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"Single Member LLCs and Asset Protection"

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Single member limited liability companies ("single member LLCs") are a unique creature authorized by the Colorado limited liability company act (the "Colorado Act") and the limited liability acts of many other states.[1] When Colorado enacted the initial version of the Colorado Act, single member LLCs were not permitted under the Colorado Act because LLCs were designed for partnership tax treatment which required two or more members. With the adoption of the check-the-box regulations by the Internal Revenue Service in 1996,[2] partnership tax treatment for all partnership entities became much easier to ensure, and single member LLCs became very popular. Under the check-the-box regulations, single member LLCs are treated either as a disregarded entity (taxed at the single member level) or as an association taxable as a corporation (if the box is checked).

Many persons look to single member LLCs as an asset protection device. That is, the person can conduct business through a single member LLC and avoid personal liability for the single member LLC's obligations while also protecting the assets of the single member LLC from the single member's creditors. The purpose of this article is not to discuss insulating the member from the debts of the single member LLC which is a question involving (among other things) legal principles related to piercing the veil of the LLC.[3] The question addressed by this article is whether the utilization of a single member LLC can protect the assets of the single member LLC from the claims of the member's creditors.

This article will conclude that, as an asset protection device, single member LLCs are not an effective tool, especially in Colorado. It is important to note that asset protection strategies are seldom perfect and are generally intended to create barriers – making access to assets more difficult for creditors, although seldom is access impossible. When the United States government or a bankruptcy trustee becomes involved, asset protection strategies are subject to their most rigorous test and a single member LLC standing alone will probably fail. A single member LLC when combined with a domestic or foreign asset protection trust or other entity will create further barriers, but they are only barriers – not guarantees. Turning the single

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1 C.R.S. § 7-80-101 *et seq.*

2 Treas. Reg. §301.7701-3.

3 For a more detailed discussion of this topic, *see* Lidstone, "Piercing the Veil of an LLC or a Corporation," 39 *The Colorado Lawyer*, no 8 at 71 (August 2010).

member LLC into a multi-member LLC will also have a better chance of succeeding than a single member LLC standing alone. Structuring a single member LLC with a "springing member"[4] or independent managers may also create a barrier to the creditor's ultimate goal of recovering the single member's debt from the LLC's assets.

Single Member LLCs and Liability Protection.

When considering single member LLCs, one has to analyze the risk of liability from two directions –

- Holding the member (or a manager or other person) liable for the debts incurred by the LLC, generally referred to as "piercing the veil," which is authorized by the Colorado Act,[5] but is in derogation of the basic rule that a single member LLC benefits from the liability protection available to LLCs in general.[6]

- A creditor of the single member seeking to enforce the member's debt against the assets of the LLC, generally referred to as "reverse piercing.

Creditors Remedies – Charging Orders and Foreclosure of the LLC Membership Interest.

Creditors of a person (the "debtor") who is a member of a Colorado LLC have two methods for recourse against the debtor's LLC interest – charging orders and foreclosure against the membership interest.[7]

Charging Orders. Charging orders in the LLC context are authorized by the Colorado Act as well as by the partnership statutes.[8] The Colorado Act specifically provides:[9]

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[4] A "springing member" is a person who becomes the holder of an economic interest in an LLC upon the occurrence of a specific event – such as the single member's bankruptcy or insolvency.

[5] C.R.S. § 7-80-107.

[6] C.R.S. § 7-80-705, "Members and managers of limited liability companies are not liable under a judgment, decree, or order of a court , or in any other manner, for a debt, obligation, or liability of the limited liability company." Piercing the veil is also possible to hold members or managers liable for improper distributions which will not be discussed further. C.R.S. § 7-80-606(2).

[7] Corporations are different in that under Colorado law and the laws of all of the other states but Nevada (discussed below), a charging orders are not a remedy available to a creditor of a corporate shareholder. Corporations can create a similar mandate through a properly drafted shareholders' buy-sell agreement. For a good discussion of buy-sell agreements, see Reichert and Rozansky, *The Practitioner's Guide to Colorado Business Organizations* (CLE in Colorado, Inc., supplemented through 2011) at chapter 18.

[8] Colorado has five different statutes defining charging orders, and each of the statutes is different:

- The charging order statute under the Colorado Uniform Partnership Law ("CUPL") is found in C.R.S. § 7-60-128(1);
- The charging order statute under the Colorado Uniform Limited Partnership Law is found in C.R.S. § 7-61-123(1);

> On application to a court of competent jurisdiction by any judgment creditor of a member, the court may charge the membership interest of the member with payment of the unsatisfied amount of the judgment with interest thereon and may then or later appoint a receiver of the member's share of the profits and of any other money due or to become due to the member in respect of the limited liability company and make all other orders, directions, accounts, and inquiries that the debtor member might have made, or that the circumstances of the case may require. To the extent so charged, except as provided in this section, the judgment creditor has only the rights of an assignee or transferee of the membership interest. The membership interest charged may be redeemed at any time before foreclosure. If the sale is directed by the court, the membership interest may be purchased without causing a dissolution with separate property by any one or more of the members. With the consent of all members whose membership interests are not being charged or sold, the membership interest may be purchased without causing a dissolution with property of the limited liability company. This article shall not deprive any member of the benefit of any exemption laws applicable to the member's membership interest.

In general, a charging order in a single or multi-member LLC is unattractive to creditors. A charging order places the creditor at the risk of being allocated for tax purposes income or losses of the partnership or LLC, but no right to receive any distributions. Furthermore, a charging order does not ensure that there will be any distributions even if the LLC is operating profitably with surplus cash. Whether to make distributions is usually in the discretion of the management of the LLC, and as an assignee or transferee, the holder of the charging order has no right to obtain information about the LLC or to require the payment of distributions.

A 2002 case from North Carolina demonstrates the very limited usefulness of a charging order to a creditor.[10] A bank had obtained a judgment against a debtor (Keasler) and (through an assignee) attempted to execute on Keasler's LLC interests. The court denied the request for seizure and sale of the LLC interest, but granted the assignee a charging order which provided that the LLC must deliver to the assignee any distributions and allocations to which Keasler would be entitled to receive on account of his membership interest, but that the creditor-assignee would not obtain any rights in the LLC except as an assignee without the ability to require any

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- The charging order statute under the Colorado Uniform Limited Partnership Act is found in C.R.S. § 7-62-703;
- The charging order statute under the Colorado Uniform Partnership Act ("CUPA") is found in C.R.S. § 7-64-504(1); and
- The charging order statute under the Colorado Limited Liability Company Act ("Colorado Act") is found in C.R.S. § 7-80-703.

[9] C.R.S. § 7-80-703.

[10] *Herring v. Keasler*, 563 S.E.2d 614 (N.C. App., Jun. 4, 2002), also avail. at http://www.assetprotectionbook.com/NC_Herring-Keasler_2002.htm

distributions or satisfaction of the judgment. After the North Carolina Court of Appeals' decision, the assignee's counsel observed:[11]

> The bad thing about having a charging order is that, at most, you get your principal and your interest – but only if the LLC works out until your judgment is paid. The charging order is worth less than selling the interest because you bear all the risk that the business will go bust before the judgment is paid. So it's worth much less than what you could get by selling it under an order. . . . If you're a member and manager of an LLC, you never have to give yourself a distribution or you don't have to do it until the judgment runs out. [The defendant] owns at least seven or eight LLCs that were formed years after the judgment with his assets, and I can't get to them. If they were shares in a corporation, we could sell them.

Where the charging order debtor is the sole member of a single member LLC, the likely results are similarly negative.

Foreclosure as a Remedy. It is probable that, under the Colorado Act, foreclosure of the membership interest is available to creditors, and, for single member LLCs, this provides a much more attractive remedy to creditors. Although foreclosure is not specifically authorized, foreclosure is mentioned in the third sentence of C.R.S. § 7-80-703: "The membership interest charged may be redeemed at any time before foreclosure." Where the LLC is a multi-member LLC, foreclosure is as weak a remedy as is a charging order because the transferee of the foreclosed membership interest will be treated as an assignee and not as a member of the LLC. As a result, the creditor will not have the right to participate in management of the LLC or inspect the records of the LLC.[12]

The Colorado Act provides that where the LLC has no members (such as is the case where the single member loses her membership interest through foreclosure or as a result of a conveyance to a bankruptcy trustee upon filing a petition in bankruptcy), the non-member assignees "of the last remaining member" may, by the unanimous consent of the assignees, "be admitted as a member or members."[13] This would include a bankruptcy trustee, a creditor foreclosing on the single member membership interest,[14] or an heir upon death of the single member.[15]

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[11] Quoted in Leimberg's Asset Protection Planning Email Newsletter, Archive Message #24, avail. at http://leimbergservices.com (subscription only).

[12] These rights are specifically available to members of a Colorado LLC, not assignees, unless the operating agreement provides that assignees will be admitted as members or treated as members for these purposes. *See* C.R.S. § 7-80-706 (voting) and § 7-80-408 (access to records).

[13] C.R.S. § 7-80-701(2).

[14] *See* C.R.S. § 7-80-703 which states that a judgment creditor "has only the rights of an assignee or transferee of the membership interest" and contemplates the possibility of foreclosure. In *Olmstead v. Federal Trade Commission*, ___ So.3d ___, 2010 WL 2518106 at *1 (Fla. 2010) the Florida Supreme Court (answering a question from the Eleventh Circuit) held that Florida's LLC Act's "statutory charging order does not preclude" a creditor attaching and foreclosing on a debtor's interest in a single member LLC. The Colorado Act specifically contemplates foreclosure as a remedy, unlike the Florida LLC Act.

The Colorado Act also clarifies that the voting/management rights of an LLC membership interest could not be separated from the economic interests in a manner to delay creditors. The Colorado Act provides that "a member ceases to be a member upon assignment or transfer of all of the member's membership interest."[16] Once appointing itself as member, the creditor who acquired the single member's interest as assignee could appoint itself the single member, remove the manager, and appoint itself as manager.[17] Thereafter the new member/manager could amend the operating agreement, and take other actions as a member to obtain value from the membership interest.

It is untested whether a single member LLC operating agreement can include spendthrift provisions which can then be successfully used to delay or hinder creditors. Arguably an operating agreement may also provide that the "manager cannot be removed by the members." However, ultimately the operating agreement is the agreement of all of the members,[18] and the creditor becoming the sole single member should be able to make appropriate amendments to the operating agreement.

Rationale for the Colorado Act. Generally the limited rights for a creditor under a charging order or as an assignee following foreclosure are intended to protect the rights of the other (non-debtor) members and partners.[19] Where there is only a single member, or the other members are all under the same obligation, there is no need to protect the other members since there are none.

Single Member LLC or Not?

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[15] *Movitz v. Fiesta Investments, LLC (In re Ehmann)*, 319 B.R. 200 (Bankr. D.Ariz. 2005), (decided on a motion to dismiss) holding that when a member of an LLC files for bankruptcy protection, the debtor's membership interest becomes an asset of the bankruptcy estate, entitling the estate to the rights of an assignee, including distributions. This decision was so negative for the LLC that it paid $85,000 to settle all creditor claims and all administrative costs in full. This payment was conditioned on the court's withdrawal of its earlier opinion to "eliminat[e] any precedential effect" of the earlier opinion. *In re Ehmann*, 337 B.R. 228 (Bankr. D.Ariz. 2006) *vacating* 319 B.R. 200 (Bankr. D.Ariz. 2005). *See, also, In re Modanlo*, Civ. Act 2006-1168 (Oct. 11, 2006) (US D.Ct. Md.), the Court held that since the bankruptcy trustee was the personal representative of the last remaining member, the bankruptcy trustee could (under 6 Del. C. § 18-801(a)) admit himself or nominee as a member and continue the LLC over the objections of the bankrupt debtor.

[16] C.R.S. § 7-80-702(2).

[17] C.R.S. § 7-80-402, third sentence, which provides: "Managers may be designated and removed by the consent of a majority of the members."

[18] C.R.S. § 7-80-102(11)(a).

[19] *Union Colony Bank of Greeley*, 832 P.2d 1112, 1114-15 (Colo. 1992). *See, also*, Nash and Bedingfield, *Charging Partnership and LLC Interests to Satisfy Creditors*, 23 THE COLO. L. 2743 (Dec. 1994); J. Gordon Gose, "The Charging Order Under the Uniform Partnership Act," 28 WASH. L. REV. 1 (1953).

The answer to this question seems to be obvious. A single member LLC is an LLC that has no more than one owner. There are, however, many variations on this theme which result in the question not being as easily answered.

As a matter of pure *dictum*, the Bankruptcy Court for the District of Colorado discussed the possibility of "peppercorn members" in *In re Ashley Albright*.[20] In that case, the Bankruptcy Court was confronted with a single-member LLC where the member was seeking to delay creditors as a result of her single member status. (This case was decided before the Colorado legislature amended the statute to provide that the assignee of the last member may appoint a new member, as discussed above.) Even without the current version Colorado Act, the Bankruptcy Court used its equitable powers to reverse pierce the LLC to place the trustee in control of the LLC and its assets. In its decision, however, the Bankruptcy Court addressed the possibility that it may have reached a different conclusion had there been other economic members of her LLC. Footnote 9 to the *Albright* decision stated:

> "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."[21]

Thus where a parent forms an LLC and gives small economic interests to his or her children for little or no consideration, these may be considered by a court following the *Albright dictum* as peppercorn members that do not impact the LLC's status as a single member LLC.[22] The same analysis may apply when the peppercorn members are not related.

A dual member LLC when the members are husband and wife, and both members file bankruptcy may be treated as a single member LLC. This occurred in *Scott A. Lowe and Allyson R. Lowe*.[23] Because both owners filed bankruptcy, the court ruled that "the [bankruptcy] trustee [in a chapter 7 case] does, indeed, have the member's interest. He is operating as a substitute member of [the LLC]." The court went on to say "[w]hether the trustee wishes to assert control and operate the entity, the LLC, is within the business discretion of the trustee. If it wishes to take actions in that regard, it's within the business judgment and can take the benefits or detriments of asserting such control."[24] According to the bankruptcy court, as the single member following the bankruptcy assignment by Mr. and Mrs. Lowe, the trustee had absolute control and

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[20] 291 B.R. 538 (Bankr. D. Colo. 2003).

[21] *Citing* 11 U.S.C. §§ 544(b)(1) and 548(a).

[22] *See* Allen Sparkman, *Family Business Entities: Preserving Wealth and Minimizing Taxes*, 32 THE COLO. LAW. 11 (Nov. 2003) at n. 133.

[23] *In re Scott A. Lowe and Allyson R. Lowe*, 07-10904 MER (Bankr. D.Colo.), transcript of oral ruling, Oct. 17, 2007.

[24] *In re Scott A. Lowe and Allyson R. Lowe*, 07-10904 MER (Bankr. D.Colo.), transcript of oral ruling, Oct. 17, 2007 at page 7.

the ability to determine whether to exercise that control. The bankruptcy court may have reached a different result where only one of the owners had filed for bankruptcy protection.

Under Colorado law, a person can establish an LLC with non-economic members.[25] However, non-economic members do not hold a "membership interest" in the LLC. "Membership interest" is defined to include a person's share of profits and losses and rights to distributions – characteristic of an economic interest, not a non-economic interest. If therefore there is a single economic member and one or more non-economic members, the assignee of the economic member (whether through bankruptcy or foreclosure by the economic member's creditor) may appoint itself as member.[26]

In Colorado and other states where LLCs can have non-economic members, peppercorn members, and economic but non-voting members, these variations may confuse the question whether an LLC is a single member LLC. J. William Callison, Esq. has proposed a method to determine whether an LLC should be treated as a one-person LLC or one with other significant parties in interest for which the charging order should be the sole remedy. Mr. Callison suggests that the ability of the owner to transfer its interest in the LLC to a third party without consent from other members should be the determinative factor.[27] This proposal would not only apply to single member LLCs (however defined), but also to multi-member LLCs where there are no (or limited) transfer restrictions. If there are no material transfer restrictions, there is no basis to require a charging order remedy.

There is likely to be significant discussion in forthcoming cases where an LLC, seeking to avoid the risks associated with a single member LLC, admits other members. The court's determination whether the members are "peppercorn members" or "non-economic members" should turn on the significance of the rights they have, the terms of the operating agreement, and perhaps other law, such as the Colorado Uniform Fraudulent Transfers Act.[28] In the end, Colorado courts have held that an individual should be responsible for his or her own torts and liabilities and will likely use legal or equitable arguments to achieve this result.[29]

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[25] C.R.S. § 7-80-501. Specifically the statute states that "a person may be admitted to a limited liability company as a member of the limited liability company without acquiring a membership interest in the limited liability company."

[26] The statute provides that the owner of the "membership interest from the last remaining member." C.R.S. § 7-80-701(2).

[2727] Callison, *Charging Order Exclusivity*, 66 The Bus. L. (ABA) 339 at 358 (Feb. 2011). Mr. Callison's statutory proposal for the conditional exclusivity of charging order is: "Charging orders are the exclusive remedy by which a member's judgment creditors can reach the member's interest in the [LLC]; provided, however, that if the judgment creditor can demonstrate that all or any part of the member's interest in the [LLC] can be assigned by the member to a third party without the other members' consent, then the charging order shall not be an exclusive remedy with respect to such freely assignable interest."

[28] CRS §§ 38-8-101 *et seq.* ("CUFTA").

[29] *Valley Dev. Co. v. Weeks*, 364 P.2d 730, 734 (Colo. 1961).

Asset Protection Legislation

Wyoming. In 2010, the Wyoming legislature adopted a pure asset protection amendment to its limited liability company act.[30] This amendment provides that, even in the case of a single member LLC, only a charging order is available to creditors of the single member.[31] As applicable to this discussion, in § 17-29-503(g), the Wyoming LLC Act now provides:

> This section [17-29-503] provides the exclusive remedy by which a person seeking to enforce a judgment against a judgment debtor, including any judgment debtor who may be the sole member, dissociated member or transferee, may, in the capacity of the judgment creditor, satisfy the judgment from the judgment debtor's transferable interest[32] or from the assets of the limited liability company. *Other remedies, including foreclosure on the judgment debtor's limited liability interest and a court order for directions, accounts and inquiries that the judgment debtor might have made are not available to the judgment creditor attempting to satisfy a judgment out of the judgment debtor's interest in the limited liability company and may not be ordered by the court.*[33]

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30 Wyoming L. 2010, ch. 94, § 1.

31 In its entirety, Wyo. Stat. § 17-29-503 (entitled "*Charging Orders*") now provides:

(a) On application by a judgment creditor of a member or transferee, a court may enter a charging order against the transferable interest of the judgment debtor for the unsatisfied amount of the judgment. A charging order requires the limited liability company to pay over to the person to which the charging order was issued any distribution that would otherwise be paid to the judgment debtor.
(b) Reserved.
(c) Reserved
(d) The member or transferee whose transferable interest is subject to a charging order under subsection (a) of this section may extinguish the charging order by satisfying the judgment and filing a certified copy of the satisfaction with the court that issued the charging order.
(e) A limited liability company or one (1) or more members whose transferable interests are not subject to the charging order may pay to the judgment creditor the full amount due under the judgment and thereby succeed to the rights of the judgment creditor, including the charging order.
(f) This article does not deprive any member or transferee of the benefit of any exemption laws applicable to the member's or transferee's transferable interest.
(g) This section provides the exclusive remedy by which a person seeking to enforce a judgment against a judgment debtor, including any judgment debtor who may be the sole member, dissociated member or transferee, may, in the capacity of the judgment creditor, satisfy the judgment from the judgment debtor's transferable interest or from the assets of the limited liability company. Other remedies, including foreclosure on the judgment debtor's limited liability interest and a court order for directions, accounts and inquiries that the judgment debtor might have made are not available to the judgment creditor attempting to satisfy a judgment out of the judgment debtor's interest in the limited liability company and may not be ordered by the court.

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32 Wyo. Stat. § 17-29-102(a)(xxii) defines the term "transferable interest" for the purposes of a Wyoming LLC as: "the right, as originally associated with the person's capacity as a member, to receive distributions from a limited liability company in accordance with the operating agreement, whether or not the person remains a member or continues to own any part of the right."

33 Wyo. Stat. § 17-29-503(g). Emphasis supplied.

Wyoming statutes do not provide a similar limitation for Wyoming partnerships and, in fact, specifically contemplate the right of a creditor to foreclose on a partner's transferable interest in a Wyoming partnership.[34] A "transferable interest" in a Wyoming partnership is defined as "the partner's interest in distributions."[35]

Nevada. In 2011, the Nevada legislature took the Wyoming LLC efforts toward asset protection to the derogation of the rights of creditors even further in Nevada Senate Bill 405. This bill (entitled "an act relating to business entities") amended Nevada law relating to corporations, partnerships and limited liability companies. The summary of Senate Bill 405 includes the following description of its purposes:

> "revising provisions governing the rights of a judgment creditor to satisfy a judgment out of the debtor's ownership interest in certain business entities."

There are three relevant sections in Nevada Senate Bill 405 which implement the stated purpose of the bill:

- Section 52 amended NRS § 78.746 to provide that, on application to a court of competent jurisdiction by any judgment creditor of a stockholder of a Nevada corporation, the court may charge the stockholders' stock with payment of the unsatisfied amount of the judgment with interest.

- Section 69 amended NRS § 86.401 similarly for the member's interest in an LLC formed under Nevada law.

- Section 75 amended NRS § 87A.480 similarly for a Nevada partnership interest.

In all cases, Nevada statutes now provide that the creditor so charging has only the rights of an assignee, and goes on to say:

> No other remedy, including, without limitation, foreclosure on the stockholder's stock [member's interest or partnership interest] or a court order for directions, accounts, and inquiries that the debtor or stockholder [member, or partner] might have made, is available to the judgment creditor attempting to satisfy the judgment out of the judgment debtor's interest in the corporation [LLC or partnership], and no other remedy may be ordered by the court.

The phrase "rights of an assignee" is defined in each of the sections to be "the rights to receive the share of distributions or dividends paid by the corporation [LLC or partnership] to which the judgment debtor would otherwise be entitled. The term does not include the rights to

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[34] Wyo. Stat. § 17-21-504.

[35] Wyo. Stat. § 17-21-502(a).

participate in the management of the business or affairs of the corporation [LLC or partnership] or to become a director of the corporation."[36] The Nevada limited liability company act amendment[37] states specifically that the application of this amendment applies equally to a single member LLC as to a multi-member LLC.

Kansas. In 1999 when adopting its LLC Act,[38] the Kansas legislature provided for charging orders and further provided that the rights provided by the charging order section "to the judgment creditor shall be the sole and exclusive remedy of a judgment creditor with respect to the member's limited liability company interest." Based on the language of the statute, it appears to be an asset protection provision as well notwithstanding the *Meyer v. Christie* interpretation.[39]

The Internal Affairs Doctrine. The laws in effect in Kansas, Nevada and Wyoming are draconian changes to the detriment of any contract, tort, or other creditor of an owner of a single member Wyoming LLC or any Nevada corporation, partnership, or LLC (and Kansas LLCs to the extent the Kansas charging order statute survives *Meyer v. Christie*).[40] These efforts raise some very interesting and important questions about whether other states will recognize such an extreme approach. Article IV, Section 1 of the U.S. Constitution provides that each state shall give "full faith and credit" to the "public acts, records and judicial proceedings of every other state."[41] On the other hand, the "internal affairs doctrine" is a choice of law rule which, simply stated, provides:

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[36] The limitations on the rights of an assignee are set forth elsewhere, but similarly, in the Nevada limited liability company act and the Nevada partnership laws.

[37] Section 69 of Senate Bill 405.

[38] Kansas L. 1999, ch. 119, § 52, codified at K.S.A. § 17-76,113.

[39] This section was interpreted by the federal district court of Kansas in *Meyer v. Christie*, 2011 WL 4857905 (D. Kan. Oct. 13, 2011), where the defendant argued that the Court could not enter the charging order because entry would violate the non-assignment provisions of the operating agreement. In an analysis of the Kansas statute, the Court reviewed the charging order statute and concluded that, since the statute provided that the charging order was the creditor's exclusive remedy, an operating agreement could not limit the statute in this respect. The Court then noted that the charging order makes the holder an assignee, and another provision of the Kansas LLC Act provides that the assignee of a single member LLC membership interest "shall have the right to participate in the management of the business and affairs of the limited liability company." K.S.A. § 17-76,112(f). Thus, rather than providing for a typical charging order remedy, the Kansas federal court went a step further and equated the holder of a charging order with an assignee and granted the holder of the charging order full management rights. This decision was criticized by Thomas E. Rutledge in PUBOGRAM, the Newsletter of the Committee on LLCs, Partnerships and Unincorporated Entities, vol. XXVIII, No. 4 at page 9. Mr. Rutledge noted that "The provision that the holder of a charging order has the rights of an assignee is not intended to be an affirmative grant but rather a limitation."

[40] Arguably the remedies of piercing the veil and fraudulent conveyances are still available for LLCs in Wyoming and Kansas, and corporations and LLCs in Nevada.

[41] *See* Colo. Rev. Stat. § 7-80-106 which provides the general assembly's intention that "the legal existence of [Colorado] limited liability companies . . . be recognized beyond the limits of this state and that, subject to any reasonable registration requirements, any such limited liability company be granted the protection of full faith and credit under section 1 of article IV of the constitution of the United States."

> The internal affairs of a corporation will be governed by the corporate statutes and case law of the states in which the corporation is incorporated.[42]

Colorado and many other states have extended the internal affairs doctrine to limited liability companies and other entities, as well.[43] What, however, are the internal affairs of a corporation or LLC formed under a state with asset protection provisions? The courts and the commentators generally consider the internal affairs of an entity to be matters involving voting, fiduciary responsibilities, and other potential conflicts between the owners and the managers – but not including issues surrounding the rights of third parties except where the third parties are parties to the governing agreements. As explained in the *Restatement (Second) of Conflict of Laws*, the internal affairs doctrine favors the needs of interstate and international business systems and promotes certainty, predictability, and uniformity, as well as protecting the justified expectation of the parties:

> Uniform treatment of directors, officers and shareholders is an important objective which can only be attained by having the rights and liabilities of those persons with respect to the corporation governed by a single law. To the extent that they think about the matter, these persons would usually expect that their rights and duties with respect to the corporation would be determined by the local law of the state of incorporation.[44]

It is arguable that relationships between creditors and an LLC (or a corporation, for that matter) are not within the "internal affairs" of an entity. That being the case, Colorado courts would be free to apply substantive Colorado law to the obligations of a Kansas, Wyoming or Nevada LLC or its single member to creditors. Nevertheless, this may be setting up a constitutional challenge by those who may believe that Nevada, Wyoming or Kansas law protecting the owners rather than the creditors should apply.[45]

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[42] *CTS Corp. v. Dynamics Corp. of Am.*, 481 U.S. 69, 89-90 (1987); *Edgar v. Mite Corp.*, 457 U.S. 624, 645 (1982); *Shaffer v. Heitner*, 433 U.S. 186, 215 n.44 (1977); *Rogers v. Guaranty Trust Co. of New York*, 288 U.S. 123, 130 (1933); *VantagePoint Venture Partners 1996 v. Examen, Inc.*, 871 A.2d 1108, 1116-1118 (Del. 2005); and *McDermott Inc. v. Lewis*, 531 A.2d 206, 215 (Del. 1987). Of course, Delaware has significant encouragement to expand the internal affairs doctrine as far as possible to protect the national and international applicability of the Delaware General Corporation Law to Delaware corporations. *See* Glynn, *Delaware's* VantagePoint*: the Empire Strikes Back in the Post-Post-Enron Era*, 102 Northwestern Univ. L. Rev. 91 (2008); Note, *Internal Affairs Doctrine: California versus Delaware in a Fight for the Right to Regulate Foreign Corporations*, 48 Boston Coll. L. Rev. 1047 (2008); and Beveridge, *The Internal Affairs Doctrine: The Proper Law of a Corporation*, 44 Bus. L. (ABA) 692 (1988).

[43] Colo. Rev. Stat. § 7-90-805(4) provides that "As to any foreign entity transacting business or conducting activities in this state, the law of the jurisdiction under the law of which the foreign entity is formed shall govern the organization and internal affairs of the foreign entity and the liability of its owners and managers."

[44] *Restatement (Second) of Conflict of Laws*, § 302(2), cmt. e; *see also* cmt. g.

[45] In his paper presented to the Colorado Bar Association 2011 Real Estate Symposium, Beat U. Steiner, Esq. raised the question: "if you form a single member LLC in a jurisdiction that expressly provides for a charging [order] as an exclusive remedy and does not provide for foreclosure (i.e. not Colorado), will a Colorado court follow the law of the state where the LLC is organized or Colorado law?" Steiner, *Colorado Limited Liability Entities: Qualities, Quirks & Queries*, § III.C.4 at page 14.

Conclusion

In Colorado and many other states, a limited liability company operating agreement is the agreement of the members and may include as parties other persons, such as lenders.[46] The statutes authorizing limited liability companies are generally contractarian – meaning that the parties to the operating agreements must "scriven with precision."[47]

Based on the Colorado statutes and the case law, single member LLCs standing alone do not provide significant protection to the member from the claims of the member's creditors. Additional protection can be added where the single member is itself a multi-member LLC or owned by a foreign or domestic trust, but in all cases the formalities of the arrangement must be honored. "Peppercorn members" (in the *Ashley Albright* sense), non-economic members, or a failure to follow the formalities required by the operating agreement or the entity structure will give a court a reason to ignore the separateness of the LLC to the detriment of the economic and non-economic members. The effect that the Wyoming and Nevada legislation may have on this analysis is yet to be determined, but as discussed above, Colorado courts are unlikely to respect the efforts to protect single member LLCs from the creditors of the single member regardless of the asset-protection provisions found in the organizational statute for the single member LLC.

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[46] C.R.S. §7-80-102(11).

[47] *Willie Gary LLC v. James & Jackson, LLC*, 2006 WL 75309, at *2 (Del.Ch.Ct. Jan. 10, 2006), affirmed *sub nom. James & Jackson, LLC v. Willie Gary LLC*, No. 59-2006 (Del. Sup. Ct. Mar. 21, 2006). There the issue was a dispute resolution clause which the court found was "unwieldy" but sufficiently clear to deny a motion to dismiss for arbitration of the claims. *See, also*, Kleinberger, "*Careful What You With For – Freedom of Contract and the Necessity of Careful Scrivening*" XXIV Pubogram 19 (October 2006), available at http://ssrn.com/abstract=939009.

