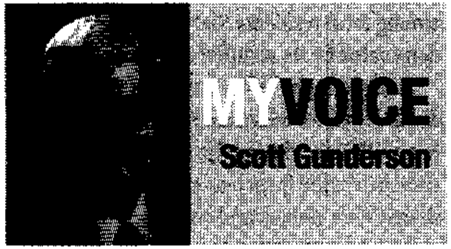
Expanded protection for single-owner entities in Nevada



Suppose you are the owner of a small business in Nevada, set up as a limited liability company (LLC) or corporation. You are on vacation in Hawaii and get into a car accident. The resulting damages exceed your auto insurance limits and a judgment is entered against you for the difference. The creditor attempts to satisfy the judgment out of the business assets held in your LLC or corporation. Will the creditor be successful? Up until now, if you (or you and your spouse) were the sole owner of the LLC or corporation, the outcome would have been very much in doubt. The Nevada Legislature has addressed this concern by unanimously approving SB405 which was signed into law by Governor Brian Sandoval on June 17. The law takes effect on Oct. 1.

The law revises sections of the Nevada Revised Statutes relating to remedies for creditors of owners of corporate, partnership and limited liability companies. Specifically, the new law clarifies that a charging order is the sole remedy for a creditor of an owner of a business entity, even if there is only a single owner of the entity. The new law also eliminates "equitable" remedies for these creditors and specifically precludes foreclosure of the charging-order interest. The change to the law states that charging orders are the sole remedy:

"... whether the limited liability company has one member or more than one member. No other remedy, including, without limitation, foreclosure on the member's interest or a court order for directions, accounts and inquiries that the debtor or member might have made, is available to the judgment creditor attempting to satisfy the judgment debtor's interest in the limited liability company, and no other remedy may be ordered by a court."

> *"Nevada continues to provide national leadership in the area of asset protection."*

A charging order is issued by a judge and is served upon the entity and directs the entity to distribute any amounts that would otherwise go to the business owner, to be instead distributed to the creditor. Under Nevada law, the judge cannot compel the entity to make a distribution to the creditor, nor can it order any other remedy.

So, in the example cited above, your creditor would be entitled to a charging order — and nothing more. The assets of your business could not be seized and sold to pay the judgment creditor.

The legislation was prompted by two recent cases which seemed to challenge the efficacy of single-member entities to survive attacks from creditors. The first case, *In Re Ashley Albright* decided by the bankruptcy court in Colorado in 2003, held that since the charging order remedy only existed to protect non-debtor partners, it wasn't appropriate to limit a creditor's rights against the assets of a single member entity, such as the one owned by Albright. A second case, from the Florida Supreme Court, *Olmstead v. Federal Trade Commission,* similarly allowed a creditor to reach the assets of a single-member LLC to satisfy a claim against the owner of the interest.

It is interesting to note that the debts owed in both of the above cases were not debts of the business entity; they were the debts of the owner of the business for activities unrelated to the business.

These two cases have made business owners very uncomfortable and dimmed the prospects of allowing a single-owner business to protect its assets from outside creditors. Many small businesses in Nevada have a single owner, or are jointly owned by husbands and wives (which are also considered a single owner for federal income tax purposes). In the LLC context, having a single owner allows for the entity to be disregarded for income tax purposes, thus requiring no income tax return for the entity.

Nevada remains the only state to extend charging order protection to shareholders of a corporation, and with the changes in SB405, even to a single-shareholder entity. In every other state, corporate assets may be easily seized by a creditor of the shareholder and used to satisfy non-corporate debt.

Florida's legislature debated changes to Florida law to address the outcome of the Olmstead case, and the new bill was approved by the legislature and signed into law by the Governor recently. But, unlike Nevada, Florida chose not to extend charging order protection to single member LLCs, but limited the charging order remedy to multi-member entities only. Nevada continues to provide national leadership in the area of asset protection.

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