

Impact Of A Bankruptcy Filing On Real Property Of A Single Member LLC

Description

A common practice when owning property for investment is to establish a limited liability company (an LLC) to hold title. This helps to compartmentalize ownership and/or investor groups. Limited liability companies are legal entities, created by and under state law, combining attributes of corporations and partnerships. Property of an LLC has the further advantage of not being liable for debts of the members (even sole members). Creditors are, at best, entitled to a charging order on the LLC's profits.

The Florida Supreme Court in *Shaun Olmstead et al. v. Federal Trade Commission*, 44 So. 3d 76 (June 24, 2010) created controversy when it interpreted Florida's limited liability company laws to hold that a court may order a judgment debtor to surrender all right, title, and interest in the debtor's single-member LLC to satisfy an outstanding judgment. The Florida legislature corrected that in 2011 by amending F.S. §608.433(4) to provide the charging order as the sole remedy for a judgment creditor. Similarly, § 13.1-1041.1.D. of the Virginia Code provides that 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 transferable interest in the limited liability company.

The line of cases in the bankruptcy courts disclose that charging orders are not the only means of affecting an LLC's real property when an LLC, comprised of a sole member, is involved in a bankruptcy.

Starting in 2003, bankruptcy courts began looking carefully at single member limited liability companies. In Colorado, Ashley Albright was the sole member and manager of Western Blue Sky LLC. When Ashley filed for Chapter 7 bankruptcy protection, she took the position that the real property owned by the LLC was not included in her bankruptcy estate and that, at best, the Chapter 7 trustee was only entitled to a charging order against the profits of the LLC. The Chapter 7 trustee took the position that Ashley's bankruptcy filing assigned her entire membership interest in the LLC to the bankruptcy estate. The court, in *In re Albright*, 291 B.R. 538, (Bankr. D. Colo. 2003), agreed with the Chapter 7 trustee, reasoning that charging orders were put in place to protect the other members of the LLC. Since Ashley was a sole member, her membership interest in the LLC constituted personal property which became a part of the bankruptcy estate upon her filing. As a result, the Chapter 7 trustee stepped into Ashley's shoes and was entitled to manage the assets of the LLC, including the real property, which the court determined could be sold by the trustee and distributed to the bankruptcy estate.

In doing so, the court fired a shot across the bow of anyone thinking that a simple solution to this dilemma was the addition of a straw party second member:

To the extent a debtor intends to hinder, delay or defraud creditors through a multi-member LLC with "peppercorn" co-members, bankruptcy avoidance provisions and fraudulent transfer law would provide creditors or a bankruptcy trustee with recourse. 11 U.S.C. § 544(b)(1) and 548(a). *In re Albright*, Case No. 01-11367 ABC,, 541 n.9 (Bankr. D. Colo. 2003).

In 2006, Ron Ryan, a debtor himself in a Chapter 7 bankruptcy, filed a Chapter 11 bankruptcy on behalf of A-Z Electronics, LLC, an Idaho limited liability company of which Ron was the sole member. Relying upon the *In Re Albright* case, the court, in *In re A-Z Electronics, LLC*, 350 B.R. 886 (Bankr. D. Idaho 2006) determined that Ron Ryan's interest in the LLC became the property of his Chapter 7 bankruptcy estate; as a result, Ron lacked the authority and ability to file a Chapter 11 petition on behalf of A-Z Electronics, LLC.

That same year, Christopher B. Mead was appointed as a Chapter 11 trustee in the Chapter 11 bankruptcy of Nader Modanlo. Following his investigation, the trustee sought to place New York Satellite Industries, LLC a Delaware limited liability company for which Mr. Modanlo was the sole member into its own chapter 11 bankruptcy. Mr. Modanlo argued that, under Delaware law, he was divested of his membership interest in the Delaware LLC, which went into dissolution upon the filing of his Chapter 11 bankruptcy, thereby denying Mr. Mead the authority and ability to file a Chapter 11 petition on behalf of New York Satellite Industries, LLC. Through an analysis of Delaware law and in reliance on the *In Re Albright* case, the court determined, in *In re Modanlo*, 412 B.R. 715 (Bankr.D. Md. 2006), that Mr. Mead had the ability of reinstate the LLC, appoint himself as its manager, and place the LLC into bankruptcy.

The groundwork for a similar decision began in Virginia in 2000. In reaching its decision, the A-Z Electronics court noted that in *In re Garrison-Ashburn, L.C.*, 253 B.R. 700 (Bankr. E.D. Va. 2000), the court considered the impact of the bankruptcy filing of a 50% member in an LLC. *Id.* at 704-08. It observed that such a member-debtor's economic rights (the membership interest and its value) fall squarely within § 541(a)(1), but so, too, do his non-economic rights (such as the ability to participate in management) because § 541(a)(1) is so broadly and intentionally drafted. *Id.* at 707-08. • *In re A-Z Electronics, LLC*, 350 B.R. 886, 890 (Bankr. D. Idaho 2006). In 2012, the Albright line came a step closer in Virginia though the United States Bankruptcy Court for the Eastern District of Virginia, Richmond Virginia. In *Spain v. Williams (In re Williams)*, 455 B.R. 485, 502 (Bankr. E.D. Va. 2011). In that case, the court confirmed the Garrison determination that membership interests become property of the bankrupt estate.

So how does this affect the title professional? When dealing with a single member limited liability company, one should also run PACER on the single member to rule out a bankruptcy. If a bankruptcy is discovered, parties should be notified of the possibility that the single member's authority to execute a deed of conveyance may have been compromised by the filing; control of the LLC, including the ability to convey property owned by the LLC may be subject to control by the bankruptcy court or a bankruptcy trustee depending on the chapter under which the relief has been sought. Guidance should be obtained from your insurer's underwriting counsel as to the exceptions or requirements that may be required to appear in the commitment and any policy.

As you proceed toward closing, cooperation of either a bankruptcy trustee may be necessary. In a Chapter 7, the trustee is vested with control of the bankruptcy estate; in a Chapter 13, the court retains jurisdiction over the bankruptcy estate pending confirmation of a Chapter 13 plan, at which time the debtor in possession assumes pertinent duties with respect to the sale of real property. That being said, permission or consent of the Chapter 13 trustee should always be sought. In a Chapter 11, proceeding, The US Trustee should be consulted unless a specific trustee has been appointed to oversee the case. In all cases, communication with and the cooperation of the debtor's counsel is of paramount importance.



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