18-703(a) (first sentence).
- c) Charging orders as creditors’ *only* remedies against LLC member-debtors-in-default and against the LLC. However:
- i) Exclusivity. The above charging order shall be the *only* remedy by which the judgment creditor may satisfy the judgment on the basis of the member’s limited liability company interest. § 18-703(d).
 - (1) I suspect that “limited liability company interest” in § 18-703 was intended by the section’s drafters to mean the member-debtor-in-default’s *membership right—i.e.*, the entirety of the member’s rights as an LLC member, including both economic and non-economic (including management) rights. However, the section is unclear on this issue.
 - ii) LLC property. The creditor shall have no remedy with respect to the LLC’s property. § 18-703(e).³ In my view, § 18-703(e) can be used to construe § 18-703(d) as a “sole remedy” provision and substantially strengthens § 18-703(d) in favor of member-debtors-in-default, their fellow members and their LLCs..

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- f) The Court of Chancery shall have jurisdiction to hear and determine any matter relating to any such charging order.

³ See *MacDonald v. MacDonald*, 1986 WL 5480 (Del. Ch. 1986) (suggesting that charging orders are the *only* remedy available to creditors of limited partners of Delaware limited partnerships with respect to their limited partnership interests). The charging order provisions of the DLLC Act and the Delaware Limited Partnership Act are essentially identical.

- 3) The critical distinction between distributions and compensation
 - a) Definitions of distributions and compensation. By their terms, charging order provisions apply only to “distributions.” While I know of no case law directly on point, I believe it is highly probable that the courts would construe:
 - i) “Distributions” by an LLC to its members as meaning transfers by the LLC to its members of its cash and other assets in the members’ capacity as members.
 - ii) Compensation by an LLC to its members as meaning payments by the LLC to its members specifically in compensation for their services.
 - b) When are payments to members in compensation for services subject to charging orders?
 - i) If an LLC compensates its members for their services to it on the basis of distributions of profits, these distributions will be subject to charging orders.
 - ii) If instead, an LLC compensates its members for their services to it on the basis of salaries (called “guaranteed payments” in the case of LLCs taxable as partnerships) and bonuses, this compensation will *not* be subject to charging orders (although it may be subject to garnishment or similar remedies under local law).
 - iii) In my view, whether a distribution is intended by the members of an LLC as compensatory or as non-compensatory depends on the member’s intent.
- 4) The critical differences between charging order protections and limited liability
 - a) Charging order protections. Charging order protections apply only when an LLC member incurs an unsatisfied judgment to a creditor in a claim *unrelated to the business of the LLC*.

EXAMPLE. Mary Jones owns a two-member LLC. While driving her automobile on business unrelated to the business of her LLC, she accidentally runs over and kills a brain surgeon. Limited liability does not apply in this situation, but charging order protections do apply.
 - b) Limited liability. Limited liability protections apply to protect the personal assets of LLC members (including their LLC membership rights) from claims against the LLC. These claims can result, for example, from negligence by the LLC’s employees. (However, the LLC liability shield will not protect an LLC member from the consequences *of the member’s personal misconduct* relating to the business of the LLC. No liability shield affords this protection.)

**B. THE FOUR PROTECTIONS AFFORDED BY CHARGING ORDER PROVISIONS—
OVERVIEW**

- 1) Introduction—analyzing charging order protections on the basis of member-debtor-in-default voting power.
 - a) As indicated, the *core* protection provided by LLC charging order provisions is to prevent creditors of member-debtors-in-default from being able to gain ownership

(by “levy and execution”) of the *management rights* of the member—i.e., the member’s voting rights, fiduciary rights, information rights, and dispute resolution rights.

- b) However it is useful to think of LLC charging orders as providing four distinct types of protections, some of which depend on the voting power of the member-debtor-in-default in question.

2) The four protections

- i) Regardless of voting power of member-debtor-in-default: Protection of member-debtor-in-default from losing his rights as an LLC member (except his right to LLC distributions). Whether the member-debtor-in-default has minority voting power, equal voting power or majority voting power, charging order protections protect from the creditor all of the member’s rights as a member *except* his right to receive distributions.

- (1) As discussed in greater detail below, these non-economic rights may be important to the member-debtor-in-default not only for business reasons but also for critical personal and family reasons.

- ii) Regardless of voting power of member-debtor-in-default: Protection of other members from having to accept the creditor as a substituted member for the member-debtor-in-default. Whether the member-debtor-in-default has minority LLC voting power, equal LLC voting power or majority LLC voting power, charging order protections protect the other members from having to accept the creditor as a substituted member for the member-debtor-in-default.

- (1) This preserves the “*delectus personae*” or “pick your partner” policy (also sometimes called the “partner compatibility policy”) of partnership-like state-law business entities, including LLCs.

- (2) This may be important to the other members not only for business reasons but also for family and personal reasons.

- iii) If member-debtor-in-default has equal voting power: Protection of the LLC from deadlock. If the member-debtor-in-default has *equal* LLC voting power, charging order protections protect the member-debtor-in-default, the other members and the LLC from the risk of deadlock.

- (1) Deadlock can, of course, wreak havoc in any business, but especially a relatively small, closely held business.

- iv) If member-debtor-in-default has majority LLC voting power: Protection of the business of the LLC and its going-concern value in the hands of the member-debtor-in-default and the other members from (i) any risk that the creditor will be able to exercise this power to control the LLC; and (ii) in particular, the risk that the creditor will be able to use this power to force a sale of LLC assets in satisfaction of the judgment. If the member-debtor-in-default has majority LLC voting power, charging order protections protect the member-debtor-in-default, the other members and the LLC (i) in general, from the risk that the creditor will be able to control the LLC; and (ii) in particular,

from the risk that the creditor will be able to force a sale of LLC assets in satisfaction of the judgment.

- (1) A sale of assets compelled by the creditor as a substitute LLC member may be a serious risk in the member-debtor-in-default situation outlined above.

C. THE PRACTICAL SIGNIFICANCE OF CHARGING ORDER PROTECTIONS FOR BUSINESS OWNERS—THE EXAMPLE OF MARY JONES

The following hypothetical example will illustrate the practical significance of the fact that LLC acts provide charging order protections while corporations under most state business corporation acts do not:

- 1) Mary Jones's new company; her lawyer. In 2010, Mary Jones decides to form a new Delaware-based company to build homes in Delaware. She asks Delaware Attorney Arthur Able to handle the legal work. In 2009, an article appeared in *In Re*, the Delaware bar newsletter, explaining the nature of charging order protections and pointing out that Delaware LLCs provide these protections but that Delaware corporations do not. However, because Able feels comfortable with Delaware corporate business organization law, has good Delaware corporate forms and feels insecure about Delaware LLC law, he forms Mary's company as a Delaware corporation. He doesn't advise Mary about LLC charging order protections. Mary owns 51% of the corporation and her husband owns 49%.
- 2) Mary's success. The corporation thrives. In 2014, it pays Mary compensation of \$500,000 for her management services to it and has net income of \$250,000. In addition, as of January 1, 2015, it owns cash, tools, vehicles and equipment and contract rights worth \$1 million.
- 3) Mary's negligence; \$10 million judgment. However, on January 2, 2015, while driving her automobile on an errand unrelated to her corporation's business, Mary accidentally but negligently runs over and kills a brain surgeon and incurs an unsatisfied judgment in favor of the brain surgeon's estate in the amount of \$10 million.
- 4) The levy. Because Mary's company is a corporation, the brain surgeon's estate levies on Mary's stock in the corporation, elects a new board and officers, sells all of the corporation's assets, and distributes 51% of the proceeds to itself. The corporation is destroyed; Mary is unemployed; and while her husband receives 49% of the corporation's cash in a liquidating distribution, he loses his interest in the going-concern value of the company.
- 5) What if Mary's company were an LLC?
 - a) If, in 2010, Arthur Able had formed Mary's company as an LLC, then, when Mary's negligence occurred, the surgeon's estate would have been able to obtain only a charging order against Mary's company for the above unsatisfied judgment. In addition, Mary's compensation from the LLC going forward would have been subject to garnishment under applicable state law, and the LLC would probably have had to continue making distributions to her in accordance with its

past distribution history (unless the LLC has a good business purpose for changing its distribution practices). These distributions would have been subject to the above charging order.

- b) However:
 - i) Mary would have kept her voting rights, her job and her right to compensation as the LLC's manager;
 - ii) The estate could not become a substituted member for Mary;
 - iii) The LLC would have been able to continue in business; and
 - iv) Mary's husband would have continued to share in the LLC's profits without reduction.

IV. THE FEDERAL INCOME TAX IMPLICATIONS OF CHARGING ORDER PROTECTIONS FOR CREDITORS AND MEMBER-DEBTORS-IN-DEFAULT

- 1) Creditors who hold charging orders under DLLC Act § 18-703 have the rights of assignees but they are not assignees. Under DLLC Act § 18-703, the holders of charging orders have, to the extent provided by the charging order, the *rights* of assignees of the limited liability company interests of LLC member-debtors-in-default. However, these creditors do not *own* these interests. Thus, for federal income tax purposes, they do not have these members' federal tax obligations, including, in particular, any obligation to pay federal income taxes on income allocated to the members.
- 2) How to construe distributions under charging orders for federal income tax purposes
 - a) How to think about distributions pursuant to charging orders
 - i) For federal income tax purposes, charging order payments should be thought of as passing first to member-debtors-in-default as income and then to their creditors as debt repayments.
 - ii) In other words, creditors that obtain charging orders should not thereby be deemed to incur "phantom income," and payments to them from LLCs under charging orders should be deemed for federal income tax purposes to be distributions of cash by the LLCs to the relevant member-debtors-in-default followed by payments of this cash by these members to their creditors in satisfaction of judgments held by the creditors.
 - (1) The above is contrary to what some asset protection "experts" proclaim about the federal income taxation of creditors who obtain charging orders.
 - b) Federal income tax consequences under above construction
 - i) As noted, only the member-debtor-in-default is liable for federal income tax on his or her share of LLC income. Indeed, the member-debtor-in-default is liable for this tax even though, if a charging order is in effect, the member will receive no distribution of cash with which to pay it. The creditor has no such

liability.

- ii) To repeat: A creditor who obtains a charging order against an LLC member-debtor-in-default has no federal income tax liability in respect of allocations of LLC income to the relevant member-debtor-in-default.
- 3) The Riser article. A compelling statement of the above view may be found in Riser, "Tax Consequences of Charging Orders: Is the 'KO by the K-1' KO'd by the Code?" *Journal of Asset Protection* (Winter 1999). See the link to this article in the introduction to this outline.
- 4) State tax consequences of charging orders. The state tax consequences of charging order protections vary widely from state to state. In thinking about the practical implications of charging orders for your clients, you should never overlook possible state tax issues.

V. ISSUES OF CLIENT SERVICE, LEGAL ETHICS AND MALPRACTICE LAW RAISED BY LLC CHARGING ORDER PROTECTIONS

- 1) Arguable ethical and malpractice issues in forming new entities as corporations rather than as LLCs. Because of the potentially great practical value of charging order protections to owners of multi-owner businesses, the fact that a lawyer forms a new multi-owner business as a corporation rather than as an LLC without discussing the business asset protection available from LLC charging order provisions:
 - a) Is arguably a serious breach of client service;
 - b) Is arguably a serious breach of professional ethics (which mandates lawyer competence); and
 - c) Arguably constitutes malpractice (which penalizes lawyer incompetence).
- 2) Arguable duty to advise the owners of existing non-LLC companies about potential benefits to them of charging order protections. Because of the potentially great value of charging order protections to the owners of existing non-LLC companies:
 - a) Lawyers who have clients who conduct their businesses as multi-shareholder corporations should advise these clients of the potential benefits to them of converting to multi-member LLCs; and
 - b) Lawyers who have clients who conduct their businesses as single-owner businesses should advise these clients to consider converting these businesses to multi-member LLCs.
- 3) Mary Jones. If, after the creditor actions against Mary Jones's construction company in the example in Part III of this outline, Mary and her husband file an ethical complaint and a malpractice suit against Arthur Able because he formed their business as a corporation rather than an LLC, will this ethical complaint or this malpractice suit succeed? (In resolving this question, the above *In Re* article may be important.)

VI. MISCELLANEOUS LEGAL ISSUES CONCERNING CHARGING ORDERS

A comprehensive discussion of the law concerning charging order protections under the DLLC Act and under other Delaware and non-Delaware business organization law statutes is beyond the scope of this outline. However, the following brief comments may be useful to readers as an introduction to this law.

- 1) The intent of charging order protections. As noted above, the intent of charging order protections is (i) to protect innocent non-debtor members of LLCs from losing the going concern value of their LLCs because of misconduct of member-debtors-in-default unrelated to the business of the LLC; and (ii) to protect the “pick-your-partner” partner-compatibility policy of traditional partnership law as applicable to LLCs.
- 2) Charging order case law. At this writing, there are no Delaware cases interpreting or applying DLLC Act § 18-703. However, numerous cases in other jurisdictions, some of which are cited below, construe similar provisions in other LLC acts.⁴
 - a) Exclusivity of charging order remedy. Above all, these cases hold that while judgment creditors may obtain charging orders against LLC member-debtors-in-default, they may not acquire any LLC rights of the member *except* the right to receive distributions to which the member would otherwise be entitled by reason of the member’s limited liability company interest.
 - b) No levy on voting rights, etc., of member-debtors-in-default. More particularly, these cases hold that these creditors may not obtain any of the members’ non-economic rights, including their voting rights, their agency rights and other management rights, their fiduciary rights, their information rights or their dispute resolution rights.

See, e.g., *Brant v. Krilich*, 835 N.E.2d 582 (Ind. App. 2005); *Herring v. Keasler*, 563 S.E.2d 614 (N.C. App. 2002). See the numerous additional cases to the same effect summarized in Professor Carter’s table, cited above.

- 3) What types of businesses and business owners can benefit from charging order protections?
 - a) Charging order protections to protect an LLC’s assets. Any business that has valuable business assets, including cash, intellectual property or hard assets such as real property, vehicles and equipment, can derive major benefits from LLC charging order protections.
 - i) Joe Blow, the taxi driver. The “value” of business assets depends on the needs of the business owner. E.g., a taxi owned by Joe Blow, a taxi driver, may have a current fair market value of only \$5,000, but it will be of great value to Joe, since it is his principal means of making a living. Thus, if Joe is

⁴ As noted above, a comprehensive list of these cases, collected and briefed by Elizabeth S. Miller, Professor of Law at Baylor University Law School, may be found at http://law.baylor.edu/pdf/faculty/faculty_CLE/Miller_LLC_LLP_CumulativeCaseLawSurvey07.pdf.

married, he should consider protecting the taxi by holding it in a husband-wife LLC.

- b) Charging order protections to protect owner management rights. In addition, because LLC charging order protections protect business owners from losing their management rights, these protections can benefit businesses and their owners even if the businesses do not own valuable business assets.
 - i) “XYZ Corporation”—statutory conversion to protect minority owners’ management rights
 - (1) I once handling a statutory conversion to a multi-member LLC of a large closely held New Hampshire business corporation (which I’ll call “XYZ. XYZ’s owners, each of whom was a minority member, were second-generation members of the founding family. XYZ had several hundred employees and assets of about \$150 million.
 - (2) The chairman and chief executive officer of the company told me that the main motive that he and the other shareholders, directors and officers of the company had for the conversion was not to protect XYZ’s business assets—which were, in any event, heavily insured. Rather, it was to protect the shareholders from the risk of having to admit unfriendly non-family shareholders to the company if the courts levied on the shares of any current shareholder who became subject to an unsatisfied judgment.
- 4) Charging order provisions in other Delaware business organization law statutes
- a) Delaware partnership statutes, etc. Charging order provisions essentially identical to DLLC Act § 18-703 are contained in all other Delaware “alternative entity” statutes. *See* Delaware Revised Uniform Partnership Act, § 15-504; Delaware Revised Uniform Limited Partnership Act, § 17-703; Delaware Statutory Trust Act, §§ 38-3805(b) and (g).
 - b) Non-Delaware jurisdictions. As noted, 50 U.S. LLC acts provide statutory charging order protections, and, as noted, these protections are available to Pennsylvania LLCs under Pennsylvania case law. In addition, charging order provisions may be found in the general partnership statutes and limited partnership statutes of most or all other U.S. jurisdictions.
- 5) Can you thwart a charging order by ceasing to make distributions that you have regularly made to a member-debtor-in-default before the effectiveness of the charging order? I know of no case law on the issue whether an LLC and its members can thwart a charging order by ceasing to make distributions to the member-debtor-in-default that, under its distribution history before the effectiveness of the charging order, it made to that member. However, I am quite sure that any court would invalidate such a tactic on equitable grounds unless the LLC had a good business purpose for changing its distribution practice.
- 5) Charging order protections apply only to debts arising *outside* the course of an LLC’s business
- a) When charging order protections apply. Charging order protections apply only

when LLC members incur unsatisfied judgments by reason of their actions and omissions *unrelated to the business of the LLC*.

- b) When charging order protections do *not* apply. Charging order protections do *not* apply when LLC members incur debts in connection with the LLC's business. In this situation, the creditors in question will be creditors not only of the culpable members as individuals but also of the LLC itself, and all of the assets of *both* the culpable members *and* the LLC will be at risk to these creditors to the extent that any judgments that the creditors may obtain exceed or are not covered by the members' or the LLC's liability insurance.

EXAMPLE A. Arthur Able is the majority member of AB, LLC, a Delaware multi-member LLC. While driving his car on a trip unrelated to AB business, Arthur accidentally but negligently runs over and kills a brain surgeon and incurs a \$10 million unsatisfied judgment to the brain surgeon's estate. Under DLLC Act § 18-703, the estate can obtain a charging order against AB but cannot obtain any other rights of Arthur as a member of AB and thus cannot force the sale of AB's assets in satisfaction of the judgment.

EXAMPLE B. Same facts as above, but Arthur runs over and kills the brain surgeon while driving his car on AB business. Under these facts, the estate may make a claim not only against Arthur in his individual capacity but also against the LLC, and all of the assets of both Arthur and the LLC will be at risk in respect of the claim.

6) Charging order protections probably do not apply in the case of single-member LLCs

- a) Innocent non-debtor members; the *Albright* case. While the matter is not without doubt, I think it is clear as a matter of law that charging order protections protect *only* multi-member LLCs and their members and *not* single-member LLCs and their members. The basis for this position is that the principal purposes of charging order protections are:
- i) To protect innocent non-debtor members of LLCs from losing the going-concern value of their LLCs because of debts incurred by member-debtors-in-default outside the course of LLC business; and
 - ii) To preserve compatibility among LLC members by excluding unwanted creditor members.

Obviously, neither of these purposes applies in the case of a single-member LLC. *See generally, In re Albright*, 291 B.R. 538; 2003 Bankr. LEXIS 291; 50 Collier Bank. Cas. 2d (MB) 1 (Bankr. D. Colo., April 4, 2003). See also the statutory argument in *Olmstead*, briefly address above and in greater detail below.

- b) *FirstMerit, etc.* But see *FirstMerit Bank, N.A. v. Washington Square Enterprises*, No. 88798, 2007 WL 22206545 (Ohio App. August 2, 2007) (suggesting, but not expressly holding, that charging order protections are available to single-member LLCs). Moreover, the plain language of DLLC Act § 18-703 and all other LLC statutes contain no express exception for single-member LLCs. See also *In re*

Modanlo, 412 B.R. 715 (Bankr. D. MD, May 19, 2006), aff'd 266 Federal. Appx. 272 (4th Cir. MD, Feb. 21, 2008). See also discussion of the *Olmstead* case, below.

7) Foreclosures on limited liability company interests

a) Foreclosures on LLC interests under DLLC Act § 18-703. The “exclusive remedy” language of DLLC Act § 18-703 makes clear that creditors may not foreclose on the limited liability company interests of Delaware LLC member-debtors-in-default. However, whether foreclosures on the LLC interests of member-debtors-in-default are subject to foreclosure in other jurisdictions depends on local law; and under non-Delaware LLC acts, the availability of foreclosure on LLC interests varies from act to act. See survey of LLC acts in Professor Bishop’s table, cited in the introduction to this outline.

b) Negative tax impact of foreclosures on creditors

i) Federal tax liability of creditors that foreclose on LLC interests of member-debtors-in-default. However, creditors that obtain foreclosures on the LLC interests of member-debtors-in-default and purchase the LLC interest at foreclosure will thereby succeed to above federal income tax obligations of these members, and the limited liability company interest that they obtain through the foreclosure will, in most cases, be illiquid. For this reason, many creditors do not seek these foreclosures; rather, they settle.

ii) Can foreclosures ever make sense? If, however, the creditors are confident that through a foreclosure, they will obtain a significant stream of income from the LLC interest of a member-debtor-in-default that they might not obtain from the charging order alone, the foreclosure may make economic sense.

(1) This confidence may arise, for example, because, historically, the LLC in question has made significant regular distributions to the member-debtor-in-default. As noted above, I believe that the LLC will probably be bound by this history.

8) Foreclosures on LLC membership rights—the *Olmstead* case. On the issue whether creditors of LLC member-debtors-in-default may foreclose on the membership rights of these members (i.e., not just on their LLC interests but on the entirety of their LLC membership rights, including their voting rights), see discussion below concerning the Florida Supreme Court’s recent decision in *FTC v. Olmstead*.

9) Charging orders and bankruptcy law

a) Section 365(c)(1)(A) of the Bankruptcy Act as possible defense against trustee in bankruptcy. There are many unanswered questions concerning the impact of federal bankruptcy law and state insolvency law on the protections afforded by LLC statutory charging order provisions. However, the existing case law under § 365(c)(1)(A) of the Federal Bankruptcy Act suggests that with regard to debtors in default that are members of multi-member LLCs, partners of general partnerships, limited partners of limited partnerships, and beneficiaries of statutory business trusts (referred to here collectively as “debtors”):

- i) Trustees in bankruptcy will, in general, succeed to all of the rights of these debtors in these entities, including voting and other non-economic rights, in proceedings under Chapter 7 of the Federal Bankruptcy Act (and in any similar proceedings under similar state laws).
- ii) However, to the extent that these debtors are directly and meaningfully involved in the management of these entities, their co-members may be able to prevent these trustees from succeeding to the management rights of the member-debtors-in-default under the “executory agreement” exception in Federal Bankruptcy Act § 365(c)(1)(A). *See generally, In re Baldwin*, 2006 WL 2034217 (10th Cir. BAP (Okla.), July 11, 2006) (limited partnership case); *Movitz v. Fiesta Investments, LLC (In re Ehmann)*, 2005 WL 78931 (Bankr. D. Ariz., January 13, 2005).⁵

10) Receivership law, etc.

- a) Receivership case law. The cases suggest that in particular circumstances, creditors may possibly be able to avoid the restrictions of LLC statutory charging order provisions by invoking their rights under state receivership statutes or constructive trust law. *See, e.g., FirstMerit Bank, N.A. v. Washington Square Enterprises, supra* (receivership case); *Baker v. David A. Dorfman, P.L.L.C.*, 2000 WL 1010285 (S.D.N.Y., July 21, 2000) (receivership case); *Delta Development and Investment Co. v. Yeh*, 2002 WL 31748937 (Wash. App., Dec. 9, 2002) (constructive trust case).

⁵ Section 365(c)(1)(A) provides as follows:

§ 365. Executory contracts and unexpired leases

- (a) Except as provided in sections 765 [dealing with “customer instructions”] and 766 [dealing with customer property] of this title and in subsections (b), (c), and (d) of this section, the trustee, subject to the court’s approval, may assume or reject any executory contract or unexpired lease of the debtor.
- (b) [Dealing with executory contracts of the debtor that are in default and with unexpired leases of the debtor]
- (c) The trustee may not assume or assign any executory contract [that is not in default] or [any] unexpired lease of the debtor, whether or not such contract or lease prohibits or restricts assignment of rights or delegation of duties, if—
 - (1)
 - (A) applicable law excuses a party, other than the debtor, to such contract or lease from accepting performance from or rendering performance to an entity other than the debtor or the debtor in possession, whether or not such contract or lease prohibits or restricts assignment of rights or delegation of duties; and
 - (B) such party does not consent to such assumption or assignment. . . .

- b) The *MacDonald* case. But see *MacDonald v. MacDonald*, 1986 WL 5480 (Del. Ch. 1986, *supra*).
- 11) Nevada corporate charging order provision. In 2007, the Nevada Private Corporation Act was amended to provide for charging order protections generally similar to those provided under DLLC Act § 18-703. To my knowledge, no other states have made similar amendments in their corporate statutes. See Section 7.8.746 of the above act, NRS 78.746 (“Action against stockholder by judgment creditor; limitations”).
- 12) Multi-state issues. Readers of this outline should be aware that complex substantive and jurisdictional issues may arise in LLC charging order litigation. These issues may arise, for example, when an LLC is formed under the LLC act of State A; the member-debtor-in-default is a resident of State B; the conduct of the member-debtor-in-default giving rise to the creditor’s judgment occurs in State C; the LLC operates in State D; and the LLC’s assets are located in State E. However, a discussion of these substantive and procedural issues is beyond the scope of this outline.
- 13) Reverse veil-piercing
- a) What is a reverse veil-piercing claim? In a reverse veil-piercing claim, a plaintiff who has a claim against a person who has an ownership interest in an LLC or other limited liability entity claims that the entity is a mere “alter ego” of the person and that, accordingly, the court should “pierce the veil” of the entity and make its assets available to satisfy the claim.
- i) These claims are called “reverse” veil-piercing claims because, in a “normal” veil-piercing claim, the plaintiff claims that the veil of a limited liability entity should be pierced to make the assets of a defendant who is an owner of an entity available to satisfy a claim against the entity.
- ii) A frequent defense against such a claim is that an entity’s assets should not be at risk for misconduct for which the entity had no responsibility. Defendants may also claim that fraudulent transfer principles supersede reverse veil-piercing claims.
- b) The relationship of reverse veil-piercing and charging order protections
- i) As with “normal” veil-piercing claims, it is difficult to prevail in reverse veil-piercing claims. This difficulty is likely to increase if the defendant can also claim charging order protections, since reliance on these protections, like reliance on the above “entity is not responsible” defense, will prevent creditors from reaching entity assets.
- ii) Another difference between creditor claims involving charging orders and those involving reverse veil-piercing:
- (1) LLC charging order protections prevent creditors from levying on the voting rights and other management rights of LLC member-debtors-in-default.
- (2) In reverse veil-piercing claims, plaintiffs may also seek to levy on the voting rights or other management rights of entity owners and overcome LLC charging order protections that prevent these levies.

- 14) Constructive trusts. As noted above, plaintiffs may seek to overcome LLC statutory charging order protections on constructive trust grounds. See e.g., *B.A.S.S. Group LLC v. Coastal Supply Company*, Civil Action No. 3743-VCP, 2009 WL 174370 (Del. Ch. June 19, 2009).

VII. *FTC V. OLMSTEAD*—ITS HOLDING AND RATIONALE; ITS SIGNIFICANCE FOR FLORIDA AND NON-FLORIDA LLCs

- 1) The *Olmstead* case—introduction. On June 24, 2010, the Florida Supreme Court handed down its decision in *FTC v. Olmstead* (the “*Olmstead*” case or “*Olmstead*”).
- 2) Facts and procedural background. The Federal Trade Commission obtained a judgment against Shaun Olmstead and others who were credit-card scammers. The defendants held valuable assets in a number of single-member LLCs. The FTC obtained a federal district court order requiring the defendants to transfer ownership of these single-member LLCs to it. The defendants appealed to the United States Court of Appeals for the Eleventh Circuit. The 11th circuit certified to the Florida Supreme Court the question of Florida state law summarized below.
- 3) The question certified in *Olmstead*
 - a) The question
 - i) The question that the 11th Circuit certified to the Florida Supreme Court in *Olmstead* was, in essence, whether, despite § 608.433(4) of the Florida LLC act (the charging order provision of that act), a court may order the member of a *single-member LLC* (emphasis mine) to transfer the member’s membership rights to a judgment creditor in order to satisfy a judgment held by the creditor.
 - ii) Stated otherwise, the question could be construed as the question whether a charging order is the *exclusive* remedy of creditors of judgment-debtors who are members of Florida single-member LLCs; or whether, instead, these creditors may foreclose on these members’ LLC membership rights.
 - iii) The Court modified the question to provide as follows: “Does Florida law permit a court to order a judgment debtor to surrender all right, title and interest in the debtor’s single-member LLC to satisfy an outstanding judgment?”
 - iv) LLC lawyers and scholars expected the Court to focus on the above “innocent non-debtor member” and “pick-your-partner” concepts in deciding whether single-member LLCs provide the same charging order protections as multi-member LLCs. The Court in fact gave very little consideration to these concepts.
- 4) The Court’s answer
 - a) Holding of *Olmstead* court. The *Olmstead* decision was a 3-2 decision. In *Olmstead*, the Court held:
 - i) That the above section of the Florida LLC Act (the “Florida Act”) is *non-*

exclusive as to member-debtors-in-default of Florida *single*-member LLCs;
and

- ii) That the section thus does not bar creditors from foreclosing on the membership rights of these members under § 56.061 (the Florida levy statute).
- b) Basis for decision. In my view, the key to the Court’s opinion is its reasoning that the Florida LLC Act requirement under § 608.433(1) that “the other members” must approve the admission of an assignee of an LLC interest makes no sense in the case of single-member LLCs and thus that the member of a single-member LLC is not barred by the Florida Act from being required to transfer the member’s membership rights to a third party. Slip. op. at page 9. I think that on this issue, the Court was right and that its rationale strongly supports its decision.
- c) Other factors in the Court’s decision. In so holding, the Florida Supreme Court also relied to a significant degree on:
 - i) The importance of maintaining the efficacy of the Florida statutory “levy” remedy with respect to the membership rights of members of single-member LLCs in the absence of clear legislative intent to the contrary in the Florida LLC Act; and
 - ii) The fact that, unlike the Florida partnership act, the Florida Act does *not* expressly provide that charging orders are the exclusive remedy of creditors of member-debtors-in-default.
- d) Implication of *Olmstead* about whether single-member LLCs qualify for charging order protections
 - i) One arguable implication of the *Olmstead* decision is that the members of single-member LLCs *are* entitled to charging order protections under § 608.433(4). On this point, I disagree with the Court; I think that the above “innocent non-debtor member” and “pick-your-partner” considerations would have justified the court:
 - (1) In construing the section differently for single-member LLCs than for multi-member LLCs; and
 - (2) In holding that the single-member LLCs are not entitled to charging order protections.
 - ii) However, the *Olmstead* decision’s holding that charging order remedies are not the exclusive remedies of creditors of single-member LLCs under that section arguably negates the value of the Florida Act charging order section for Florida single-member LLCs.
- 5) The dissent; reactions from LLC lawyers and scholars; the 24 “exclusive” states.
 - a) The dissent. Two of the judges of the Florida court issued a strong dissent to the above decision. The dissent is based on numerous grounds. The dissenters interpreted the majority opinion as applying not only to *single*-member LLCs but also to *multi*-member LLCs. I believe that on this issue, the dissenters were wrong.

- b) Was *Olmstead* wrongly decided? A number of LLC lawyers and scholars have expressed the view that the *Olmstead* decision was wrongly decided, particularly because of its failure to give due weight to the “pick-your-partner” and “innocent non-debtor member” arguments. However, I think these lawyers overlook the language in the above slip op. at page 9.
- 6) Application to multi-member LLCs. I believe that because of its reliance on 608.433(1), the *Olmstead* decision does not apply to Florida multi-member LLCs; and I believe that for Florida *multi*-member LLCs, charging orders are the exclusive remedy of creditors with unsatisfied judgments against member-debtors-in-default. However, the dissenters in *Olmstead* expressly stated the opposite view, and the matter is by no means without doubt.
 - a) Thus, Florida lawyers and lawyers in other states who want to ensure that clients for whom they are forming LLCs but under whose home-state LLC acts charging order provisions are not clearly exclusive should consider forming these LLCs under the DLLC Act or under another act whose charging order provisions are unquestionably exclusive.
- 7) Table of states. A table of states that arguably do and do not expressly permit such foreclosures is attached as Exhibit B. This table is based on Professor Bishop’s table of the 51 U.S. LLC acts, cited above. Under this table, 24 LLC acts are arguably exclusive as to the remedy of the charging order; the rest are not.

VIII. THE IMPLICATIONS OF LLC CHARGING ORDER PROTECTIONS FOR THE PLANNING AND DRAFTING OF LLC OPERATING AGREEMENTS

- 1) Do you need to include provisions in operating agreements to address charging order issues?
 - a) The only impact of a charging order on an LLC and its members is to require the LLC to distribute to the relevant creditor any distributions that would otherwise go to the member-debtor-in-default.
 - b) Thus, charging orders as such don’t affect LLC operations, and they have an economic effect only on the member-debtor-in-default.
 - c) Thus, arguably, there should be no need to address charging order issues in LLC operating agreements.
- 2) Possible operating agreement provisions to address charging order matters
 - a) Minimizing the right to distributions, maximizing guaranteed payments, etc. However, because of charging order considerations, the members of some LLCs may want to maximize the amount of LLC profits paid to working members on the basis of salary, guaranteed payments or bonuses and minimize payments in the form of distributions.
 - b) Converting distributions to guaranteed payments, etc. In addition, LLC members may want to provide for the possibility of charging orders against their members

as follows:

- i) If the LLC becomes subject to a charging order because of a judgment against a member-debtor-in-default, the LLC will convert amounts that might otherwise be paid to the member as distributions to salary or bonus.
 - ii) In this event, the allocations to the member will be reallocated pro rata among the other members.
- c) Dissociation of members whose misconduct results in charging orders against the LLC. Finally, since the above arrangements may be set aside by a court, members may want to provide in their operating agreements that if a member engages in conduct that results in a charging order against the LLC, the other members may dissociate the member.
- i) This provision may be useful because, among other considerations, members who are no longer able to receive distributions from their LLCs by reason of charging orders may lose some or all of their motivation to provide competent services to or for their LLC.

EXHIBIT A

STATE LLC ACT CHARGING ORDER PROVISIONS—IS A CHARGING ORDER THE EXCLUSIVE REMEDY OF CREDITORS HOLDING UNSATISFIED JUDGMENTS AGAINST MEMBERS OF SINGLE-MEMBER LLCs; OR MAY THESE CREDITORS FORECLOSE ON THE MEMBERSHIP RIGHTS OF THESE MEMBERS?

Preliminary note. Under the LLC acts of 24 of the 51 U.S. jurisdictions listed below, the membership rights of LLC member-debtors-in-default with respect to whom creditors obtain charging orders against these members' LLCs (other than the rights of these members to receive LLC distributions) would appear not to be subject to levy by these creditors. The relevant membership rights not subject to levy include voting rights, agency rights, information rights, and fiduciary rights.

The above 24 jurisdictions are, in alphabetical order, Arkansas, Delaware, Hawaii, Idaho, Illinois, Iowa, Kansas, Kentucky, Michigan, Montana, Nebraska, Nevada, New Jersey, North Dakota, Ohio, South Carolina, South Dakota, Tennessee, Texas, Utah, Vermont, Virginia, West Virginia, and Wyoming.

STATE	MAY CREDITOR LEVY ON MEMBERSHIP RIGHTS OF MEMBER-DEBTOR-IN-DEFAULT?
1. Alabama	No
2. Alaska	No
3. Arizona	No
4. Arkansas	Yes
5. California	No
6. Colorado	No
7. Connecticut	No
8. Delaware	Yes
9. District of Columbia	No
10. Florida	No
11. Georgia	No
12. Hawaii	Yes
13. Idaho	Yes
14. Illinois	Yes
15. Indiana	No
16. Iowa	Yes
17. Kansas	Yes
18. Kentucky	Yes
19. Louisiana	No
20. Maine	No

STATE	MAY CREDITOR LEVY ON MEMBERSHIP RIGHTS OF MEMBER-DEBTOR-IN-DEFAULT?
21. Maryland	No
22. Massachusetts	No
23. Michigan	Yes
24. Minnesota	No
25. Mississippi	No
26. Missouri	No
27. Montana	Yes
28. Nebraska	Yes
29. Nevada	Yes
30. New Hampshire	No
31. New Jersey	Yes
32. New Mexico	No
33. New York	No
34. North Carolina	No
35. North Dakota	Yes
36. Ohio	Yes
37. Oklahoma	No
38. Oregon	No
39. Pennsylvania	No
40. Rhode Island	No
41. South Carolina	Yes
42. South Dakota	Yes
43. Tennessee	Yes
44. Texas	Yes
45. Utah	Yes
46. Vermont	Yes
47. Virginia	Yes
48. Washington	No
49. West Virginia	Yes
50. Wisconsin	No
51. Wyoming	Yes

EXHIBIT B

LLC CHARGING ORDERS—21 SELF-TEST QUESTIONS

- 1) What is an LLC charging order (a “charging order”)?
- 2) Which state LLC acts provide for charging order protections and which do not?
- 3) What are three benefits of charging orders to LLCs and their members?
- 4) To what parties do charging orders apply?
- 5) What is the legislative intent of charging orders?
- 6) Do charging orders apply to single-member LLCs?
- 7) What is the federal tax treatment of creditors who obtain charging orders against LLCs?
- 8) What is the difference between a guaranteed payment paid by an LLC to its members and a distribution made by the LLC to its members?
- 9) Do LLC distributions ever function as compensation for LLC members?
- 10) What types of businesses can benefit from charging order protections?
- 11) What types of business owners can benefit from charging order protections?
- 12) Are charging orders principally useful when the relevant member-debtors-in-default are (a) majority members; (b) 50% members; or (c) minority members?
- 13) Do any state business corporation acts provide for charging order protections?
- 14) Why are LLC statutory charging order provisions relevant in non-tax choice of entity in choosing among LLCs, corporations and other business entities?
- 15) If a lawyer forms a new entity as an LLC rather than as a corporation for a business founder, can this ever give rise to an ethics claim or a malpractice claim?
- 16) What types of business organization law statutes provide for charging orders?
- 17) If an LLC member-debtor-in-default voluntarily or involuntarily becomes bankrupt, can a trustee in bankruptcy take possession of the member’s LLC voting rights and, if the member is a majority member, vote to dissolve the LLC?
- 18) What provisions might be included in an LLC operating agreement to take account of the risk that members may engage in conduct that will result in charging orders against the LLC?
- 19) Is it possible to summarize the law that applies when two or more states may have jurisdiction over LLCs, their members or their assets in situations in which the LLCs are or may be subject to charging orders?
- 20) What is the relation between charging order protections and “reverse veil-piercing”?
- 21) What is the impact of the June 24, 2010 decision of the Florida Supreme Court in *FTC v. Olmstead* on non-tax choice of entity in general and, in particular, on whether the membership rights of an LLC member-debtor-in-default are likely to be subject to foreclosure by a creditor of the member?