The Role of Veil Piercing & Fraudulent Conveyances in Collection Matters

A. UNIFORM FRAUDULENT TRANSFER ACT (UFTA)

Congratulations, you have just won a final judgment for your client. You were sure to have it conclude with the magic words," for which let execution issue." Unfortunately, your work is not yet finished. You now have to collect on the judgment, and in the event the judgment debtor is now or has been attempting to rid himself of his assets you are going to have to set aside those transfers.

The Uniform Fraudulent Transfer Act of 1984, 11 USCA § 548 et seq. has been adopted by 44 states.[1] While it was originally designed to protect a debtor's estate from exhaustion by creditors,[2] it has been used to set aside transfers by debtors who use those transfers to fraudulently defeat claims by creditors. In a typical fraudulent scenario, a debtor will transfer an asset or incur a debt.
To set aside the transfer the creditor must prove the transfer was made with the intent to defeat the claim of a creditor. The claim can arise either before or after the transfer if the transfer was fraudulently made. In the instance of **pre-transfer creditors**, the creditor need only show **badges of fraud** to establish an inference of fraud, whereas post-transfer creditors must show **fraud in fact or an actual intent** to defraud. *Sherry v. Ross*, 846 F.Supp. 1424 (D. Haw. 1994).

B. INTENT

In order to prove actual fraud, a showing of the debtor's intent to defeat or delay the rights of creditors is paramount. *Alabama Credit Corp. v. Deas,* 417 F.2d 135 (5th Cir. 1969).The **existence of a debtor's intent to defraud, often referred to by courts as "fraud-in-fact," permits a court to set aside a conveyance made with such intent** even though a fair consideration has been paid, and even though the debtor was solvent at the time of the transfer. Additionally, the intent must have existed at the time the transfer was made. *Erjavec v. Herrick*, 827 P.2d 615

[1] 1 The Act has been adopted in jurisdictions including Alabama, Arizona, Arkansas, California, Colorado, Connecticut, Delaware, District of Columbia, Florida, Georgia, Hawaii, Idaho, Illinois, Indiana, Iowa, Kansas, Maine, Massachusetts, Michigan, Minnesota, Mississippi, Missouri, Montana, Nebraska, Nevada, New Hampshire, New Jersey, New Mexico, North Carolina, North Dakota, Ohio, Oklahoma, Oregon, Pennsylvania, Rhode Island, South Dakota, Tennessee, Texas, Utah, Vermont, Washington, West Virginia, Wisconsin, Wyoming.

[2] UFTA §3, Comment 2.

(Colo. Ct. App. 1992) (applying Colorado law). Thus, in order to set aside a transfer as having been made with an **actual intent** to hinder, delay or defraud creditors, one court has stated that the plaintiff creditor must establish:

1. that the thing transferred has **value,** out of which the creditor could have realized a portion of its claim;
2. that this thing was **transferred or disposed of** by the debtor; and
3. that the transfer was done with **actual intent to defraud**.

In re Kovler, 249 B.R. 238 (Bankr. S.D.N.Y. 2000). In determining which type of fraud must be shown to establish whether the debtor has made a fraudulent conveyance, some states take into consideration the **time at which the conveyance was made**; whether the creditor arises pre-transfer or post-transfer. *Nelson v. Hansen*, 278 Or. 571, 565 P.2d 727 (1977).

C. ACTUAL FRAUD AND BADGES OF FRAUD

According to *Alabama Credit Corp. v. Deas*, 417 F.2d 135 (1969), "actual fraud" means **actual intent to defeat or delay the rights of creditors**. This term is generally used in instances where a grantor, who is indebted at the time, conveys property on a "good", as distinguished from a "valuable," consideration.
In determining whether **actual intent** to hinder, delay or defraud any creditor of the debtor the UFTA recommends that consideration should be given, among other factors, to whether:

1. the transfer or obligation was to an **insider**;
2. the debtor **retained possession** or control of the property transferred after the transfer;
3. the transfer or obligation was **disclosed or concealed**;
4. before the transfer was made or obligation was incurred, the debtor had been sued or **threatened with suit**;
5. the transfer was of substantially **all the debtor's assets**;
6. the debtor **absconded;**
7. the debtor removed or **concealed** assets;
8. the value of the consideration received by the debtor was reasonably **equivalent to the value of the asset** transferred or the amount of the obligation incurred;
9. the debtor was **insolvent** or became insolvent shortly after the transfer was made or the obligation was incurred;
10. the transfer occurred **shortly before or shortly after a substantial debt was incurred**; and

11. the debtor transferred the essential assets of the business to a lienor who transferred the assets to an insider of the debtor.

The common Badges of Fraud on which a court including a **Bankruptcy Court**[3] may rely in deciding whether an alleged Fraudulent Transfer was made with actual intent to hinder, delay or defraud creditors includes:

1. lack or inadequacy of consideration;
2. existence of family, friendship or other close relationship between transferor and transferee;
3. transferor's retention of possession, control, benefits or use of property;
4. financial condition of transferor both before and after transfer;
5. cumulative effect of transactions and course of conduct after the onset of financial difficulties or dependency or threat of suit by creditors; and
6. general chronology and timing of transfer in question

D. CONSTRUCTIVE FRAUD

Constructive Fraud, however, amounts to legal fraud **regardless of actual intent**. It occurs when (1) a voluntary gift is made, (2) there is an existing or contemplated indebtedness against debtor, and (3) debtor has failed to retain sufficient property to pay the indebtedness. *Wachovia Securities, LLC v. Neuhauser*, 528 F.Supp.2d 834 (N.D.Ill.2007). In order to succeed under a constructive fraud theory, **§548(a)(2) of the Bankruptcy Code** requires that the creditor establish that the debtor experience one of the following maladies in addition to failing to retain sufficient property to pay the indebtedness:

- The debtor was **insolvent on the date the transfer was made** or the obligation was incurred;
- The transfer or obligation **caused the debtor to become insolvent**;
- The debtor was engaged in business or a transaction for which its **remaining property was an unreasonably small capital**;
- The debtor was **about to engage in business or a transaction** for which its remaining property was unreasonably small capital
- The debtor intended to incur debts that it would be **unable to pay when due**; or
- The debtor **believed it would incur debts** it would not be able to pay when due.

[3] 11 USCA § 727(a)(2), In re Metro Sewer Services, Inc., 374 B.R. 316 (Bankr. M.D. Fla. 2007)

1. DEBTOR'S REMAINING ASSETS UNREASONABLY SMALL

If a Plaintiff intends to prove that a transfer was constructively fraudulent, they may prove that the transfer left the debtor with assets that were unreasonably small for the debtor's business or for a transaction in which the debtor was about to engage. [4]This allows the plaintiff to set aside a transfer or obligation that left the debtor barely solvent.[5] In general, a debtor has unreasonably small assets when nonpayment of his or her debts is reasonably foreseeable given the debtor's remaining financial resources. See Credit Managers Association v Federal Co, 629 FSupp 175 (CD Cal 1985); Kupetz v Continental Illinois National Bank & Trust Co, 77 Bankr Rep 754 (CD Cal 1987). The plaintiff can establish that the debtor's remaining assets were unreasonably small by showing that the challenged transfer or obligation left the debtor with inadequate future cash flow. Factors relevant to a determination of inadequate future cash flow include the amount of liquid assets required for the debtor's business or contemplated transaction, the amount of the debtor's foreseeable future debt and expenses, and the debtor's history of profitability.[6]

2. REASONABLY EQUIVALENT VALUE

To set aside a constructively fraudulent transfer or obligation, the plaintiff must show that the debtor did not receive reasonably equivalent value in the transfer or in undertaking the obligation.[7] There must be a showing of substantial disparity between the value of the asset transferred by the debtor and the value received by the debtor in exchange. See *In re Smith, 24 Bankr Rep 19* (Bankr Ct WD NC 1982).

3. DEBTOR'S INSOLVENCY

To establish that a transfer was an insider preference, or that, under certain circumstances, a transfer or obligation was constructively fraudulent, the plaintiff

[4] See, UFTA § 4(a)(2)(i).
[5] See UFTA § 4, Comment 4.
[6] 26 Causes of Action 773
[7] See UFTA §§4(a)(2), (5(a).

must prove that the debtor was insolvent at the time of the transfer or obligation.[8] In order to establish that the debtor is insolvent, it is sufficient to show that the debtor's indebtedness exceeded his or her assets. This is called "balance-sheet" insolvency.[9] The debtor's assets include all property of the debtor, except:

(1) property encumbered by a valid lien;
(2) property exempt under non-bankruptcy law;
(3) property held in tenancy by the entirety;
(4) property concealed or removed with the intent to hinder, delay, or defraud creditors;
(5) property that was the subject of a transfer voidable under the act.

The debtor's debts include liability on all claims against it, regardless of whether the claim is reduced to judgment or not, liquidated or unliquidated, fixed or contingent, matured or unmatured, disputed or undisputed, legal or equitable, or secured or unsecured, other than a debt secured by an asset excluded from the valuation of the debtor's assets.[10]

4. TRANSFER TO INSIDER

To establish that a transfer was an insider preference, It is sufficient to establish that the transferee came within the **definition of "insider.**"[11] It also will be sufficient to show that the transferee was an **insider-in-fact**, although the transferee did not come within the definition of "insider."[12]

Where the **debtor is an individual**, all that is required is to establish that a transferee was an insider is to show that the transferee was a partnership in which the debtor was a general partner; a general partner in such a partnership; a corporation in which the debtor was a director, officer, or person in control; or a relative of the debtor or of a general partner in a partnership in which the debtor was a general partner.[13] A relative of an individual is a person related to the individual by consanguinity within the third degree, the individual's spouse, or a person related to the spouse within the third degree of consanguinity.[14]

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[8] UFTA §3.
[9] UFTA § 1(2); §2(D); §2, Comment 1
[10] UFTA § 1(3); § 1(5); § 2(e); § 2, Comment 1. *26 Causes of Action 773*

[11] UFTA § 1 (7).
[12] UFTA § 1, Comment 7.

[13] UFTA § 1(7)(i).
[14] UFTA § 11.

Where the **debtor is a corporation**, it will be sufficient, in order to establish that a transferee was an insider, to show that the transferee was an officer or director of the debtor, a partnership in which the debtor was a general partner, a general partner in such a partnership, or a relative of an insider.[15]

Where the debtor is a **partnership**, it will be sufficient, in order to establish that a transferee was an insider, to show that the transferee was a general partner of the debtor, a relative of a general partner, or a person in control of the debtor.[16]
In addition, it also will be sufficient, to establish that a transferee was an insider, to show that the transferee was **an "affiliate" of an insider or an insider of an "affiliate" or, where the debtor was a partnership or a corporatio**n, that the transferee was a managing agent of the debtor.[17] An "affiliate" is a person who owns, controls, or holds, with power to vote, 20 percent or more of the outstanding voting securities of a corporation, a person who operates the debtor's business or controls substantially all of the debtor's assets, or a person whose business or assets are controlled by the debtor. UFTA § 1(1).

In order to establish that the transferee was an **insider-in-fact**, it will be necessary for the plaintiff to show that the transferee did not deal at arm's length with the debtor, and that the transferee had a special relationship with the debtor through which it was possible to compel payment by the debtor. See, In re International Club Enterprises Inc, 109 Bankr Rep 562 (Bankr Ct D RI 1990).

E. PRIMA FACIE CASE

a. In order to establish a prima facie case in an action to set aside or recover for an **actually fraudulent transfer** or obligation, the plaintiff must plead and prove that:

1. the debtor made a transfer or incurred an obligation;
2. the plaintiff was a creditor of the debtor; and
3. the debtor made the transfer or incurred the obligation with actual intent to hinder, delay, or defraud any creditor of the debtor.

b. In order to establish a prima facie case in an action to set aside a **constructively fraudulent transfer** or obligation, the plaintiff must plead and prove that:

1. the debtor made a transfer or incurred an obligation;
2. the plaintiff was a creditor of the debtor;

[15] UFTA § 1(7)(ii).

[16] UFTA § 1(7)(iii).

[17] UFTA § 1(7)(iv), (v).

3. the debtor did not receive reasonably equivalent value in exchange for the transfer or obligation; and

4. (a) the debtor was engaged or was about to engage in a business or a transaction for which the debtor's remaining assets were unreasonably small; or (b) the debtor intended to incur, or believed or reasonably should have believed that he or she would incur, debts beyond the debtor's ability to pay as they matured; or (c) (i) the debtor was insolvent at the time the transfer was made or the obligation was incurred, or became insolvent as a result of the transfer or obligation , and; (ii) the plaintiff's creditor status existed at the time of the transfer or obligation.

c. In order to establish a prima facie case in an action to set aside an **insider preference transfer**, the plaintiff must plead and
prove that:

1. the debtor made a transfer to an insider for an antecedent debt;
2. the plaintiff was a creditor of the debtor at the time of the transfer;
3. the debtor was insolvent at the time of the transfer; and
4. the insider had reasonable cause to believe that the debtor was insolvent at the time of the transfer .[18]

F. DEFENSES

a. There will be no liability, whether the challenged transaction involved **actual fraud, constructive fraud, or an insider preference**, where:

1. the challenged transaction involved neither a transfer nor an obligation;
2. the plaintiff was not a creditor of the debtor;
3. the defendant was a second transferee or obligee (*i.e.*, the defendant received the transfer or obligation from the initial transferee or obligee) who received the asset or obligation in good faith and for value;
4. the defendant was a third or subsequent transferee or obligee who received the asset or obligation in good faith;

Additionally, liability will be limited where the defendant was an initial transferee or obligee who acted in good faith and gave value in the transaction
b. Where **constructive fraud allegedly was involved**, there will be no liability where:

[18] 26 Causes of Action 773

1. the initial transferee or obligee gave reasonably equivalent value in the transaction;
2. the challenged transaction was the termination of a lease upon the debtor's default, as provided for in the lease;
3. the challenged transaction was the enforcement of a
security interest in compliance with Article 9 of the Uniform Commercial Code;
4. the plaintiff's claim is asserted under UFTA Form 4(a)(2)(i), relating to the debtor's unreasonably small assets, and the debtor was neither engaged nor about to be engaged in a business or transaction for which the debtor's assets remaining after the challenged transaction were unreasonably small;
5. the plaintiff's claim is asserted under UFTA Form 4(a)(2)(ii), relating to the debtor's incurring of future debts, and the debtor neither intended to incur nor reasonably should have believed that he or she would incur debts beyond the debtor's ability to pay as they became due;
6. the plaintiff's claim is asserted under UFTA Form 5(a), relating to the debtor's insolvency, and the debtor neither was insolvent at the time of the transaction nor became insolvent as a result of the transaction;
7. the plaintiff's claim is asserted under UFTA § 5(a), relating to the debtor's insolvency, and the plaintiff became a creditor of the debtor after the challenged transaction;

c. Where an **insider preference transfer** allegedly was involved, there will be no liability where:

1. the transferee was not an insider.
2. the transfer was not for an antecedent debt.
3. the debtor was not insolvent at the time of the transfer.
4. the transferee did not have reasonable cause to believe that the debtor was insolvent at the time of the transfer.
5. the plaintiff was not a creditor of the debtor at the time of the transfer.
6. the transfer was made in the ordinary course of business or financial affairs of the debtor and the transferee.
7. the transfer was a good faith effort to rehabilitate the debtor and secured present value given for that purpose as well as the debtor's antecedent debt.
8. the challenged transaction was the termination of a
lease upon the debtor's default, as provided for in the lease.
9. the challenged transaction was the enforcement of a security interest in compliance with Article 9 of the Uniform Commercial Code.

10. Additionally, the transferee's liability will be limited to the extent that the transferee gave new value to or for the benefit of the debtor, so long as the new value was not secured by a valid lien.

G. PARTIES

a. Creditor holding claim against debtor at time of transfer or obligation may bring action.
b. Creditors whose claim against debtor arose after transfer may bring action with respect to certain types of transfers.

The action may be brought against the debtor, the initial transferee or obligee, or any subsequent transferee or obligee.

H. JURISDICTION

Action usually will be brought in a state court of general jurisdiction.
Action may be brought in federal district court if the requirements for diversity jurisdiction are met.

I. LIMITATIONS

Action involving **insider preference** must be brought within one year of the transfer. Action involving **constructively fraudulent transfer** or obligation must be brought within four years of transfer or obligation. [19] Action involving **actually fraudulent transfer** or obligation must be brought within four years of transfer or obligation, or one year of date by which transfer or obligation reasonably could have been known.

[19] § 18

J. CAUSE OF ACTION

Just what is it that a Plaintiff can expect if he brings a suit under the UFTA? It is important to understand that the act does not create a new tort. It "is simply another creditors" remedy. It is either an action by a creditor against a transferee directed against a particular transaction, which, if declared fraudulent, is set aside thus leaving the creditor free to pursue the asset, or it is an action against a transferee who has received an asset by means of fraudulent conveyance and should be required to either return the asset or pay for the asset (by way of judgment or execution.)" ***Yusem v. South Florida Water Management Dist*****., 770 So.2d 746, 749 (Fla. 4th DCA 2000).**

By the same token the statute does not create an action for aiding and abetting. Under Florida"s Uniform Fraudulent Transfer Act or FUFTA there is no cause of action for aiding and abetting a fraudulent transfer when the alleged aider-abettor is not a transferee. This point was made abundantly clear in ***Freeman v. First Union,*** 865 So. 2d 1272 (Fla. 2004) Here the Plaintiff, a receiver filed a lawsuit in the U.S. District Court for the Southern District of Florida alleging that a company called Unique Gems ran a "ponzi scheme." Unique Gems maintained bank accounts at First Union National Bank. The receiver claimed that First Union National Bank was liable to the receiver for money damages on the grounds that it aided and abetted a fraudulent transfer by allowing Unique Gems to wire transfer money to Liechtenstein even after the State of Florida filed a lawsuit against the ponzi scheme operator. The receiver claimed that although the Defendant bank had informed its customer, Unique Gems in a letter that it would close its account in ten days, the bank did not close the account. Subsequently, a court-ordered injunction was entered, freezing the Unique Gems account. While the motion to freeze was pending, Unique Gems was able to transfer $6.6 million from its First Union account to Liechtenstein. Even after the injunction was entered, and after the Defendant bank told Unique Gems that its account would be closed thirty days thereafter, the bank still allowed Unique Gems to wire transfer an additional $2 million to Liechtenstein.

The district court dismissed the Receiver"s aiding and abetting claim against First Union for failure to state a cause of action under Florida law. The district court held that the FUFTA allows creditors only to set aside fraudulent transfers. The court considered the FUFTA to be similar to the fraudulent transfer provisions of the Bankruptcy Code and held that neither provides for abider and abettor liability. The district court noted that while the Receiver cited cases recognizing

aiding and abetting as common law fraud, or another cause of action, none of the cases related to the Uniform Fraudulent Transfer Act.

On appeal, the Eleventh Circuit Court of Appeals, 329 F.3d 1231 (11Cir. 2003) noted that the FUFTA remedies for fraudulent conveyance are different and possibly broader than those of the Bankruptcy Code. The appeals court said that, "While the Bankruptcy Code limits remedies to the recovery of transferred property or its value…the FUFTA clearly provides additionally for " any other relief the circumstances may require." Thus, the issue before the Eleventh Circuit was whether the FUFTA remedies, like bankruptcy remedies, include only equitable powers to cancel a fraudulent transfer, or whether the FUFTA's "catch-all" phrase of "any other relief the circumstances may require" gives rise to common law theories for damages against third party non-transferees. The Eleventh Circuit felt it could not predict how the Florida Supreme Court would rule on the issue. Specifically, the Eleventh Circuit asked the Florida Supreme Court, "Under Florida law is there a cause of action for aiding and abetting a fraudulent transfer when the alleged aider-abettor is not a transferee?" Id.
After further considering legislative intent, the Supreme Court stated that, "There is simply no language in the FUFTA that suggests the creation of a distinct cause of action for aiding-abetting claims against non-transferees. Rather, it appears that the FUFTA was intended to codify an existing but imprecise system whereby transfers that were intended to defraud creditors were to be set aside." The Court stated, "We simply can see no language in FUFTA that suggests intent to create an independent tort for damages." The Supreme Court explained that, "To adopt the appellants‟ position in this case would be to expand the FUFTA beyond its facial application and in a manner that is outside the purpose and plain language of the statute. Consistent with this analysis we conclude that the FUFTA was not intended to serve as a vehicle by which a creditor may bring a suit against a non-transferee party (like First Union in this case) for monetary damages arising from the non-transferee party‟s alleged aiding and abetting of a fraudulent money transfer." Kleinfeld & Alper, *"The Florida Supreme Court Finds No LiabilityFor Aiding Or Abetting A Fraudulent Transfer,"* **Florida Bar Journal, June 2004.**

K. BURDEN OF PROOF

Where actual fraud is alleged as the ground upon which to set aside the conveyance the **burden is upon the creditor to prove it**. It is not sufficient merely to charge **an intent** to hinder, delay or defraud creditors. Rather, the charge must plainly show the facts which constitute the fraud. Alabama Credit Corp. v. Deas et

al., 417 F.2d 135 (1969) (citing *Smith v. Wilder*, 270 Ala. 637, 120 So.2d 871 (1960).

Where constructive fraud is alleged, i.e., where the conveyance is sought to be vacated on the ground that it was voluntary, the **plaintiff has the burden to show that his debt was antecedent to the conveyance attached**. Alabama Credit Corp. v. Deas et al., 417 F.2d 135 (1969), When this burden is met, the burden to go forward with the evidence shifts to the grantee. When the evidence shows that the grantor was insolvent at the time he made the conveyance, the grantee has the burden of showing a valuable and adequate consideration. Upon the discharge of this burden by the grantee, the burden of proof then shifts back to the creditor to show that the grantee knew of the grantor's fraudulent intent or of such facts as put him upon inquiry which, if pursued, would have disclosed such fraudulent intent. Ledbetter, et al. v. Davenport Bros., et al., 154 Ala. 336, 45 So. 467 (1908).

L. REMEDIES

A creditor's remedy in a fraudulent conveyance action is limited to reaching the property that would have been available to satisfy the judgment had there been no conveyance. A creditor cannot, without legal process, appropriate fraudulently transferred property to the payment of his debt.

Under the **UFTA** and as set forth in **Flat. Stat. §726.108**, the creditor may obtain:

1. **Avoidance** of the transfer or obligation to the extent necessary to satisfy the creditor's claim;
2. An **attachment** or other provisional remedy against the asset transferred or other property of the transferee;
3. An **injunction** against further disposition by the debtor or a transferee, or both, of the asset transferred or of other property; or
4. A creditor has the remedy of **appointment of receiver**.

In some states, the ULTA provides that in an action for relief against a transfer or obligation, a creditor may have the fraudulent conveyance set aside or obligation annulled to the extent necessary to satisfy his claim, or disregard the conveyance and attach or levy execution on the property conveyed.

Both under these acts and under similar legislation, a fraudulent conveyance is subject to attack, either at law or in equity. Therefore, a creditor may

1. institute a suit in equity **to set aside the conveyance**;
2. **levy** upon the property and have it sold; or

3. subject the property to the satisfaction of his claim by **attachment or garnishment proceedings**.[20]

"The ***United States Supreme Court in Grupo Mexicano de Desarrollo, S.A., et al. v. Alliance Bond Fund, Inc., et al.*** solidified a property owner"s right to freely transfer his property prior to judgment subject to subsequent equitable remedies under fraudulent conveyance statutes. This case involved an action for money damages where the creditor sought a preliminary injunction in federal court to prevent a defendant from transferring its assets prior to judgment being entered. The majority opinion pointed out prerequisites for equitable remedies as well as the general availability of injunctive relief against asset transfers depend on common law principles of equity. The Supreme Court stated that, "It was well established, however, that, as a general rule, a creditor"s bill could be brought only by a creditor who had already obtained a judgment establishing the debt." The Court reiterated its understanding of the well-established general rule, "that a judgment establishing the debt was necessary before a court of equity would interfere with the debtor"s use of his property." In other words, under common law a creditor has no property interest in the assets of a debtor prior to the creditor obtaining a judgment, and before judgment, a debtor"s property is freely alienable." Kleinfeld & Alper, supra

Olmstead v. Fed. Trade Comm"n

The Florida Supreme Court recently came out with an important case. Chief Justice Canady authored the opinion in Olmstead v. Fed. Trade Comm"n, 35 Fla L. Weekly S357 (Fla. June 24, 2010). The opinion was written to answer a question certified by the 11th Circuit in Fed. Trade Comm"n v. Olmstead, 528 F. 3d 1310 (11th Cir. 2008). The Court rewrote the question to "Whether Florida law permits a court to order a judgment-debtor to surrender all right, title and interest in the debtor's single member limited liability company to satisfy an outstanding judgment." The Court answered the question, yes.

The case arose in response to an injunction, restitution order and judgment obtained by the FTC freezing and placing into receivership all of appellant's assets. Among the assets placed into that receivership were several single member LLCs belonging to appellant or his wife. To satisfy the judgment the FTC obtained an order compelling the appellant to surrender to the receiver all of his right, title and interest in the LLC"s. The opinion outlined provisions of Florida's laws relating to LLCs and creditor's remedies of levy and sale under execution as provided by Fla.

[20] Fla. Stat § 726.108, AmJur FrauduConv §142

Stat. § 56.061. Justice Lewis in his dissent accused the majority of rewriting the law and of expanding it beyond single member LLCs to all LLCs.

This case is a must read even if you do not practice in Florida. By this case Florida became the first state to follow the lead of bankruptcy courts in cracking the protections offered to debtors by use of LLCs. This is particularly poignant when one considers that the opinion was authored by Chief Justice Canady, who before his appointment to the Florida Supreme Court was a member of the United States Congress known for his conservative positions.

LLCs are used by business owners in every state to protect assets and for tax purposes. Under the Florida Limited Liability Company Act (LLCA), chapter 608 of the Florida Statutes (2008), creditor's remedies were set out by the establishment of a charging order "created for the personal creditors of partners. See City of Arkansas City v Anderson, 752 P.2d 763, 681-683 (Kansas 1988) (discussing history of partnership charging order remedy)." Olmstead, Id. As stated in the opinion, a "charging order affords a judgment creditor access to a debtor's rights to profits and distributions from the business entity in which the debtor has an ownership interest." Id. Thus, if the owner/member/debtor never declared a distribution the creditor would never realize any proceeds and the money could just sit there. The statute provides that a member's interest in the LLC is personal property which is assignable. The charging order is the mechanism by which a judgment creditor can seek to collect, but the creditor's rights are limited to that of an assignee. The assignee has no right to participate in the management of the business. The only thing the assignee gets is to share in the profits and losses, to receive distributions and allocations of income, gain, loss, deductions, or credit to the extent assigned by the debtor/member.

This statutory scheme is obviously an attractive way to shield one's assets and some states provide that a creditor is limited to a charging order in lieu of execution on the shares of an LLC themselves. See Wyo. Stat. §17-15-505. However in 2003 the Bankruptcy Court in In re Albright, 291 B. R. 538 (D. Colo. 2003) ruled that the sole owner of an single member LLC membership shares were subject to seizure by a bankruptcy trustee and liquidation to pay judgment creditors. See also, In re Modanlo, 412 B. R. 715 (D. Md. 2006); and In re A-Z Electronics, 350 B. R. 886 (Bankr. Idaho 2006)

This opinion has been attacked as being unsophisticated and unfriendly to business. See, Gassman, Denicolo "After Olmstead Will a Multiple-member LLC Continue to have Charging Order Protection?" Florida Bar Journal, Dec. 2010.

I. GARNISHMENT

Just as execution is the post judgment procedural equivalent of prejudgment attachment, so too is post judgment garnishment the procedural equivalent to prejudgment garnishment. As was the case with prejudgment garnishment, the use of post judgment garnishment historically grew out of another writ. As to post judgment garnishment, the writ developed as a proceeding in aid of the writ of execution. It was necessitated by the fact that the writ of execution could not reach the judgment debtor's property possessed by third parties; nor could execution usually reach debts owed by third parties to the judgment debtor. On the other hand, in a few jurisdictions, post judgment garnishment is seen as completely separate from execution. Finally, some states treat post judgment garnishment as a form of execution. Today, **garnishment, or its equivalent, is purely a statutory remedy.** [21]

A. PREJUDGMENT GARNISHMENT

From a procedural standpoint, whether garnishment is in aid of execution or is completely separate, there are some obvious differences between post judgment and prejudgment garnishment. The principal difference lies in the simple fact that the creditor has obtained a judgment. As a result, the procedural impediments faced by a creditor seeking prejudgment garnishment of the debtor's property or debts are in large part removed. As is the case regarding issuance of the writ of execution, the judgment creditor basically needs only to establish the existence of an unsatisfied judgment and the reasonable belief that a third party possesses assets of the judgment debtor or owes a debt to the judgment debtor.

B. POST JUDGMENT GARNISHMENT

Beyond the simplified grounds for obtaining issuance of the post judgment writ of garnishment, the use and effect of a post judgment garnishment for the most part parallels prejudgment garnishment. Once notice of garnishment is served on the third party, the garnishee is required to answer the complaint within a stated time. Failure to do so may result in a default judgment. In some states, default judgments are not easily obtained against a garnishee. In his answer to the complaint, the garnishee indicates that he holds property belonging to the debtor or that he is otherwise indebted to him. In the alternative, the garnishee might defend himself

[21] 1 The Law of Debtors and Creditors § 6:55

by asserting that he holds such property but has an interest in it that is paramount to the debtor's interest. He might also indicate that there is no property in his possession or that no debt is due the judgment debtor. Such defenses can include setoff defenses that the garnishee has to assert against the judgment debtor. The garnishee may also use the defense that the debtor's property in his hands is exempt. If the garnishee admits to holding the debtor's property, the court will order that it be turned over to the court or sheriff to satisfy the judgment. In the case of prejudgment garnishment, the garnishee may not be required actually to turn over the garnished property until he receives a further order following judgment against the debtor. If the garnishee does not admit the existence of such property or debt or otherwise contends that the judgment creditor is not entitled to it, the judgment creditor may controvert the answer, and, in this case, the controverted issue is tried like any other civil matter.

Post judgment garnishment reaches the same property that is reached by a prejudgment garnishment. Similarly, a garnishment lien may also be created as in the case of prejudgment garnishment. However, post judgment garnishment liens are not provisional in nature due to the already obtained judgment. Otherwise, the effect of the lien parallels that of a lien obtained by way of prejudgment garnishment. [22]

C. PROCEDURE

The basic procedure for the issuance of the writ of garnishment prior to judgment closely resembles the statutory procedure for issuance of the writ of attachment. If garnishment is treated as a writ in aid of attachment, then the writ of attachment must be issued prior to, or concurrently with, the writ of garnishment. Alternatively, if garnishment is statutorily separated from attachment, the issuance of attachment is unnecessary to the validity of the issued writ of garnishment.

In order to **initiate the proceeding**, the creditor must:

- File a **motion with supportive affidavits stating** that the grounds for issuance of the writ of prejudgment garnishment are present.
- In addition, he must usually **post a bond**.

Traditionally, prejudgment garnishment statutes did not provide the debtor with prior notice or an opportunity for a hearing regarding the issuance of the writ. If ex parte issuance of the writ occurred, a post issuance hearing was often provided the debtor. Due to a line of U.S. Supreme Court cases declaring these procedures to be in violation of the debtor's right to due process of law, prior notice and hearing is now often required by statute or case law. Nevertheless, as is the case with

[22] Id.

attachment, the notice and supportive affidavits must be filed to initiate the proceeding. The same guidelines for the preparation and filing of the motion and affidavit discussed in relation to attachment apply to prejudgment garnishment procedure.

In Florida, if the **allegation in the motion for writ of garnishment is not proved**, an order must be entered **dissolving the garnishment**.

If the motion to dissolve is successful, the writ must be dissolved. The conglomeration of statutes on notices and motions to dissolve is confusing and most of them are unnecessary. They are:

(1) The writ of garnishment must contain a **notice to the garnishment defendant** of the right to an immediate hearing for dissolution of the writ. The clerk must mail a copy of the writ to the garnishment defendant. Presumably the **writ of garnishment itself must contain the notice**. The garnishment plaintiff is required to serve a copy of the writ on the garnishment defendant.

(2) The clerk must attach a notice to the writ of garnishment if the garnishment defendant is **a natural person**. The notice must be in the statutory form that informs the garnishment defendant of his right to dissolve the writ and gives him a claim for exemption in the form.

- The garnishment plaintiff is required to mail a copy of the writ, a copy of the motion for the writ and the notice to the natural person garnishment defendant **within five business days** after the writ is issued or three business days after the writ is served on the garnishee, whichever is later.
- If the mail is undelivered, the garnishment plaintiff must diligently search for the last known address and mail the items to that address.
- The garnishment plaintiff must file a certificate of service.
- If the garnishment defendant files the claim of exemption and requests hearing, the hearing must be held as soon as practicable.
- If the garnishment plaintiff does not file a sworn written statement that contests the garnishment defendant's claim of exemption within three business days after hand delivering the claim and request or eight business days if the claim and request are served by mail, no hearing is required and the clerk must dissolve the writ and notify the parties of the dissolution by mail.
- The times are ridiculously short and may constitute lack of due process. The garnishment plaintiff has no chance to investigate the exemption claim, but must respond to it within an impossibly short time. It puts the garnishment plaintiff in the position of being defaulted and losing his ability to collect a judgment. After all, the merits of the matter have already been decided. It is a continuation of the public policy of the State to help persons avoid paying their just obligations.

(3) **Within five days after service of the garnishee's answer or after that time has expired, the garnishment plaintiff must mail a copy of the garnishee's answer and a notice advising the garnishment defendant that the garnishment defendant must move to dissolve the writ within 20 days** after the date of the certificate of service in the notice if any allegation in the garnishment plaintiff's motion for the writ is untrue. These documents are to be served on the garnishment defendant at his last known address and at any other address disclosed by the garnishee's answer and on any other person disclosed in the garnishee's answer to have any ownership interest in the property controlled by the garnishee.

(4) The writ can be dissolved unless the garnishment plaintiff proves the grounds upon which the writ was issued and, in a prejudgment writ, a reasonable probability that final judgment will be rendered in the garnishment plaintiff's favor is shown. No standard for that subjective matter is given. Again, the only allegation that is subject to a dispute is in garnishment before judgment. This motion to dissolve must be scheduled for immediate hearing. (5) Any person having an ownership interest in the property may file a motion to dissolve the writ within 20 days after the date in the certificate of service of the notice under § 77.055 Florida Statutes stating that any allegation in garnishment plaintiff's motion for the writ is untrue. On the motion this issue is tried. If the allegation is not proven, the garnishment must be dissolved. Failure of the defendant or any other interested person to timely file and serve the motion to dissolve requires striking of the motion and the proceedings being in a default posture. (6) Finally § 77.06(2) simply repeats what the writ already commands. Subsection (4) repeats what subsection (1) says. This is a useless and confusing repetition. The chapter needs a complete revision. The failure to clearly distinguish between garnishment before and after judgment is inexcusable.
Assuming the statutory grounds of issuance of the writ of garnishment have been satisfied, the court or **clerk of the court will issue the writ directing the sheriff to serve the garnishment on the third-party garnishee who holds property of the debtor or owes a debt to the debtor**.

State statutes sometimes additionally provide that a debtor should be notified after issuance of the writ. Upon service, prejudgment garnishment becomes a **warning or notice to the garnishee** that the garnishor claims to have the property or debt applied to the satisfaction of the garnishor's claim when reduced to judgment. **The content of the writ typically orders the garnishee to hold the property until the creditor action has been tried and the resulting judgment is satisfied.**

After the service of the summons or notice of garnishment upon the garnishee, the garnishee is required to answer the garnishment within a statutory stated period. In Florida, the statutory period is 20 days.
In its answer, the garnishee must provide:
(4) Information regarding **the assets or debts, if any, that he holds for or owes to the debtor**; and
(5) As a part of the answer, the garnishee is given an opportunity to **defend against the garnishment**.

If the garnishee's answer is unsatisfactory to the garnishor, the latter may controvert the answer and have the matter litigated.
The consequences to the garnishee of the **failure to answer properly** are twofold:
(6) First, the garnishee can be held in **contempt of court**. In this regard, penalties and other sanctions might be issued by the court to the garnishee;
(7) Second, the garnishment also makes the garnishee personally liable to the garnishor. In this regard, the failure of the garnishee to comply properly with the writ may result in judgment against the garnishee personally[23]

D. DUTIES OF GARNISHEE

A garnishee is merely a neutral stakeholder caught in an underlying dispute between a judgment creditor and debtor. The garnishee owes primary loyalty to the garnishee's own creditor until properly served. The proper service of garnishment papers then immediately imposes duties and potential liabilities upon the garnishee in favor of the judgment creditor. A writ of garnishment serves to preserve assets of a judgment debtor by creating an inchoate lien that is binding and prevents the garnishee from disposing of the assets in the garnishee's possession until a judgment is entered in a garnishment proceeding.
A garnishee must stand neutral with the money or other property in its possession, disclose all information relating to that property, and hold the property pending a decision by the court.
A garnishee occupies, in some respects, the position of a trustee. The garnishee is bound to protect, by legal and proper means, the rights of all parties to the property or credits attached and in the garnishee's hands. However, the garnishee is not bound in duty to the defendant to go further than to look to the jurisdiction, to act fairly, and to make a full disclosure in the garnishment proceedings.

[23] . FL-PRACPROC § 33:6

By virtue of a seizure under a garnishment order or writ, a garnishee becomes the legal custodian of wages and holds them subject to the future orders of the court. Similarly, once a bank account has been garnished, the bank is obligated to retain the funds of the depositor in obedience to the writ. [24]

Concerning liability to the debtor, the question might be raised as to whether the garnishee must assert the debtor's exemptions for him. As a general rule, the garnishee has only an obligation of fair play with respect to the debtor, including the duty to keep him appraised of any occurrence that affects the debtor's rights to an exemption. However, authority is divided on the issue of whether the garnishee owes a duty to the debtor to claim a known exemption so that failure to do so would deprive the garnishee of the right to plead the garnishment in payment as a defense in a subsequent action brought against the garnishee by the debtor.

II. EXECUTION

A judgment creditor is legally entitled to enforce the debt with the assistance of the court. State laws provide remedies to a judgment creditor in collecting the amount of the **judgment.** These measures bring the debtor's property into the **custody** of the court in order to satisfy the debtor's obligation; they involve the seizure of property and money. The process of enforcing the judgment debt in this way is called **execution**.

The process commences with a hearing called a **supplementary proceeding**. The judgment debtor is summoned to appear before the court for a hearing to determine the nature and value of the debtor's property. If the property is subject to execution, the court orders the debtor to relinquish it.

Because debtors sometimes fail to surrender property to the court, other means of satisfying the debt may be necessary. In these cases the law refers to an **unsatisfied execution** — an outstanding and unfulfilled order by the court for property to be given up. Usually this will lead the judgment creditor to seek a writ of attachment. To secure a writ of attachment, the judgment creditor must first place a judgment lien on the property. The writ of attachment sets in motion the process of a levy, by which a sheriff or other state official actually seizes the property and takes it into the physical possession of the court. The property can then be sold to satisfy the debt.

[24] 6 Am. Jur. 2d Attachment and Garnishment § 438

III. OFFSHORE TRUSTS

Among the most effective asset-sheltering tools is the offshore trust. These trusts take advantage of the donor-debtor friendly laws of a foreign jurisdiction. The laws of these jurisdictions generally allow a donor to retain a financial interest in, and control over, trust assets without subjecting the assets to creditor claims. Moreover, such jurisdictions generally do not recognize U.S. judgments (including divorce decrees) or other legal processes such as asset freezes and forfeitures. Thus, by establishing a trust in an appropriate foreign jurisdiction, a donor may be able to retain greater interests in the trust assets without sacrificing protection from creditor claims.

In addition to the opportunity to remove property from spouses and other creditors, the off-shore trust offers estate planning benefits in the form of probate avoidance and privacy. In the past, off-shore trusts were touted as a means of escaping estate and income taxes. Today, it is widely agreed that the use of off-shore trusts for this purpose is improper.

As noted above, off-shore trusts are generally quite effective at defeating creditor claims. However, to the extent that an offshore trust is subject to U.S. jurisdiction, its asset-sheltering effectiveness is considerably diminished. An off-shore trust may be subject to U.S. jurisdiction if it has a U.S.-affiliated trustee. Thus, creditors wishing to reach assets in an off-shore trust would be wise to examine the identity of the trustee.

A donor who transfers assets to an off-shore trust is, of course, subject to the laws of fraudulent conveyance. However, as noted above, repatriation of assets that were fraudulently conveyed may be quite difficult.