

Single-Member LLCs v The Member's Judgment Creditor: How Strong is the Shield?

By Michael J. Willis*

Introduction

You advised your client to wrap his investment property in a single-member limited liability company ("SMLLC") for asset protection purposes. Subsequently, the client is sued in an action unrelated to his SMLLC and a judgment is issued. The client looks you in the eye after his debtor's exam and asks "well, at least they can't touch my investment property because it is separate and protected by Michigan's LLC laws...right?"

Commentators have indicated that a member of an SMLLC might have few rights against a judgment creditor in an instance such as that described above based on *In re Ashley Albright*, 291 BR 538 (Bankr D Colo 2003).¹ This article intends to provide clarity to the statutory "outside" creditor protection rights that exist in Michigan for the member of a SMLLC and why, in this author's opinion, *In re Ashley Albright* should not be extended in a Michigan court to allow a member's outside creditor the right to collapse on the membership interest of an SMLLC.

Critics of the SMLLC urge that *In re Ashley Albright* might receive nationwide application in creditor protection legal analysis.² Ashley Albright was a debtor in a Chapter 7 bankruptcy proceeding and otherwise proud owner, sole member, and manager of a Colorado limited liability company named Western Blue Sky LLC ("Western Blue Sky"), which LLC owned certain real property located in Colorado somewhere near the Old Spanish Trail. Her bankruptcy trustee contended that because Ms. Albright was the sole member and manager of Western Blue Sky at the time she filed for bankruptcy, that he controlled Western Blue Sky and therefore could force the entity to sell its real estate and distribute the proceeds to his bankruptcy estate. Ms. Albright countered that the best position the bankruptcy trustee could arrive at would be that of an owner of a charging order and certainly in such a position could not assume management of Western Blue Sky or, of course, cause the entity to sell its historic real property.

The position of Ms. Albright sounds familiar. As business lawyers in the Great Lakes state, we routinely inform budding entrepreneurs of the terrific outside-creditor protection rights that exist through the formation of a Michigan limited liability company. This author has heard many experienced Michigan business counselors inform on the charging order or assignee interest and how it is a member's outside creditor's best possible position due to the strength of Michigan's limited liability company statutes. In the instance that a member of a limited liability were to, for example, cause an auto accident and lose a related third-party claim and otherwise not have adequate insurance, such third-party claimant's best possible position would be that of one holding a charging order, or assignee interest, against the member's limited liability company interest. Since a charging order does not allow its holder to vote or otherwise control the action of the limited liability company, and certainly not the power to foreclose on the assets of the limited liability company, and further given that the holder of a charging order, or assignee interest, may be required to pay taxes on the distributive-share income of the limited liability company, such an order should result in a settlement of the claimant's position at less than 100 percent of the claim. Or, so goes the rhetoric according to the *In re Ashley Albright* court.

The *In re Ashley Albright* Colorado bankruptcy court granted Ms. Albright's bankruptcy trustee her otherwise disputed membership interest, and all her rights of membership including the right to manage her LLC. Like Michigan law, Colorado's statutes define a membership interest in an LLC as personal property. The ruling in *Albright* was based on Colo Rev Stat 7-80-702(1) which read:

(1) The interest of each member in a limited liability company constitutes the personal property of the member and may be transferred or assigned. However, if all of the other members of the limited liability company other than the member proposing to

*The author wishes to give special thanks to Kindra Taplin for assisting in the preparation of this article, as well as special thanks to Matthew Miller, J.D., for his contributions to this article.

dispose of his or its interest do not approve of the proposed transfer or assignment by unanimous written consent, the transferee of the member's interest shall have no right to participate in the management of the business and affairs of the limited liability company or to become a member. The transferee shall only be entitled to receive the share of profits or other compensation by way of income and the return of contributions to which that member would otherwise be entitled.³

The *Albright* court held, “[b]ecause there [were] no other members in the limited liability company, no written unanimous approval of the transfer was necessary. Consequently, [Ms. Albright’s] bankruptcy filing effectively assigned her entire membership in the limited liability company to the bankruptcy estate, and the trustee obtained all her rights, including the right to control the management of the limited liability company.”⁴ Ouch! Related to the outside-creditor protection a limited liability company affords a member of an SMLCC, the *Albright* court stated that “the charging order...exists to protect *other* members of an LLC from having involuntarily to share governance responsibilities with someone they did not choose, or from having to accept a creditor of another member as a co-manager” and that the “charging order limitation serves no purpose in a single member limited liability company, because there are no other parties’ interests affected.”⁵

May *Albright* be applied to a Michigan single-member LLC with the result being that an outside creditor of the single member could directly charge against the assets of the SMLLC? The authors of *Asset Protection: Concepts & Strategies for Protecting Your Wealth* believe as much. They indicate that, “The primary purpose of the charging order [in an LLC setting] is...to protect the non-debtor members from being involuntarily forced into a partnership with (sic) the debtor member’s creditor.”⁶ They further espouse that “there is only one member in a SMLLC, so there are no non-debtor members to protect.”⁷ If this last statement sounds eerily like the *Albright* court, that is because these same authors believe that “until *Albright* is overturned or rejected by other courts, the safe presumption will be that SMLLCs probably do not provide charging order protection.”⁸

The authors above are not alone in their opinions. The esteemed Warren, Gorham & Lamont, via its “Business Entities” publication, issued a paper titled “The Albright Decision – Why an SMLCC is Not an Appro-

prate Asset Protection Vehicle.” This paper informs that, “Certain elements of the statutory structure of LLCs, including the charging order and the requirement of approval by the current owners for the admission of new members, lose their rational support when viewed in the context of a single-member LLC,” and that “the Albright case is an archetypical demonstration of this situation....”⁹

Michigan’s Big Difference

In re Ashley Albright states that “Section 7-80-702 of the Limited Liability Company Act require[d] the unanimous consent of ‘other members’ in order to allow a transferee to participate in the management of the limited liability company. Because there [were] no other members in the limited liability company, no written unanimous approval of the transfer was necessary.”¹⁰ Under MCL 450.4506, the Michigan Legislature added a layer of statutory protection that was not found in the Colorado statutes at the time of the *Albright* decision. MCL 450.4506(1) specifically applies to how an assignee becomes a member of an LLC in the State of Michigan, as follows:

(1) Unless otherwise provided in an operating agreement, an assignee of a membership interest in a limited liability company having more than 1 member may become a member only upon a unanimous vote of the members entitled to vote. *An assignee of a membership interest in a limited liability company having 1 member may become a member in accordance with the terms of the agreement between the member and the assignee.* (italics added)

Interestingly, Michigan’s statute used to read like Colorado’s statute in 2003 before a 1997 amendment. The relevant piece of this Michigan statute previously read: “(1) Except as provided in an operating agreement pursuant to subsection (2), an assignee of a membership interest in a limited liability company may become a member only if the *other members unanimously consent.*” (italics added) The current Michigan statute, after the 1997 amendment, makes clear that the member of a single-member LLC must consent to an assignee becoming a member. This distinction in Michigan law is extremely important in determining the law that will control Michigan courts. In the state of Michigan, an assignee can only become a member of the LLC through terms of the agreement between the member and the assignee. It is safe to assume that the debtor member will generally not come to an agreement with the judicial lien creditor that will allow such creditor to

Under MCL 450.4506, the Michigan Legislature added a layer of statutory protection that was not found in the Colorado statutes at the time of the *Albright* decision.

collapse on the assets of the SMLLC.¹¹ *In re Ashley Albright* is an interesting case, but the Michigan Legislature appears to have performed a better job than Colorado's lawmakers in ensuring the protection of the Michigan SMLLC against the attacks of outside creditors.¹²

Conclusion

For the critics of the single-member LLC it is easy to review the final outcome of *In re Ashley Albright* and conclude that the case could be extended to allow a member's outside creditor direct access to the assets of a SMLLC. However, a review of the law that is used to support the Colorado court's opinion leads to the conclusion of this author that *In re Ashley Albright* should not be used in Michigan courts for such an extension due to the major differences in Michigan's statutory law.

Under Michigan law, a creditor should not be allowed to use a judgment claim to foreclose on the assets of a single member LLC without consent and agreement of the single member and *Albright* should not be persuasive precedent in a court interpreting Michigan law related to the "outside" creditor protection rights that exist for the member of an SMLLC.

As noted above, this article does not advise the creation of single-member LLCs solely for third party creditor protection purposes. Instead, the article outlines how the author deems a court should rule, based on Michigan statute, related to third party creditor protection matters of the member of an SMLLC. Further, as noted in Footnote 11, this article does not extend its analysis to the bankruptcy court. These disclaimers, however, do not in any way water down the solid argument of the member of an SMLCC being attacked by a creditor arising outside of the SMLLC. Under Michigan law, such a creditor should not be allowed to use a judgment claim to foreclose on the assets of an SMLLC without the consent and agreement of its member.

Building Stumbling Blocks: A Practical Take on Charging Orders, 5 BUS. ENTITIES 28 (Sept/Oct 2006).

2. *Id.*

3. In 2006, this section was rewritten as discussed in footnote 12.

4. *In re Ashley Albright*, 291 BR 538, 540 (2003)

5. *Id.* at 541.

6. Adkisson & Riser, *Single Member LLCs (SMLLCs)*.

7. *Id.*

8. *Id.*

9. *The Albright Decision – Why an SMLLC is Not an Appropriate Asset Protection Vehicle* at its Conclusion.

10. *In re Ashley Albright* at 540. The specific reference, then, to the required consent of other members (of which there were none in *Albright*), appears to be the hinge on which the *Albright* court turns.

11. It is worthy to note that although protection seems clear, in this author's opinion, in the case of an outside creditor, the Michigan statute could still seemingly be used by a bankruptcy trustee to argue that the assets of a single member LLC are controlled by the bankruptcy trustee upon the filing of a bankruptcy petition by its sole member (arguing that the trustee becomes the new member by agreement of the prior member which agreement was evidenced by the filing of the petition for bankruptcy).

12. To the credit of the Colorado Legislature, Colo Rev Stat 7-80-702(1) of the Colorado Limited Liability Company Act was rewritten in 2006 and now states as follows: "(1)The interest of each member in a limited liability company constitutes the personal property of the member and may be assigned or transferred. Unless the assignee or transferee is admitted as a member, the assignee or transferee shall only be entitled to receive the share of profits or other compensation by way of income and the return of contributions to which that member would otherwise be entitled and shall have no right to participate in the management of the business and activities of the limited liability company or to become a member." Therefore, Colorado's 2006 statute currently provides significantly more outside creditor protection to the member of a SMLLC than its predecessor.



Michael is the managing partner of Willis & Willis, PLC. He holds a license as a CPA and is licensed to practice law in both Florida and Michigan. He practices Corporate Law and Estate Planning. Michael received his B.A. from the University of Notre Dame and his J.D. from the University of Michigan Law School. In 2007, he was selected by Michigan Lawyer's Weekly as one of Michigan's Up and Coming Lawyers. In 2008, he was selected as a Rising Star by Michigan Super Lawyers. He was selected by the State Bar of Florida as the 2009 recipient of the Pro Bono Service Award for the Out of State (49 states) Judicial Circuit.

NOTES

1. Adkisson & Riser, *Asset Protection: Concepts & Strategies For Protecting Your Wealth* 219 (2004). Adkisson & Riser, *Single Member LLCs (SMLLCs)* <http://www.assetprotectionbook.com/singlememberllc.htm> (accessed May 29, 2008). Rutledge & Geu., *The Albright Decision – Why An SMLLC Is Not An Appropriate Asset Protection Vehicle*, 5 BUS. ENTITIES 16 (Sept/Oct 2003). The perceived potential creditor protection limitations of a SMLLC as a result of *Albright* are also discussed in Stein,