

## ***Kentucky Responds Not To Olmstead, But To the Problem of Asset Protection SMLLCs***

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Kentucky has responded to the use of single member LLCs as asset protection vehicles by making them far less viable.

The *Olmstead* decision<sup>1</sup> arose out of the actions of Shawn Olmstead placing certain non-income generating assets in SMLLCs. When the FTC sought to collect his assets to satisfy his restitution obligation, Olmstead asserted that all the FTC could receive is a charging order on his interest in the SMLLCs.<sup>2</sup> Ultimately the Florida Supreme Court determined that the charging order is not the exclusive remedy available to the judgment creditor of a member of a Florida LLC and permitted the FTC to seize all “right, title and interest” in each SMLLC.

Kentucky did not have the problem of the charging order not being identified as the exclusive remedy of the judgment creditor – such is exclusively stated.<sup>3</sup> But there continues to exist the question as to whether the use of SMLLCs as asset protection vehicles should be permitted. Informing that consideration is that Kentucky does not permit the formation of self settled spendthrift trusts. From there the determination

was made that while an asset protection SMLLC should not be prohibited, neither should they be reinforced.

Under the laws of many states, a member is dissociated upon the transfer of their entire economic interest in the LLC.<sup>4</sup> In contrast, under Kentucky law, a member’s dissociation after transferring the entirety of the economic interest in the LLC required a vote of a majority-in-interest of the other members.<sup>5</sup> But what about SMLLCs? Upon foreclosure of the charging order, by what mechanism would the member (judgment debtor) be removed from the position as a member?

Revisions made to KRS section 275.280<sup>6</sup> address a transfer of all of a member’s limited liability company interest, drawing distinctions between single and multiple member LLCs. The existing rule, namely that dissociation following the transfer of the entire interest in the LLC requires a vote of the other members, has been retained for LLCs in which, prior to the transfer, there were at least two members.<sup>7</sup> The revisions go to what were, prior to the assignment, single member LLCs. In those situations, the class of non-assigning members bring a null set, no post-transfer action is required, and the transferor member ceases to be a member of the LLC upon the effective time and date of the transfer.<sup>8</sup>

One effect of this amendment is to address single-member LLCs used for abusive asset protection. By way of

<sup>1</sup> *Olmstead v. Fed. Trade Comm.*, 44 So.3d 76 (Fla. 2010). See also *FTC v. Olmstead*, 528 F.3d 1310 (11<sup>th</sup> Cir. 2008).

<sup>2</sup> See FLA. STAT. ANN. § 608.433(4).

<sup>3</sup> See KY. REV. STAT. ANN. § 275.260(1); see also Thomas Earl Geu, Thomas E. Rutledge and John W. DeBruyn, *To Be Or Not To Be Exclusive: Statutory Construction of the Charging Order In the Single Member LLC*, 9 DEPAUL BUSINESS & COMMERCIAL LAW JOURNAL 83, 94-96 (Fall, 2010) (reviewing the question of exclusivity under the Florida LLC Act).

<sup>4</sup> See, e.g., DEL. CODE ANN. tit. 6, § 18-702(b)(3); MONT. CODE § 35-8-803.

<sup>5</sup> KY. REV. STAT. ANN. § 275.280(1)(c)2. Similar laws exist in, for example, Indiana (IND. CODE § 23-18-6-5(a)(3)(B)), Arkansas (ARK. CODE § 4-32-802(a)(3)(B)), Connecticut (CONN. CODE § 34-180(a)(3)(B)) and New Mexico (N. MEX. CODE § 53-19-38(A)(3)(b)). See also REV. UNIF. LTD. LIAB. CO. ACT § 602(4)(b), 6B U.L.A. 502 (2008).

<sup>6</sup> Essentially section 802 of the 1992 Prototype LLC Act.

<sup>7</sup> See KY. REV. STAT. ANN. § 275.280(1)(c)2 as amended by 2011 Ky. Acts, ch. 29, § 15.

<sup>8</sup> See KY. REV. STAT. ANN. § 275.280(1)(c)3 as created by 2011 Ky. Acts, ch. 29, § 15.

example, assuming a SMLLC, the judgment-debtor against whom a charging order has been issued<sup>9</sup> will be dissociated upon the foreclosure on the charged limited liability company interest. Foreclosure will require a court order and the plaintiff demonstrating that foreclosure is appropriate, presumably on the basis that the SMLLC and its assets are not expected to generate distributions from which the judgment can be satisfied.<sup>10</sup> From there the holder of the interest may elect themselves a member of the LLC<sup>11</sup> or permit the LLC to dissolve for the lack of a member;<sup>12</sup> either way the assets of the SMLLC, subject to other creditor claims, will be available to satisfy the judgment.<sup>13</sup>

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<sup>9</sup> See KY. REV. STAT. ANN. § 275.260. For a review of the charging order under Kentucky LLC, partnership and limited partnership acts, see Thomas E. Rutledge and Sarah S. Wilson, *Look Before You Charge: An Examination of the Charging Order under Kentucky's LLC and Partnership Acts (Part I)*, [REDACTED] KY. L.J. ONLINE [REDACTED] (2011) (forthcoming), available on SSRN, abstract 1791856.

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<sup>10</sup> The requirement of a court determining that foreclosure is appropriate protects the generally applicable rule of asset segregation. See KY. REV. STAT. ANN. § 275.240(1) (property of the LLC is not property of the members). The Kentucky LLC Act's charging order does not define the test for when foreclosure is appropriate.

<sup>11</sup> See KY. REV. STAT. ANN. § 275.285(4)(b); see also Rutledge, *The 2007 Amendments to the Kentucky Business Entity Statutes*, 97 KENTUCKY LAW JOURNAL 229 at 245-46 (2008-09).

<sup>12</sup> See *id.*; see also KY. REV. STAT. ANN. § 275.015(11) (an LLC must have at least one member).

<sup>13</sup> See also Thomas E. Rutledge, *I May Be Lost But I'm Making Great Time: The Failure of Olmstead to Correctly Recognize the Sine Qua Non of the Charging Order*, 13 J. PASSTHROUGH ENTITIES 65 (Nov./Dec., 2010) (discussing the mechanism of foreclosure as a means for addressing SMLLCs used for abusive asset protection).

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