

**Steve Leimberg's Asset Protection Planning Email Newsletter  
- Archive Message #112**

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**From:** Steve Leimberg's Asset Protection Planning Newsletter

**Subject:** **Forum Shopping  
For Favorable FLP and LLC Legislation**

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**Executive Summary:**

The race for states to attract trust business is not the only race with big dollars at stake. Many states seek to attract corporate, limited partnership, and limited liability company business. One of the primary factors an estate planner should consider when forum shopping for favorable limited partnership law or limited liability law is “sole remedy charging order protection.” This LISI provides a chart regarding the law of each state, and whether such state provides for sole remedy charging order, allows the judicial foreclosure sale of an limited partnership interest or member interest, or is silent on the issue leaving the decision to future case law. In our next LISI, we will discuss whether “sole remedy” actually means “sole remedy?”

**Facts:**

Regarding limited partnerships, nine states provide for “sole remedy” charging order. On the other hand, twenty-one states provide for the judicial foreclosure sale of the limited partnership interest, and nineteen states are silent on the issue. One state, Louisiana does not have any “charging order” language within its statute.

In the case of limited liability companies, sixteen states provide for “sole remedy” charging order, while only twelve states provide for the judicial foreclosure sale of the

membership interest. Also, two states, Nebraska and Pennsylvania, do not have any “charging order” language within their statutes.

## **Discussion:**

### **What’s Charging Order Protection?**

Partnership law (and subsequently LLC law) developed differently than corporate law. Rather than allowing a creditor to attach all of the rights of a partnership interest, a charging order allows a creditor only to attach a right to distributions. The creditor does not receive any voting rights. In layman’s terms, a charging order may be defined as a right to a distribution, when and if ever made. With a charging order, a creditor is left with a right to distributions, however, the creditor has no method (i.e., voting rights) to force a distribution. If a charging order is the sole remedy of the creditor, the result is a waiting game, with the question being who can wait the longest - the client or the creditor? If the client can out-wait the creditor, typically the creditor will settle for less than the judgment amount.

### **What Happens if There is A Judicial Foreclosure Sale?**

It is easier to illustrate a judicial foreclosure sale by example rather than provide a technical explanation. Let’s assume that we have Dr. Anne who has a \$2 million medical malpractice judgment against her. Many years ago, she created an FLP that holds \$3 million of assets. Dr. Anne owns a ninety-five percent limited partnership interest and her husband Ray is the general partner. The creditor obtains a charging order over Dr. Anne’s ninety-five percent interest, but does not receive any voting rights and no distributions are made. The creditor complains to the court that no distributions are being made from the partnership. As an additional remedy, the court, and the judge orders the judicial foreclosure sale of Dr. Anne’s limited partnership interest. At the sheriff’s auction, Dr. Anne’s ninety-five percent limited partnership interest is sold to a speculative investor for a fraction of the underlying value, let’s say \$250,000. The speculative investor’s proceeds are transferred to Dr. Anne’s creditor. Dr. Anne still owes the original creditor \$1.75 million, plus interest and attorney fees.

Now Dr. Anne has two parties she must negotiate a settlement with. The original creditor has not gone away, and Dr. Anne still owes the original creditor \$1.75 million, plus interest. Also, some time in the future, Dr. Anne must also negotiate a separate deal with the speculative investor to purchase back her limited partnership interest.

Worse yet, the speculative investor received more rights than the original creditor. The original creditor had a right to distributions until the charging order was paid. However, this is not what the speculative investor purchased. At the sheriff’s auction, the speculative investor purchased Dr. Anne’s partnership interest, not the charging order. After the purchase of Dr. Anne’s partnership interest, the speculative investor has the right to distributions forever. Fortunately, the partnership agreement is properly

drafted, the speculative investor does not become a substituted partner with voting rights and cannot force a liquidation of the partnership.

Regarding the effectiveness of an FLP or LLC in a non-sole remedy state, one of the authors contacted the debtor and creditor attorneys on almost all of the judicial foreclosure reported cases and learned that when the court ordered this remedy, the cases settled almost immediately on relatively unfavorable terms.

### **THE LIMITED PARTNERSHIP/LIMITED LIABILITY COMPANY SOLE REMEDY/JUDICIAL FORECLOSURE LAW TABLE:**

The following table lists each state and is divided in the middle between the state’s limited partnership and limited liability company law. If the two columns under either limited partnership or limited liability company are blank, this means that the state has language substantially similar to the Revised Uniform Limited Partnership Act of 1976, which states that a charging order is a remedy, but the statute does not specifically state that it is the sole remedy. Otherwise, one of the two columns will denote the states that are either a “sole remedy state” or a “judicial foreclosure state.”

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State	Limited Partnership		Limited Liability Company	
	Sole Remedy	Permits Judicial Foreclosure	Sole Remedy	Permits Judicial Foreclosure
Alabama		Pending Legis <sup>1</sup>	Statute <sup>2</sup>	
Alaska	Statute <sup>3</sup>		Statute <sup>4</sup>	
Arizona	Statute <sup>5</sup>		Statute <sup>6</sup>	
Arkansas		Statute <sup>7</sup>		
California		Statute <sup>8</sup>		Case Law <sup>9</sup>
Colorado				Statute <sup>10</sup>
Connecticut		Case Law <sup>11</sup>		Implied <sup>12</sup>
Delaware	Statute <sup>13</sup>		Statute <sup>14</sup>	
District of Columbia				
Florida	Statute <sup>15</sup>			
Georgia		Case Law <sup>16</sup>		Implied <sup>17</sup>
Hawaii		Statute <sup>18</sup>		Statute <sup>19</sup>
Idaho		Statute <sup>20</sup>		
Illinois		Statute <sup>21</sup>		Statute <sup>22</sup>
Indiana				
Iowa		Statute <sup>23</sup>		
Kansas			Statute <sup>24</sup>	
Kentucky		Statute <sup>25</sup>		
Louisiana	No charging order language <sup>26</sup>			
Maine		Statute <sup>27</sup>		

Maryland		Case Law <sup>28</sup>		
Massachusetts				
Michigan		Statute <sup>28</sup>		
Minnesota		Statute <sup>29</sup>	Statute <sup>30</sup>	
Mississippi				
Missouri		Case Law <sup>31</sup>		
Montana				Statute <sup>32</sup>
Nebraska			No charging order language <sup>33</sup>	
Nevada		Statute <sup>34</sup>	Statute <sup>35</sup>	
New Hampshire		Case Law <sup>36</sup>		
New Jersey			Statute <sup>37</sup>	
New Mexico		Case Law <sup>38</sup>		
New York				
North Carolina			Case Law <sup>39</sup>	
North Dakota		Statute <sup>40</sup>	Statute <sup>41</sup>	
Ohio		Statute <sup>42</sup>		
Oklahoma	Statute <sup>43</sup>		Statute <sup>44</sup>	
Oregon				
Pennsylvania		Case Law <sup>45</sup>	No charging order language <sup>46</sup>	
Rhode Island				Statute <sup>47</sup>
South Carolina				Statute <sup>48</sup>
South Dakota	Statute <sup>49</sup>		Statute <sup>50</sup>	
Tennessee			Statute <sup>51</sup>	
Texas	Statute <sup>52</sup>		Statute <sup>53</sup>	
Utah				Statute <sup>54</sup>
Vermont		Statute <sup>55</sup>		Statute <sup>56</sup>
Virginia	Statute <sup>57</sup>		Statute <sup>58</sup>	
Washington				
West Virginia				Statute <sup>59</sup>
Wisconsin				
Wyoming			Statute <sup>60</sup>	

### Unexpected Reversal of State Law

The Uniform Limited Partnership Act of 2001 specifically provides for the judicial foreclosure sale of a limited partnership interest. Minnesota previously provided sole remedy charging order protection by case law and Nevada previously provided sole remedy charging order protection by statute. Both of these state laws were unexpectedly reversed when the Uniform Limited Partnership Act was passed. Also, Oklahoma currently has sole remedy charging order, however HB 1361, adopting the ULPA (2001), passed the Oklahoma House and is currently pending in the Senate Judiciary Committee.

### No Charging Order Language

As noted in the charts above, three states (one under a limited partnership act and two under limited liability company acts) do not have any charging order language. Does this mean that any creditor can attach the partner's or member's interest and vote the partnership interest or membership interest similar to corporate stock? If so, there is little, if any asset protection in these three states provided by charging order. On the other hand, it is also possible that a court in these three states would look to other state law and adopt charging order protection by case law.

**Conclusion:**

The race continues as many estate planners forum shop for sole remedy charging order protection. Several lead trust jurisdictions have also designed lead limited partnership and limited liability company laws. Some of these states have actually added a turbo charge to the words "sole remedy." In our next LISI, we will discuss whether a charging order is really the sole remedy? On the other hand, if you cannot wait until then, you may wish to join us at Professor Regis Campfield's Notre Dame Tax and Estate Planning Institute for a discussion of this issue.

**HOPE THIS HELPS YOU HELP OTHERS MAKE A *POSITIVE* DIFFERENCE!**

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*Bill Comer*

Technical Editor □ **Duncan Osborne**

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1 Proposed legislation in committee adopting ULPA(2001) – HB 940  
The ULPA 2001 specifically provides for the judicial foreclosure sale of limited partnership interests.

2 Ala. Code §10-12-35

3 Alaska Stat. §32.11.340

4 Alaska Stat. §10.50.380

5 Ariz. Rev. Stat. §29-341

6 Ariz. Rev. Stat. §29-655

7 Arkansas HB 1009 (2006-2007) legislature, which should be codified as Ark. Code § 4-47-703.

8 Cal. Corp. Code §15907.03 adapting ULPA 2001, previously judicial foreclosure sale was allowed by  
the following cases *Hellman v. Anderson*, 233 Cal. App. 3d 840 (1991); *Crocker Nat. Bank v Perroton*,  
208 Cal. App. 3d 1 (1989).

9 *Severson v. Superior Ct.*, 2006 WL 1495309 (unreported)

10 Colo. Rev. Stat. §7-80-703

11 *Madison Hills Limited Partnership II v. Madison Hills, Inc.*, 644 A.2d 363 (Conn. App. Ct. 1994).  
Noting that the ULPA(1976) provides that the remedies of the UPA may be imported. The UPA  
provides for the judicial foreclosure sale of partnership interests.

12 *PB Real Estate, Inc. v. Dem II Properties*, 1997 WL 625465 – dictum regarding that an LLC statute  
should also be able to import the remedies of the UPA, including the judicial foreclosure sale of the  
LLC interest.

13 Del. Code 6 § 17-703

14 Del. Code 6 § 18-703

15 Fla. Stat. ch. 620.1703; also previously by case law *In re Stocks*, 110 B.R. 65 (Bankr. N.D. Fla. 1989);  
*Givens v. National Loan Investors, L.P.*, 724 So.2d 610 (Fla. App. 1998).

16 Ga. Code Ann. §14-9-703, which specifically states a charging order is not a creditor’s exclusive  
remedy; *Nigri v. Lotz*, 453 S.E. 2d 780 (Ga. App. 1995); *Stewart v. Lanier Medical Office Building,*  
*Ltd.* 578 S.E. 2d 572 (Ga. App. 2003)

17 Ga. Code Ann. §14-11-504(b), similar to the limited partnership statute above states that a charging  
order is not a creditor’s exclusive remedy.

18 Haw. Rev. Stat. §425D-703, which adopted ULPA (2001)

19 Haw. Rev. Stat. §428-504

20 Idaho Code § 53-42-703, which adopted the ULPA (2001)

21 805 ILCS 206/504, which adopted ULPA (2001)

22 805 Ill. Comp. Stat. § 206/504

23 Kan. Stat. Ann. §17-76, 113

24 Ky. Rev. Stat. §362.2-703, which adopted the ULPA (2001)

25 The Louisiana statute has no charging order language. Query: Does this mean if the creditor attaches  
the member’s interest, the creditor may vote the member’s interest? If so, a Louisiana LLC provides  
very little, if any, asset protection.

26 31 M.R.S.A. §1383, which adopted the ULPA (2001)

27 *Lauer Construction, Inc. v. Claude Schrifft*, 716 A.2d 1096 (Md.App. 1998); *Gibson’s Lodging v.*  
*Lauer*, 721 A.2d 989 (Md. 1989).

28 M.C.L.A. §449.28

- <sup>29</sup> Minn. Stat. Ann. §322A.0504 adopting ULPA(2001) and reversing prior case law regarding sole remedy under *Chrysler Credit Corp. v. Peterson*, 342 N.W. 2d 170 (Minn. Ct. 1984).
- <sup>30</sup> Minn. Stat. §322B.32
- <sup>31</sup> *Deutsch v. Wolf*, 7 S.W. 3d 460 (Mo. App. 1999)
- <sup>32</sup> Mont. Code Ann §35-8-705
- <sup>33</sup> The Nebraska LLC statute has no charging order language, similar to the Louisiana statute. Again, does this mean a creditor can attach and vote the limited partnership interest similar to corporate stock.
- <sup>34</sup> Previously, Nevada was a sole remedy state and for these limited partnerships sole remedy protection remains. However, N.R.S. §88.535 adopted the ULPA (2001) and, for all limited partnerships formed after October 1, 2007, the statute allows the judicial foreclosure sale of the limited partnership interest.
- <sup>35</sup> N.R.S. §86.401
- <sup>36</sup> *Baybank v. Catamount Construction, Inc.*, 693 A.2d 1163 (N.H. 1997) stating that a court may look to the UPA for remedies not mentioned in the ULPA (1976), including the judicial foreclosure sale of the limited partnership interest.
- <sup>37</sup> N.J. Stat. Ann. § 42:25-45
- <sup>38</sup> *In re Priestley*, 93 B.R. 253 (D.N.M. 1988)
- <sup>39</sup> *Herring v. Keasler*, 563 S.E.2d 614 (N.C. App. 2002)
- <sup>40</sup> N.D. Code § 45-10.2-64
- <sup>41</sup> N.D. Code §10-32-34
- <sup>42</sup> Ohio Rev. Code §1775.27 adopting ULPA (2001). Previously, Ohio allowed judicial foreclosure sale by case law – *Larson v. Larson*, 2000 WL 1566522 (Ohio App. 11. Dist.) unreported.
- <sup>43</sup> Okla. Stat. tit. 54, §342
- <sup>44</sup> Okla. Stat. tit. 18, §2034
- <sup>45</sup> *In re Allen*, 228 B.R. 115 (Bankr. W.D. Pa. 1998); *Auburn Steel Company v. American Steel Engineering Co.*, 1993 WL 257379 unreported case.
- <sup>46</sup> No charging order language contained in the statute. Similar to Louisiana and Nebraska, does this mean that a creditor may attach and vote the limited partnership interest.
- <sup>47</sup> R.I. Gen. Laws § 7-16-37.
- <sup>48</sup> S.C. Code Ann. § 33-44-504
- <sup>49</sup> S.D. Code §48-7-703; 2007 Legislative Session SB 77
- <sup>50</sup> S.D. Code §47-34A-504; 2007 Legislative Session SB 78
- <sup>51</sup> Tenn. Code Ann. §48-218-105
- <sup>52</sup> 2007 Texas Session Laws H.B. 1737
- <sup>53</sup> 2007 Texas Session Laws H.B. 1737
- <sup>54</sup> Utah Code § 48-2c-1103
- <sup>55</sup> Vt. Stat. Ann. Tit. 11, §3244
- <sup>56</sup> Vt. Stat. Ann. Tit. 11, §3074
- <sup>57</sup> Va. Code § 50-73.46:1 also prior to statutory law, *In re Piske*, 1 B.R. 913 (Bankr. E.D. Va. 1981) held that a charging order was the sole remedy.
- <sup>58</sup> Va. Code § 13.1-1041.1
- <sup>59</sup> W. Va. Code § 31B-5-504

<sup>60</sup> W.S. § 17-15-145