PROTECTING LLC ASSETS: UNDERSTANDING CHARGING ORDERS AND ASSET PROTECTION STRATEGIES

By

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I. INTRODUCTION: PROTECTING LLC ASSETS IN A LITIGIOUS WORLD

Last year, we delved into the essential clauses that every LLC operating agreement must have to ensure smooth governance, effective dispute resolution, and the long-term success of your business. We focused on the foundational principles that protect the integrity of the LLC structure.

This year, we shift our focus to an equally critical aspect of LLC management—protecting the assets of the LLC and its members from external threats, particularly through the strategic use of charging orders and other asset protection strategies. In today's increasingly litigious environment, it is imperative to understand how to safeguard your LLC's assets from creditors and how the law, specifically in Virginia, provides mechanisms to shield these assets effectively.

Asset protection strategies are vital for safeguarding the interests of LLC members and ensuring that the LLC can continue operating even when individual members face personal financial difficulties. Without proper protection mechanisms, a creditor could potentially disrupt the operations of an LLC, jeopardizing its assets and the livelihoods of its members. Thus, understanding and implementing robust asset protection measures is not just advisable—it is essential.

The concept of charging orders, while seemingly straightforward, involves complexities that can have significant implications for LLC members. Whether you are defending against a creditor's claim or advising on the structure of an LLC to minimize exposure, a deep understanding of charging orders and the available asset protection strategies is essential. Today, we will explore these tools in detail, ensuring that you leave with practical strategies to implement in your own practices.

II. CHARGING ORDERS

A. WHAT ARE CHARGING ORDERS?

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A charging order is a legal remedy that allows a creditor to claim the distributions that an LLC member would otherwise receive, but without granting the creditor any rights to the management or assets of the LLC. In essence, a charging order acts as a lien on the debtor-member's interest in the LLC, providing a way for creditors to collect on their judgments without disrupting the operations of the LLC or other members' interests.

In Virginia, the legal foundation for charging orders is found in the Virginia Limited Liability Company Act (VLLCA), specifically under § 13.1-1041.1. This statute establishes that a charging order is the "exclusive remedy" by which a judgment creditor of an LLC member may satisfy a judgment out of the debtor's membership interest. This provision underscores the protective nature of LLCs, prioritizing the continuity of the business and the interests of non-debtor members over the claims of outside creditors.

The concept of charging orders is rooted in the need to balance the interests of creditors with the protection of LLC assets. While creditors are entitled to seek repayment of debts, the law in Virginia has long recognized the importance of protecting the operations of LLCs from the direct impact of such claims. This protection ensures that the LLC's business can continue unimpeded by the financial troubles of any single member.

- **Protection for LLCs:** Charging orders prevent creditors from seizing LLC assets or interfering with the management of the LLC. This ensures that the day-to-day operations of the LLC remain uninterrupted, protecting the interests of all members, not just those facing creditor claims.
- **Limitation on Creditors' Rights:** Creditors with a charging order are limited to receiving any distributions that the debtor-member would have received. However, they do not gain any voting rights, management authority, or access to the LLC's financial or operational records. This limitation is crucial in maintaining the separation between the debtor's personal financial issues and the LLC's business activities.
- **Encouraging Settlement:** The restrictive nature of charging orders often incentivizes creditors to settle rather than endure the potentially long and uncertain process of waiting for distributions. Since LLCs can often defer distributions, creditors may find that pursuing a charging order yields little immediate benefit, leading them to negotiate alternative arrangements.

B. VIRGINIA CODE § 13.1-1041.1

Statute governs a lot of charging order limitation and procedure, with Virginia's § 13.1-1041.1 being the main provision that applies for LLCs. This provision states:

1. A court having jurisdiction may charge the transferable interest of a judgment debtor to satisfy the judgment, but the judgment creditor only has the right to receive distributions to which the judgment debtor would otherwise have been entitled with respect of the interest. (Section A)

2. A charging order is a lien on the judgment debtor's transferable interest in the LLC (Section B)
3. Charging order does not deprive the member or member's assignee of a right under exemption laws with respect to the debtor's interest in the LLC (Section C)
4. Charging order is the exclusive remedy for a judgment creditor can satisfy a judgment out of the judgment debtor's transferable interest in the LLC (Section D)
5. No creditor of a member or a member's assignee shall have any right to obtain possession of, or legal or equitable remedies with respect to the property in the LLC (Section E)

C. LIMITATIONS AND SCOPE IN VIRGINIA

While charging orders are a powerful tool for protecting LLC assets, they are not without limitations. Understanding these limitations is essential for both LLC members and their legal advisors:

1. **No Direct Access to LLC Assets:** A creditor with a charging order cannot directly seize LLC assets. Their right is strictly limited to receiving any distributions made to the debtor-member. This means that the LLC's assets, including real estate, cash reserves, and intellectual property, remain protected from creditor claims.
2. **No Influence on LLC Management:** The creditor cannot use the charging order to influence the management or decision-making processes of the LLC. This includes having no say in when or if distributions are made. As a result, the other members of the LLC retain full control over the business, ensuring that the creditor's involvement is minimal.
3. **Potential for Limited Recovery:** In some cases, an LLC may choose to withhold distributions indefinitely, particularly if doing so aligns with the best interests of the business. This can severely limit the creditor's ability to recover the full amount of their judgment, making charging orders a less attractive option for creditors.
4. **Non-Transferability:** A charging order does not transfer any of the debtor-member's actual membership interest to the creditor. If the debtor-member's interest is eventually sold or transferred, the charging order may be satisfied, but the creditor does not gain membership in the LLC or any control over its assets.

D. COPE (CHARGING ORDER PROTECTED ENTITY.

COPE (Charging Order Protected Entity) LLCs offer robust protection against creditors. The COPE LLC is not just designed to protect members from liability for the LLC (as with all LLCs), but also to protect the assets inside the LLC from being affected by the indebtedness of any member.

COPE protection does not stem from the creation of a certain type of LLC but rather the protection of laws in certain jurisdictions, including Virginia. In Virginia, a judge will give an order charging a debtor to pay creditors from the distributions of the LLC, but not allow the creditor to foreclose on or dissolve the entity to get at the asset.

There are about 20 states who have COPE laws, including NV, AZ, and VA. These states thus offer stronger asset protections in LLCs. In some states, like CO, courts are more likely to allow foreclosure on single member LLCs (291 B.R. 538 (Bankr. D. Colo. 2003).

E. CHARGING ORDERS AND PARTNERSHIPS

Under Virginia law, charging orders are a legal remedy not only applicable to LLCs but also to partnerships, as outlined in Virginia Code § 50-73.46:1. This statute provides a structured mechanism by which judgment creditors can seek to satisfy a debt by charging a partner's transferable interest in a limited partnership. The statute is designed to balance the interests of creditors seeking to enforce a judgment and the protection of the partnership's operations and assets.

> Partner's transferable interest subject to charging order.
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> A. On application by a judgment creditor of a partner or of a partner's assignee, a court having jurisdiction may charge the transferable interest of the judgment debtor to satisfy the judgment. To the extent so charged, the judgment creditor has only the right to receive any distribution or distributions to which the judgment debtor would otherwise have been entitled in respect of the interest.
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> B. A charging order constitutes a lien on the judgment debtor's transferable interest in the limited partnership.
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> C. This chapter does not deprive a partner or a partner's assignee of a right under exemption laws with respect to the judgment debtor's interest in the limited partnership.
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> D. The entry of a charging order is the exclusive remedy by which a judgment creditor of a partner or of a partner's assignee may satisfy a judgment out of the judgment debtor's transferable interest in the limited partnership.
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> E. No creditor of a partner or of a partner's assignee shall have any right to obtain possession of, or otherwise exercise legal or equitable remedies with respect to, the property of the limited partnership.

III. MECHANICS OF CHARGING ORDERS.

The process of obtaining a charging order in Virginia is straightforward but requires a clear understanding of the legal procedures and the strategic implications for both creditors and LLC members.

A. LEGAL PROCEDURE FOR OBTAINING A CHARGING ORDER

- **Securing a Judgment.** A creditor secures a judgement and seeks to satisfy the judgement via the debtor's partnership or LLC interest. There can be no charging order without a judgement.
- **Filing a Motion:** The creditor must file a motion in the court where the judgment was entered, requesting a charging order against the debtor-member's interest in the LLC. This motion should detail the amount of the judgment and identify the specific membership interest to be charged.
- **Notice to Debtor-Member:** The debtor-member must be notified of the motion and given an opportunity to respond. This ensures that the member is aware of the creditor's actions and can prepare any defenses or objections.
- **Court Issuance of the Charging Order:** Upon reviewing the motion and any responses, the court may issue a charging order. The order effectively directs the LLC to divert any distributions owed to the debtor-member to the creditor instead, up to the amount of the judgment.
- See Index A for a Form Charging Order and a real case example

B. ENFORCEMENT OF CHARGING ORDERS

- **LLC's Role in Enforcement:** Once a charging order is issued, the LLC is legally obligated to comply by redirecting distributions that would otherwise go to the debtor-member. Failure to do so can result in the LLC being held in contempt of court.
- **Duration of the Charging Order:** A charging order remains in effect until the judgment is fully satisfied or the court orders otherwise. During this time, the creditor has the right to receive any distributions made to the debtor-member.
- **Challenges in Enforcement:** Creditors may face challenges in enforcing charging orders if the LLC opts to defer distributions or if the debtor-member has limited rights to distributions under the operating agreement. These challenges highlight the importance of understanding the debtor-member's financial entitlements within the LLC.

C. IMPACT ON DISTRIBUTIONS AND MANAGEMENT RIGHTS

Charging orders are specifically designed to impact a debtor-member's financial rights without interfering with the management or governance of the LLC. This section explores how charging orders affect distributions and what rights creditors do—and do not—acquire through this remedy.

1. **Effect on Distributions**

    - **Redirection of Distributions:** Once a charging order is in place, any distributions that would normally be made to the debtor-member must be paid directly to the creditor. This can include profits, dividends, or any other form of financial distribution.

    - **Deferred Distributions:** LLCs have the option to withhold or defer distributions if such actions are justified under the operating agreement. In some cases, LLCs may choose to reinvest profits into the business or retain earnings, delaying any payments that might otherwise satisfy the charging order.

2. **No Impact on Management and Voting Rights**

    - **Management Rights Remain Intact:** A key feature of charging orders is that they do not grant the creditor any management rights in the LLC. The creditor cannot participate in decision-making, vote on LLC matters, or influence the direction of the business.

    - **No Access to LLC Records:** Creditors with a charging order do not have the right to inspect the LLC's financial or operational records. Their involvement is limited solely to receiving distributions, ensuring that the internal workings of the LLC remain confidential and under the control of its members.

    - **Protection for Other Members:** By limiting the creditor's rights to distributions only, charging orders protect the interests of other LLC members. This protection ensures that the personal financial troubles of one member do not jeopardize the stability or operations of the entire LLC.

IV. COMPARISON: LLC CHARGING ORDERS vs CORPORATIONS

Unlike corporations, creditors cannot directly force the sale of a member's ownership interest in a Virginia LLC. However, as stated previously, creditors can levy upon monetary distributions that the LLC makes to the individual debtor/member.

Under Va Code § 8.01, creditors may be able to foreclose on or force the sale of shares in a corporation. See In re Cutright, 2012 Bankr. LEXIS 2419 (Bankr. E.D. Va. May 30, 2012). The court may appoint a receiver under § 13.1-748 to market and sell those shares. The proceeds from the sale go toward satisfying the creditor's judgment and any remaining funds after the judgment is fully satisfied are returned to the debtor. However, the damage has already been done at that point, as the debtor was unable to protect the assets (the shares) and they no longer own shares in the corporation. The only wrinkle to this sale doctrine, is that there may be restrictions on transfers (§ 13.1-649) of the corporate shares, which can make it more difficult for creditors to cash out.

A. IMPLICATIONS FOR BUSINESS STRUCTURING

- For business owners prioritizing asset protection, an LLC is generally more advantageous than a corporation. The charging order mechanism, combined with the ability to include protective clauses in the operating agreement, provides a stronger shield against creditor claims compared to the remedies available to creditors of corporate shareholders.

- LLCs allow members to retain control over the business even in the face of creditor claims, as creditors are excluded from management and decision-making. In contrast, the forced sale of corporate shares can lead to a loss of control, particularly if a significant portion of shares is seized by creditors.

- The flexibility offered by LLCs in terms of management structure, distribution of profits, and asset protection measures makes them an attractive option for small businesses and family-owned enterprises. However, corporations might be preferred in scenarios where the business seeks to raise capital through the sale of shares or plans to go public in the future.

B. CASE LAW EXAMPLES: [See Index C]

1. Eileen E. Bildman, et al. v. Ronald C. Devine, et al., Case No. CL 2018-0010192.
   - Plaintiffs sought a charging order under Virginia Code §§ 13.1-1041.1 and 50-73.46:1, requesting that the court impose a lien on Defendant's membership interests in the LLCs. Additionally, the Plaintiffs requested that the court require these LLCs to provide regular financial reports to monitor potential distributions.
   - The court denied Plaintiffs' request for additional remedies beyond the standard charging order lien. Specifically, the court ruled that it lacked the authority under Virginia law to require the LLCs to provide regular financial reports to the judgment creditors. According to the court, the charging order remedy is limited to receiving distributions and does not extend to obtaining financial reports or exerting influence over the LLC's operations.

- "*Regardless, the Court's actions are limited to charging the transferable interest in the LLC. Virginia law clearly states that "[n]o creditor of a partner or a partner's assignee shall have any right to obtain possession of, or otherwise exercise legal or equitable remedies with respect to, the property of the limited partnership". Virginia Code § 50-73.46:1(E). As such, strictly construed, Virginia's LLC laws would not allow the Court to charge outside the scope of transferable interest with respect to the property of the LLC. The Court would not be able to order the LLC to provide judgment creditors with regular financial reports as that would go beyond the language of the statute*."

2. First Union National Bank of Virginia v. Nancy Craun, 853 F. Supp. 209 (W.D. Va. 1994)
   - In this case, the court dealt with the priority of charging orders over other secured interests. The court held that a charging order does not automatically take priority over a perfected security interest if the security interest was perfected before the charging order was entered. The case involved the defendant's limited partnership interests in two Virginia limited partnerships, and the court concluded that the charging order would not override the priority of an existing perfected security interest. This case underscores the importance of the timing of both charging orders and the perfection of security interests, highlighting that a charging order alone may not always be sufficient to secure priority over other claims.
   - *"Under Virginia law, charging order, without more, does not take priority over security interest perfected after judgment but before entry date of charging order."*

V. STRUCTURING LLCs TO MINIMIZE CREDITOR ACCESS

Proper structuring of an LLC is essential to limit exposure to creditors and protect the assets of both the LLC and its members. By following best practices in structuring, members can ensure that their personal and business assets are shielded from potential claims.

1. Segregating Business Activities

- One of the most effective strategies is to create separate LLCs for different lines of business. For example, if a business owner operates both a real estate investment firm and a consulting practice, each should be placed in a separate LLC. This way, if one business faces a lawsuit or creditor claim, the assets of the other business remain protected.

2. Asset Holding LLCs.

- Another strategy is to use a separate LLC solely for holding valuable assets, such as real estate or intellectual property. The operating business can lease or license these assets from the holding LLC. This structure protects the assets from any claims against the operating business, as the holding LLC's assets are not directly involved in business operations.

3. Using Multiple Members in an LLC.

- Single-member LLCs are often more vulnerable to creditor claims, as courts may disregard the LLC's separate legal status under the "alter ego" theory, especially if formalities are not observed. This makes it easier for creditors to pierce the corporate veil and attach personal assets. Furthermore, courts have, in some cases, allowed creditors to foreclose on the debtor's entire membership interest, effectively dissolving the LLC.

- Having multiple members can provide a stronger defense against creditor claims. In a multi-member LLC, creditors can generally only obtain a charging order, which entitles them to the debtor-member's distributions but does not allow them to participate in management or access the LLC's assets. This limitation reduces the creditor's leverage and protects the other members' interests.

- Multi-member LLCs also allow for creative structuring, such as granting different classes of membership interests, which can further shield assets.

4. **Series LLCs in Virginia**

- As of July 1, 2020, Virginia introduced the Series LLC as part of its legal entity landscape, modeled on the Uniform Protected Series Act. A Series LLC in Virginia functions as a single entity with one or more "series" that operate as separate legal persons, distinct from the parent LLC and from each other.

- A key feature of Series LLCs is the ability to hold assets and incur liabilities in each individual series, separate from the other series and the parent LLC. This segregation is critical for protecting the assets of one series from the creditors of another.

- To maintain liability protection, both the Series LLC and each individual series must maintain records that clearly distinguish the assets and liabilities of each series. This detailed record-keeping is essential for preserving the legal protections afforded by the Series LLC structure.

- **Limitations in Mergers and Bankruptcy**: Unlike traditional LLCs, individual series within a Series LLC in Virginia are generally prohibited from participating in mergers, reorganizations, conversions, and domestications independently of the parent LLC. Additionally, the treatment of Series LLCs in bankruptcy remains uncertain, posing potential risks for businesses considering this structure.

VI. OPERATING AGREEMENTS - DRAFTING CONSIDERATIONS

An LLC's operating agreement is a critical document that outlines the governance, financial arrangements, and operational procedures of the LLC. It also serves as a key tool for asset protection, particularly against creditor claims. Including specific protective clauses can help ensure that the LLC and its members are shielded from external threats.

The operating agreement should be tailored to address the specific risks faced by the LLC and its members. This includes incorporating clauses that restrict the transfer of membership interests, limit creditor rights, and define the procedures for handling disputes. Here are some examples:

1. Pre-existing Security Interest Clauses

The pre-existing security interest clause grants the LLC a security interest in the membership interest of each member as soon as the operating agreement is executed. This lien takes priority over any subsequent claims by outside creditors.

When a creditor attempts to obtain a charging order, the security interest held by the LLC must first be satisfied before the creditor can claim any distributions. This can deter creditors from pursuing claims against LLC members, knowing that the LLC's interests come first.

Sample Clause Language: "To further protect the assets of the LLC, each Member hereby grants to the LLC a security interest in their respective membership interest. The LLC may file a UCC-1 financing statement to perfect this security interest. In the event that a Member's interest becomes subject to a charging order or other creditor claim, the LLC's security interest shall be satisfied in full before any distributions are made to satisfy the creditor's claim."

It is crucial to ensure that the automatic security interest is properly documented and that any necessary filings, such as a UCC-1 financing statement, are made to perfect the security interest. This will strengthen the LLC's position in the event of a creditor dispute.

2. Member Loan Back Provisions

Member loan back provisions offer an innovative way for an LLC to help a member satisfy a creditor's claim without exposing the LLC's assets directly. Under this provision, the LLC may offer to loan the debtor-member an amount equal to the fair market value of their interest in the LLC. The loan is secured by the member's interest in the LLC, and the proceeds are used to satisfy the creditor's claim.

The loan is typically structured with commercially reasonable interest rates and repayment terms. The member remains liable for the repayment of the loan to the LLC, which helps preserve the LLC's financial integrity while protecting its assets from external claims.

Sample Clause Language: In the event that a Member's interest in the LLC becomes subject to a charging order or other adverse claim, the LLC may, at its discretion, offer to loan the affected Member an amount equal to the fair market value of the Member's interest, secured by the Member's interest in the LLC. The loan shall bear interest at a commercially reasonable rate and shall be repayable according to terms determined by the LLC. The loan proceeds shall be used by the Member to satisfy the creditor's claim, thereby protecting the LLC's assets.

3. **Distribution in Kind Clauses**

These clauses give the LLC the option to make distributions in the form of non-liquid assets, such as real property or equipment, instead of cash. This can reduce the creditor's incentive to pursue a charging order, as non-cash assets are often more difficult to liquidate or value.

Sample Clause Language: If a Member's interest in the LLC becomes subject to a charging order, the LLC may, at its sole discretion, make distributions to the affected Member in the form of non-liquid assets, including but not limited to real property, equipment, or other tangible assets. Such distributions shall be deemed to satisfy the LLC's obligations to the Member for the purposes of this Agreement.

4. **Discretionary Distribution Schedule**

This clause grants the Manager sole and absolute discretion to determine if and when distributions will be made to members. The Manager can choose to defer distributions or reinvest the funds back into the business, depending on the current and future needs of the LLC. By making distributions discretionary, this clause minimizes the risk that a creditor can access LLC funds via a charging order.

Sample Clause Language: Distributions of any kind from the LLC shall be made solely at the discretion of the Manager. The Manager shall have the sole and absolute authority to decide whether any distributions will be made to the Members, and if so, the amount and timing of such distributions. The Manager may defer distributions or choose to reinvest such funds into the LLC's operations or hold them in reserve as deemed appropriate. Members shall have no entitlement to distributions unless and until the Manager determines that such distributions shall be made.

Note that careful drafting of this clause is essential, as a minority member who is not receiving distributions may have a claim under the operating agreement or as an oppressed minority member if the majority refuses to make profit distributions.

This also raises the issue of phantom income, which occurs when the LLC earns a profit, and that profit is allocated to the members based on their ownership percentages, but the Manager decides not to distribute those profits as cash to the members. Despite not receiving any cash, the members are still responsible for paying income taxes on their share of the LLC's profits because, for tax purposes, it is considered income that has been earned.

For example, if an LLC earns $100,000 in profit and has two members, each owning 50%, each member would be allocated $50,000 of that profit. If the Manager decides to reinvest all $100,000 back into the business rather than distribute it, each member still owes taxes on the $50,000 allocated to them, even though they didn't actually receive any cash. This tax liability on income that hasn't been distributed is what is referred to as "phantom income."

VII. EXECUTORY VS. NON-EXECUTORY CONTRACTS IN THE CONTEXT OF CHARGING ORDERS AND BANKRUPTCY

Understanding whether a contract is executory or non-executory is critical when an LLC is dealing with bankruptcy, particularly when considering the implications of charging orders. A charging order is a remedy that creditors use to attach the debtor's interest in an LLC. In the context of bankruptcy, the distinction between executory and non-executory contracts can significantly influence how charging orders are handled (See Index D).

A. Relevance of Executory Contracts in Bankruptcy

An executory contract is one where both parties have significant, unperformed obligations at the time of the bankruptcy filing. Under Section 365 of the Bankruptcy Code, the bankruptcy trustee has the option to assume or reject these contracts. This power allows the trustee to continue beneficial contracts or terminate those that are burdensome to the bankruptcy estate.

If an LLC's operating agreement or another contract related to the LLC is deemed executory, the trustee's decision to assume or reject the contract can affect the creditor's ability to enforce a charging order. Specifically, if the contract is rejected, the debtor's obligations under that contract are effectively terminated, which could limit the assets available to satisfy a charging order.

For instance, in In re Ehmann, if the LLC's operating agreement had been deemed executory, Section 365(e)(2) could allow state law or contract-based restrictions to limit the trustee's powers, potentially preserving limitations on charging orders. However, if deemed non-executory, Section 541(c)(1) would override such restrictions, allowing the trustee to ignore these limitations, which could expose more assets to the reach of creditors via charging orders.

Furthermore, in In re Bootjack Dairy M&D, LLC, the court considered whether the LLC could reject a Purchase and Sale Agreement (PSA) as an executory contract upon filing for bankruptcy. Although the court ruled against the rejection due to the LLC's financial health, had the LLC been allowed to reject the PSA, the impact on creditors holding charging orders could have been significant. The rejection could diminish the value of the debtor's estate, thereby reducing the assets available to satisfy any charging orders.

B. Non-Executory Contracts and Their Impact on Charging Orders

In contrast, non-executory contracts are those where the primary obligations have already been fulfilled by one or both parties. Since these contracts are not subject to the assumption or rejection process under Section 365, they become part of the bankruptcy estate as is.

When an LLC's contract is deemed non-executory, it is automatically included in the bankruptcy estate under Section 541. This inclusion means that the trustee has control over the debtor's interest in these contracts, and restrictions on charging orders may be lifted. This situation could increase the creditor's ability to enforce a charging order against the LLC member's interest.

For example, in Davis v. Cleve Marsh Hunt Club, only the land interest sale was considered executory, while the right-of-way was non-executory. If the right-of-way had been subject to a charging order and the LLC filed for bankruptcy, the trustee's control over that non-executory contract could enable the creditor to more easily collect on the judgment.

C. Strategic Considerations for LLCs and Creditors

LLCs Evaluating Contracts Pre-Bankruptcy: LLCs facing potential bankruptcy should assess whether their key contracts are executory or non-executory. Executory contracts offer the possibility of renegotiation or rejection, which can be used strategically to limit exposure to charging orders and protect the LLC's assets. However, non-executory contracts automatically enter the bankruptcy estate, potentially increasing the risk that creditors can enforce charging orders against the LLC's interests.

Creditors' Perspective: Creditors should carefully evaluate the nature of the LLC's contracts when considering a charging order. If a key contract is executory, the creditor's ability to collect may hinge on the trustee's decision to assume or reject the contract. Conversely, if the contract is non-executory, the creditor might have a stronger position to enforce a charging order, as the contract's obligations will continue as part of the bankruptcy estate.

The distinction between executory and non-executory contracts is crucial in the context of bankruptcy and charging orders. LLCs can use the executory status of contracts strategically to protect their assets in bankruptcy, while creditors must consider the nature of these contracts when pursuing charging orders. Understanding the interplay between these contracts and the provisions of the Bankruptcy Code can significantly impact the outcome for both debtors and creditors.

Some general case law examples of executory contracts are listed in Index D.

VIII. FRADULENT CONVEYANCE

A. WHAT IS A FRAUDULENT CONVEYANCE?

When transferring assets to and from LLCs, one must keep the doctrine of fraudulent conveyance in mind. In Virginia, fraudulent conveyance is a transfer of property made with the intent to hinder, delay, or defraud creditors. The relevant statutes governing fraudulent conveyances in Virginia are found in §§ 55.1-400 to 55.1-404 of the Virginia Code. These provisions outline what constitutes a fraudulent conveyance and provide the legal framework for addressing such actions. Fraudulent conveyances are defined and described in § 55.1-400 to § 55.1-404 of the Va. Code. These provisions generally state:

- § 55.1-400
  - Defines what constitutes a fraudulent conveyance: A gift, conveyance, assignment, or transfer of, or charge upon, any estate, real or personal, made with intent to delay, hinder, or defraud creditors.
- § 55.1-401
  - If a transferor is insolvent at the time a transfer is made, without valuable consideration, then the transfer shall be voidable by prior creditors. This section does not require finding of an intent to hinder, delay or defraud on the part of the grantor or grantee.
- § 55.1-402
  - A complaint can be filed by a creditor to set aside a conveyance, declared void by Sections 55.1-400 or 55.1-401, before obtaining judgment or decree. Thus, a potential creditor need not wait until the underlying legal action has run its course before filing suit to challenge a debtor's conveyance.
- § 55.1-403
  - In any action brought by a creditor pursuant to Section 55.1-400 or 55.1-402, where a conveyance is declared void, the court "shall award counsel for the creditor reasonable attorney fees against the debtor." Furthermore, upon a finding of fraudulent conveyance pursuant to Section 55.1-400, the court may assess sanctions (including attorney fees) against all parties who participated in the conveyance
- § 55.1-404
  - A court may set aside a fraudulent conveyance or voluntary transfer pursuant to Section 55.1-400 on "its own motion, provided that all parties who have an interest in the property subject to the conveyance or transfer are given notice of the proceeding."

- Statute of Limitations
  - Under Virginia law, a fraudulent conveyance has no specific statute of limitations but is governed by the concept of Laches. Laches is defined as the neglect or failure to assert a known right or claim for an unexplained period of time under circumstances prejudicial to the adverse party. See In re: Porter, 37 B.R. 56, 66 (E.D. Va.1984).
  - However, under Virginia law, a voluntary conveyance has a statute of limitation of five years. Va. Code § 8.01-253

B. VOLUNTARY VS. FRAUDULENT CONVEYANCES

Not all transfers of assets from an LLC are fraudulent. Despite the above, merely gifting something to a loved one from an LLC is not necessarily a fraudulent conveyance. A voluntary conveyance is the transfer of property from one party to another without consideration or for nominal consideration. This type of transfer is typically done as a gift or for estate planning purposes. In a voluntary conveyance, the transferor does not intend to defraud creditors; the intent is usually benevolent, such as to provide for family members. As a result, voluntary conveyances are generally legal and valid as long as they do not harm creditors. Unlike fraudulent conveyances, there is a statute of limitations (SOL) for challenging voluntary conveyances. § 8.01-253 applies: A lawsuit to void must be filed within five years of recording or discovery.

As previously stated, a fraudulent conveyance is a transfer of property made with the intent to hinder, delay, or defraud creditors. This type of transfer is designed to put assets beyond the reach of creditors, often when the debtor is insolvent or facing significant financial difficulties. The primary purpose of the transfer is to avoid paying debts or fulfilling obligations to creditors. Similar to voluntary conveyances, fraudulent transfers often involve inadequate or no consideration.

C. TYPES OF FRAUDULENT CONVEYANCE

There are two types of fraudulent conveyances: actual fraud and constructive fraud.

Actual fraud (fraud in fact) is the intentional transfer of property to defraud creditors. The circumstances surrounding the conveyance are not such that the law conclusively infers a fraudulent intent from them, but where the parties have actually intended to delay, hinder or defraud the creditors or purchasers. Arias v. Jokers Wild, 73 Va. Cir. 281, 302 (Cir. Ct. 2007).

Constructive fraud (fraud in law) occurs when: The law itself conclusively infers the fraudulent intent from the intrinsic nature of the circumstances without an inquiry into the actual intent of the parties to the transaction. Arias v. Jokers Wild, 73 Va. Cir. 281, 302 (Cir. Ct. 2007).

D. HOW COURTS EVALUATE FRAUDULENT CONVEYANCES

Courts look to enumerated badges of fraud as a part of a totality of the circumstances analysis to determine if a conveyance was fraudulent. In a suit to set aside a fraudulent conveyance, proof of the fraudulent intent must be "clear, cogent and convincing." Hutcheson v. Savings Bank of Richmond, 129 Va. 281, 289 (1921). However, because "of the difficulty of establishing 'actual intent,' evidence of fraud may be, and generally must be, circumstantial." In re: Porter, 37 B.R. at 63. Once a party introduces evidence to establish a badge of fraud, "the burden shifts, and the defendant must establish the bona fides of the transaction." First National Bank of Bluefield v. Pressley, 176 Va. 25, 28 (1940). While there are many badges of fraud, some of the main factors than Virginia courts look to are:

- Relationship of the Parties
  - If the parties are related then the court will likely scrutinize the transfer closely. However, the relationship itself is not conclusive evidence of a fraudulent conveyance as family members are allowed to conduct business with each other. Johnson v. Lucas, 103 Va. 36 (1904).
  - Hutcheson v. Savings Bank, 129 Va. 281 (1921)
    - The relationship of a father and son did not constitute a badge of fraud when they did business with each other
    - But, the Court scrutinized that the father and son did not complete the subject transaction in traditional manner:
    - No payments were ever made to the father.
    - The transaction debts were not listed on the son's subsequent bankruptcy filing.
    - Court determined this was a fraudulent conveyance.
- Grantor's Insolvency
  - The mere fact that an insolvent debtor makes a conveyance is not conclusive evidence that the debtor perpetrated a fraud upon his creditors. See McClintock v. Royall, 173 Va. 408 (1939)
  - Bank of Commerce v. Rosemary & Thyme, Inc., 218 Va. 781(1978)
    - In the case of insolvency, transactions in which the party that received payment was aware of the transaction's fraudulent nature are likely to be deemed fraudulent conveyances
    - However, the mere fact of payment of a valid debt by an insolvent corporation was insufficient to make the payment fraudulent even if it had the incidental effect of releasing other creditors
- Pursuit by Creditors
  - The badges of fraud have been implicated when there was threat of litigation by creditors at the time of the transfer, in addition other elements of fraud. See Westwood Bldgs. Ltd. P'ship v. Grayson, 96 Va. Cir. 312 (Fairfax County 2017)

- Lawyers Title Ins. Corp. v. P.R.T. Enters., 65 Va. Cir. 271, 276 (2004)
  - The more that is owed, the more the strict the court will be in applying this factor. This is because more money owed means there is more motive to defraud or hinder creditors. For example, in this case the debtor admitted to owing millions of dollars, putting them in a precarious financial situation.
  - The timeline of events (when the conveyance happened in relation to the pursuit or notification of/by creditors) is also scrutinized.
  - The court will also investigate if the property was concealed from Creditors.

- Lack of Consideration
  - Mere inadequacy of price is not grounds for setting aside a conveyance, unless so gross as to shock the conscience and furnish decisive evidence of fraud. See Young v. Willis, 82 Va. 291 (1886)
  - Grayson v. Westwood Bldgs. L.P., 300 Va. 25, 859 S.E.2d 651 (2021)
    - Consideration deemed valuable at law' means, in effect, 'something,' or 'adequate consideration to support a contract.' The Va. Code's language creates a standard that requires only that something of value be exchanged and does not require equivalence."
  - Flame S.A. v. Indus. Carriers, 39 F. Supp. 3d 769, 788 (E.D. Va. 2014)
    - Any transaction must evidence fair market consideration with observance of corporate formalities and records, as opposed to parties who "intermingle their funds via sham transactions whereby funds are transferred between one company or another in disregard of corporate formalities and on an as-needed basis."
- Retention of Interest
  - If the grantor remains in possession of the property after the transfer, this is a circumstance where a fraudulent intent may be discovered. Young v. Willis, 82 Va. 291 (1886)
  - Fox Rest Assocs., L.P. v. Little, 282 Va. 277, 286 (2011)
    - In this case, a Manager of an LP was sued in a derivative action. He retained an interest in a jointly held bank account with his wife where he deposited funds from the company. He was also aware of the investor's dissatisfaction before the transfer and retained possession of office equipment that had supposedly been sold.

E. CREDITOR REMEDIES

There are limited statutory remedies available for fraudulent conveyances, but judges may grant other equitable relief in extraordinary cases. The statutory remedies are:

- The court may void the conveyance and return the fraudulently conveyed asset to the grantor. Plaintiff could then seek or try to enforce a judgement
- The court may award the plaintiff creditor reasonable attorney's fees against the debtor.
- The court may assess sanctions against anyone (parties, lawyers, professionals, etc.) who participated in the conveyance.

IX. VEIL PIERCING AND REVERSE VEIL PIERCING

A. WHAT IS VEIL PIERCING?

While LLCs offer many protections, these protections can be stripped by the courts in the case of veil piercing. veil piercing is a legal principle that allows creditors and litigants to hold shareholders or members personally liable for the debts or obligations of a corporation or Limited Liability Company (LLC) in certain circumstances.

Under Virginia law, corporations and LLCs are considered separate legal entities, distinct from their shareholders or members. This separation provides limited liability protection, shielding the personal assets of shareholders and members from the debts and obligations of the business entity (§ 13.1-1019). However, in some situations, courts may decide to pierce the corporate veil, holding shareholders or members personally liable. Virginia law treats piercing the corporate veil of traditional corporations and other limited liability entities in the same manner.

The court applies this equitable remedy when they determine that the separate legal existence of a corporation or LLC has been abused or used to perpetrate fraud, injustice, or illegal activity. This remedy is mostly governed by case law, as there is no specific veil piercing statute that lays out the criteria for when the remedy can be used.

Courts have emphasized the principle that piercing the corporate veil is an extraordinary remedy that should be applied sparingly.

B. WHAT IS REVERSE VEIL PEIRCING?

While corporate veil piercing allows creditors to hold shareholders or members personally liable for a corporation's or LLC's debts, reverse veil piercing is an inverse legal doctrine that permits creditors to reach the assets of a corporation or LLC to satisfy the personal debts of a shareholder or member (i.e., Hold a corporation liable for the debts of its owner).

Reverse veil piercing is less common than traditional veil piercing and is often viewed with skepticism by courts due to the potential for harming innocent shareholders or members. Generally, courts should consider the same factors in deciding whether to apply either doctrine

(A.G. Dillard, Inc. v. Stonehaus Constr., LLC), with a few additional factors concerning the fairness to innocent (non-debtor) members or shareholders.

X. COLLECTIONS: THE JUDGMENT PROCESS IN VIRGINIA AND ITS RELATION TO CHARGING ORDERS

As discussed earlier, forming an LLC is a powerful asset protection strategy, especially when facing potential creditor claims. However, an LLC alone cannot provide absolute protection from all creditors. Understanding the Virginia collections process that leads to judgments is crucial, as these judgments can allow creditors to gain access to certain assets of the debtor, potentially including interests in an LLC. This section delves into the judgment process in Virginia, offering insights into how creditors pursue collections and how this process interacts with charging orders, particularly in protecting LLC assets.

A. PRE-JUDGEMENT

Before a creditor can obtain a judgment, there are often preliminary steps designed to avoid litigation. Creditors typically begin by sending formal demand letters or notices to the debtor, seeking payment and sometimes negotiating settlements. However, if these efforts fail, a lawsuit becomes necessary.

B. POST JUDGEMENT DISCOVERY

Before assets can be accessed by Creditors, they must know what assets the debtor has. To aid in this inquiry, there are post-judgement discovery methods such as Debtor Interrogatories. Va. Code § 8.01-506. Debtor interrogatories are a way to get the Debtor to answer questions about the quantity and location of their assets and liabilities. If the debtor refuses to answer questions (or possibly appear) then they can be held in contempt. These interrogatories are often sent out with a subpoena duces tecum (subpoena that requires an individual to produce documents, records, or other tangible evidence for a legal proceeding.) A judgment creditor is also allowed discovery on third parties that may owe the judgment debtor money. Va. Code § 8.01-506. However, a creditor is only allowed to conduct debtor's interrogatories every six months on any one judgment debtor. Va. Code § 8.01-506.

While the charging order allows the creditor to claim distributions from the debtor's LLC interest, effective collection requires knowledge of the debtor's overall financial situation. Through post-judgment discovery, creditors can determine whether the debtor has other assets or whether the LLC is making distributions. However, because a charging order does not give the creditor access to LLC management or operational records, the creditor's ability to uncover detailed information about the LLC itself remains limited, reinforcing the protective function of charging orders.

C. COLLECTING ON A JUDGEMENT

There are three main forms of collection: Liens on real property, Levy of personal property, and Garnishment of intangible personal property.

1. Liens on Real Property

In Virginia, a judgment lien can only be attached to real estate, not personal property. Real estate encompasses the debtor's house, condo, land, or similar property interests. Creditors must record the judgment lien in the public records office of the city or county where the property is located, as judgment liens are county-specific. Once filed, the lien applies to all real property owned or later acquired by the debtor in that jurisdiction, prompting creditors to record the judgment lien in multiple counties in case the debtor acquires property elsewhere (Va. Code § 8.01-458).

In Virginia, a judgment from a circuit court is automatically recorded in the public land records where the circuit court is situated. However, for judgments from general district courts, creditors must manually record the judgment in the land records. This recorded judgment lasts for ten years and can be renewed. According to a new Virginia law effective January 1, 2022, judgments entered in a Virginia circuit court after July 1, 2021, have a 10-year limitation period and may be extended up to two additional 10-year periods, making a maximum limitation period of 30 years (Va. Code § 8.01-446).

The Uniform Enforcement of Foreign Judgments Act (UEFJA) allows creditors to enforce a judgment obtained in another state without re-litigating the entire case. This process requires proof of the judgment, the debtor's last known address, and any applicable filing fees. Most states, including Virginia, D.C., and Maryland, have adopted the UEFJA, with California and Vermont being notable exceptions. Enforcing a judgment in another state under the UEFJA enables the creditor to attach a judgment lien to the debtor's property in that state.

Creditors may wait for the debtor to sell the property or another creditor to initiate foreclosure by filing a "Creditor's Bill in Equity." Once a judgment attaches, it accrues interest at the judgment rate of 6% (Va. Code §6.2-302). Creditors can also begin the costly foreclosure process, involving a lawsuit with all interested parties. If property profits are insufficient to repay the judgment within five years, the property may be sold at a public auction.

2. Levy of Personal Property

Creditors in Virginia can seize and sell the debtor's personal property, such as vehicles, jewelry, and appliances, to satisfy a judgment. The process begins with obtaining a "Writ of Execution" or "Writ of Fieri Facias" (fi fa) from the court where the property is located. This writ authorizes the seizure of the debtor's personal property. Creditors can request the court to issue a fi fa after 21 days from the entry of the judgment, allowing the debtor a window to comply voluntarily before enforcement actions begin. There are two main methods for levying personal property: "levy and seize" and "list and leave." For a "levy and seize," the creditor must post a surety bond to protect against wrongful levy, and the Sheriff's Office can then seize and store the property until the foreclosure sale. This method is more secure but incurs additional costs for bonding and storage. Alternatively, the Sheriff can "list and leave" the property, which is less expensive and can pressure the debtor to pay due to the embarrassment of having labeled property. The writ must include the total debt owed, including accrued interest, and if property seizure is attempted after 90 days, a new writ is required to ensure that the information remains current and accurate.

3. Garnishment of Intangible Personal Property

Creditors can garnish intangible personal property such as bank accounts, wages, rent, and accounts receivable. The process begins with the filing of a "Summons in Garnishment" (Va. Code § 8.01-502), which notifies the financial institution or entity holding the debtor's funds of the creditor's intention to use those funds to satisfy the judgment. This summons must be served to both the garnishee (the entity holding the funds) and the debtor. A court date must be set within 90 days for all garnishments except wages, which can extend to 180 days (Va. Code § 8.01-514). If uncontested, the court will issue an "order of payment," directing the garnishee to release the funds to the creditor. In Virginia, all unprotected funds in the judgment debtor's bank account can be seized, and the account can be frozen to take any future deposits made during the garnishment period.

Wage garnishment is limited to the lesser of 25% of the debtor's disposable earnings or the amount by which the debtor's weekly disposable earnings exceed forty times the federal minimum wage ($290), protecting the debtor's essential income while allowing creditors to recover debts. Some personal items and amounts are exempt from garnishment, providing a level of protection for essential personal assets. Garnishments may be refiled every 180 days until the debt is paid in full, allowing creditors to continue pursuing payment over time. Garnishment is a separate lawsuit, and the garnishee can contest whether it owes the judgment debtor anything, ensuring that only legitimate claims are enforced.

IV. <u>OTHER CONCERNS IN COLLECTIONS</u>

There are a number of other considerations that are often taken into account during the collections process. The first is bankruptcy. Bankruptcy can significantly impact the collections process, often slowing or halting it entirely. In the event of bankruptcy, the secured creditor's rights in the "security property" (property used as collateral) are not affected by the bankruptcy. While foreclosure may be delayed, secured creditors will eventually collect as long as there is sufficient equity in the property. General unsecured creditors, on the other hand, will share only in the assets that are not already encumbered as security property for a secured lender, typically receiving a smaller portion of the debtor's assets compared to secured creditors. Once bankruptcy is filed, an automatic stay is imposed, preventing creditors from continuing collection activities and barring them from suing the debtor for new security property or preferential payments. If a property owner files for bankruptcy within 90 days after a lien is established, that lien may be considered a preference and can be avoided (set aside) by the bankruptcy court, preventing unfair advantage to certain creditors just before bankruptcy is declared.

There are additional considerations for creditors when enforcing judgments. One important issue is the correct naming of parties. The judgment must be in the correct name to attach to the debtor's property. If the judgment is in a name different from the property owner, such as if the property is in the name of an LLC or another entity instead of the debtor personally, the judgment will not attach until the name is corrected. Another concern is the form of ownership, which affects the attachment of the judgment. For example, if the property is owned as tenants in common, each owner's interest is separate, and only the debtor's portion can be attached. If owned as tenants by the entirety (a form of ownership typically used by married couples), the property may be protected from creditors of one spouse unless both spouses are debtors. These considerations are crucial for ensuring that creditors can effectively navigate the complexities of judgment enforcement and asset recovery.

INDEX A

CHARGING ORDER EXAMPLES

ORDER CHARGING JUDGMENT DEBTOR'S INTEREST IN ABC LLC

The judgment creditor has applied to this Court for a charging order against the judgment debtor's interest in ABC LLC. Good cause having been shown in support of the application, it will be GRANTED.

Based upon the admissible evidentiary submissions of the judgment creditor, the Court finds as follows:

(1) The judgment creditor holds an enforceable judgment which has not been satisfied in full against the judgment debtor;

(2) The judgment debtor holds an interest in ABC LLC; and

(3) Notice of the application has been served upon the judgment debtor and given to ABC LLC through its registered agent.

Based upon the foregoing findings, the Court hereby orders as follows:

(1) The judgment debtor's interest in ABC LLC is hereby charged with a lien until the judgment held by the judgment creditor has been satisfied in full;

(2) Distributions made by ABC LLC to the judgment debtor's interest in ABC LLC shall instead be paid immediately to the judgment creditor c/o the judgment creditor's attorney at [address];

(3) The judgment debtor is hereby prohibited from receiving from ABC LLC any other money or assets other than distributions, whether by way of loans, fees, wages, salary,[FN 1] or payment of the obligations of the judgment debtor such as the judgment debtor's credit cards, or otherwise;

(4) Should the judgment debtor receive or otherwise come into possession, by whatever means, of any moneys or assets from ABC LLC, the judgment debtor shall immediately advise the judgment creditor of the same, and immediately remit those moneys or assets to the judgment creditor c/o the judgment the creditor's attorney at [address]; [FN 2]

(5) Upon the judgment debtor's receipt of any financial information from ABC LLC, including, but not limited to, financial statements, annual statements, notifications of distributions made or to be made, U.S. Internal Revenue Service Form K-1, any other state or federal tax forms or statements, the judgment debtor shall immediately provide a copy thereof to the judgment creditor. [FN 3]

Any violation of this order, whether by the judgment debtor or any other person receiving notice of this order, may be punishable by contempt.

SO ORDERED this ____ day of _________, 20__.

____

Hon. [Judge Name]
Judge of the District Court

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Example Charging Order

Fenghua Wang v. Equity Res., No. CL20000329-00, 2021 Va. Cir. LEXIS 404, at *1-2 (Cir. Ct. Apr. 16, 2021) – Loudon County Circuit Court

CHARGING ORDER

THIS MATTER came before the Court upon the day of April 2021 upon the Plaintiffs' Post-Judgment Motion for Entry of Charging Order; upon the Response filed herein by Defendants Kevin Faulkner and Napoleon Ibiezugbe, upon a remote ore tenus hearing of the evidence; and upon argument of counsel; and

IN CONSIDERATION THEREOF it hereby ADJUDGED and ORDERED as follows:

1. The interests of Defendants, Kevin Faulkner and Napoleon Ibiezugbe as members in ASNK, LLC; Equity Resource, LLC; McLean H LLC; Montello 2 Holdings, LLC; Varmont 1509 Holdings LLC; Vermont 4 LLC; Vermont 1509 LLC; 1312 Adams St LLC; 460 Mellon Holdings LLC; AAAF Construction LLC; Adams 3 LLC; ASHHA LLC; AVA SW LLC; Clifton DC LLC; and Petworth Group LLC ("LLCs") are subject to a charging order pursuant to Va. Code Section 13.1-1041.1 in favor of the Plaintiffs Fenghua Wang and Eric Ranne.

2. Quarterly, starting April 30, 2021, and continuing until the judgment is paid in full, Defendants shall file with the clerk of this court a sworn answer reporting to the court all amounts distributable or payable to Defendants at the time of service of this order and at all subsequent times attributable to any interest owned in the LLCs.

3. The LLCs [*2] are hereby directed to pay to Plaintiffs any and all profits and distributions which the Defendants are entitled in respect to their interests (including a share of the asset of the LLCs upon liquidation, or any return of Defendants' member interests in the LLCs to Defendants including their interests and rights in the LLCs) and which payments shall continue until the remaining amount of the outstanding judgment which currently is $599,730 is paid in full or this Order is modified by the Court.

AND THIS CAUSE IS ENDED.

ENTERED this 16 day of April; 2021.

/s/ [Signature]

JUDGE

INDEX C

CHARGING ORDER CASE LAW EXAMPLES

- <u>Bildman v. Devine</u> (100 Va. Cir. 63) (2018)
  - Under the Virginia LLC Act, can the court require the LLC that is the subject of the Charging Order to provide regular financial reporting of the LLC 's operations and distributions to the judgement creditors?
    - No. The court employed a strict reading of § 50-73.46:1(E) and § 13.1-1041.1 in finding that a charging order cannot require a defendant to provide financial reports to the judgement creditor
- <u>S. Bank & Tr. Co. v. Joshi</u> (90 Va. Cir. 202) (2015)
  - Can a creditor place a Charging Order against an interest in a professional limited liability company (PLLC)?
    - Yes. Despite PLLCs being discussed distinctly from traditional LLCs in § 13.1-1101.1 and § 13.1-1102, the court found that a creditor can place a Charging Order against a PLLC in the same fashion as any other LLC
- <u>First Union Nat'l Bank v. Allen Lorey Family Ltd. P'ship</u> (34 Va. Cir. 474) (1994)
  - A money judgment was entered against two general partners of the partnership. A charging order was entered against the partnership interests of the two judgment debtors.
  - The creditor of the money judgment sought dissolution of the partnership by virtue of the charging order. Did the Court grant the dissolution?
    - No. The court found while Va. Code Ann. § 50-32 allowed an assignee by virtue of a charging order to petition for dissolution where there was an at-will partnership, Va. Code Ann. § 50-73.50 did not allow such a petition by an assignee, but only by or for a partner.
    - The statutory language did not allow a creditor of a partner in a limited partnership to dissolve the partnership merely by obtaining a judgment and charging order against a partner's interest.
- <u>In re Talbut,</u> (2016)
  - This was an Ch. 7 Ohio Bankruptcy proceeding that concerned VA law because the Trustee was trying to foreclose on and sell an interest in a VA LLC.
  - Under Virginia law, a judgment lien creditor could obtain a lien against Debtor's economic interest and § 544(a) of the Bankruptcy Code confers upon the Trustee those same rights and powers. Did the court allow the sale?
    - No. Non-Bankruptcy law does not permit the sale. Section 13.1-1041.1 expressly states that entry of a charging order is the "exclusive remedy" and "the judgment creditor has only the right to receive any distributions" that the member would have been entitled to.

        - The prior version of § 13.1-1041.1 also included language that "[t]he court may order a foreclosure of the interest subject to the charging order at any time." Va. Code Ann. § 13.1-1041.1(B) (2004). This language was deleted when the statute was amended in 2006.
- <u>Crocker v. Perroton</u>, 208 Cal. App. 3d 1 (1989)
    - Under CA law, if a partnership interest can be transferred to the creditor without causing an interruption in business can it be done? If so, does it require the consent of the other Partners?
        - Yes, and Yes. The court ruled, charging order protection was originally enacted as a means of protecting the non-debtor partners and to ensure that partnership business remains uninterrupted, not so that a debtor-partner can escape paying his debts. However, non-debtor partners need to consent to the transfer.
- <u>Hellman v. Anderson</u>, 233 Cal. App. 3d 840 (1991)
    - Under CA law, if a partnership interest can be transferred to the creditor without causing an interruption in business can it be done? If so, does it require the consent of the other Partners?
        - Yes, and No. Despite the Crocker case being decided just two years prior, this court ruled that the transfer was allowed without the consent of the other partners.

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EXECUTORY CONTRACT CASE LAW EXAMPLES

- Davis v. Cleve Marsh Hunt Club, 242 Va. 29 (1991)
  - The Davises sold part of a marsh to the Hunt Club, a limited partnership. The contract had two parts, one for the land interest and one for a right of way across Davis's farm.
  - The land interest provision stated simply the Davises "agree to sell" and the Hunt Club "agree[s] to pay." The right of way agreement stated the Davises "hereby give" the right-of-way. Which, if any, of these is executory?
    - Only the land interest sale was considered executory. was considered executory. In that provision, the Davises agreed to sell, and the Hunt Club agreed to pay, indicating mutual ongoing obligations.
    - The language "hereby give" in the part of the contract pertaining to the right-of-way indicated a present grant, not an executory promise.
- In re Ehmann, 319 B.R. 200 (Bankr. D. Ariz. 2005)
  - This an Arizona case that was applied in VA in (In re Tsiaoushis), 383 B.R. 616.
  - If an LLC's operating agreement is deemed non-executory in a Ch.7 Bankruptcy Proceeding, which provision of the Bankruptcy code applies, and what difference does that make in determining an LLC Member's interest?
    - The court explained that if the operating agreement was an executory contract, § 365(e)(2), if applicable, would permit "the enforcement of state and contract law restrictions on the Trustee's rights and powers," but if it was not an executory contract, § 541(c)(1) would render "such restrictions or conditions unenforceable against the Trustee."
    - Thus, if an operating agreement is deemed non-executory, the limitations on the charging order remedy may be removed under certain circumstances.
- In re Bootjack Dairy M&D, LLC, 654 B.R. 368, (Bankr. D. Idaho 2023)
  - In Idaho, if an LLC enters into a Purchase and Sale Agreement (PSA) for real property as a seller, can it then declare bankruptcy and reject the contract as executory?
    - It can depend, but not here. In general, filing a bankruptcy case to reject a lease or executory contract is not bad faith. However, to properly seek bankruptcy protection and use the bankruptcy code, a debtor must have a valid bankruptcy purpose.
    - Here, the LLC was in fine financial condition and the dispute could be resolved in state court. Thus, despite the bankruptcy and the contract being executory, the seller could not get out of the PSA

INDEX E
VEIL PIERCING CASE LAW

- C.F. Trust, Inc. v. First Flight Ltd. Partnership, 306 Va. 380 (2001)
  - The C.F. Trust case involved a claim by a creditor seeking to hold the members of an insolvent LLC personally liable for the LLC's debts.
  - The court held that to pierce the corporate veil of an LLC in Virginia, the plaintiff must establish that (1) the entity was the "alter ego" or "instrumentality" of its members, and (2) the entity was used to perpetrate a fraud, injustice, or illegal activity.
  - The "alter ego" principle applies when the unity of interest and ownership is such that the separate personalities of the entity and the individuals no longer exist and to adhere to that separateness would work an injustice.
  - The court emphasized that merely showing the domination or control of an entity by its members is insufficient to pierce the veil. The plaintiff must also demonstrate that the entity was used to perpetrate fraud, injustice, or an illegal act
  - The court laid out factors to evaluate in determining the appropriateness of veil piercing:
    - Inadequate Capitalization
    - Disregard of corporate formalities
    - Commingling of Assets
    - Fraud or Injustice
- Cheatle v. Rudd's Co., 234 Va. 207 (1987)
  - Is inadequate capitalization alone sufficient to pierce the corporate veil?
    - No. If there is no showing of commingling personal and corporate assets, no fraud, and corporate formalities were maintained, then inadequate capitalization alone cannot justify piercing of the corporate veil.
- In re White, 412 B.R. 860, 863 (2009)
  - Can the court pierce the LLC veil if the creditor has not yet gotten a judgement against the LLC?
    - No. Procedurally, a court may not pierce the LLC veil until after the requesting party obtains a judgment against the LLC.
- Dana v. 313 Freemason, A Condo. Ass'n, 266 Va. 491, (2003)
  - Two Partners marketed condos for sale, knowing the roof of the building continually leaked and had major structural defects.
  - They formed a corporation, but the corporation did not have any liquid assets and all corporate funds were deposited into a shareholder's personal checking account. Did the Court pierce the corporate veil?

        - Yes. The court determined the shareholders formed the corporation to evade personal liability while the condominium continued to be marketed with a known defective roof.
        - The inability of the corporation to satisfy the judgment against it was not the result of poor business decisions, mismanagement, or unexpected liabilities such that an expected profit never materialized. Instead, it was a deliberate decision. The court determined providing corporate protections here would amount to an injustice
- <u>O'Hazza v. Executive Credit Corp</u>., 246 Va. 111, (1993)
    - An equipment leasing company sought recovery of the unpaid balance of a loan made to a corporation, naming the corporation and appellant sole shareholders as defendants in the action.
    - The corporation had an initial capitalization of only $10,000, the shareholders had made loans to the corporation, and there was substantial financial and tax documentation for the corporation. Did the Court pierce the corporate veil?
        - No. The court determined the initial capitalization to be low, but not low enough to show impropriety as a matter of law. The loans made by shareholders similarly did not show any fraud (they were in good faith), and the significant business documentation showed a legitimate business purpose.
        - The court also noted that the election of the corporation as a subchapter S tax status did not suggest impropriety.

INDEX F
REVERSE VEIL PIERCING CASE LAW

- C.F. Tr., Inc. v. First Flight Ltd. P'ship, 266 Va. 3 (2003)
  - This case was a continuation of the earlier C.F. Trust case, but concerned reverse veil piercing
  - The court found nothing in § 50-73.1 which prohibited the court from piercing the veil of a limited partnership in reverse.
  - In this case, Peterson, who controlled several entities, directed overpayments by the LP to a corporation he owned and used these funds to cover his personal expenses, frustrating his creditors.
  - The court held that Peterson's entities were his alter ego and the separate corporate personalities no longer existed. This allowed the court to disregard the LP structure and pierce the veil.
  - In addition to the usual veil piercing standards, reverse veil piercing also requires a court weigh the impact on innocent partners or members, the impact on innocent creditors, and the availability of alternative remedies. Additionally, a litigant who seeks reverse veil piercing must prove the necessary standards by clear and convincing evidence.
- A.G. Dillard, Inc. v. Stonehaus Construction, LLC, 2016 Va. Unpub. LEXIS 16
  - A creditor sought to collect a judgement against a debtor's LLC by going after other, related LLCs the debtor had which had more assets. The creditor alleged that the defendant had siphoned funds from one LLC and moved it to a different LLC to evade collection. The related entities presented themselves to the public as a single entity and comingled all their assets.
  - The idea behind the action was to pierce the judgement LLC to get to the debtor, and then reverse pierce to reach the other LLCs. Was a demurrer granted on the idea of reverse veil piercing?
    - No. On appeal the Supreme Court reversed the circuit court's decision to sustain the demurrer. The court stated because the debtor was a member or manager of all the LLCs, the complaint alleged he siphoned funds to avoid collection, and there was a comingling of different entity's assets, the action could not be dismissed.
    - In essence, because the debtor exerted significant control over all entities and treated the as though they were a single entity, he did not deserve to get protection enough to sustain the demurrer.
- Krauss v. Apex Custom Homes, LLC, 2019 Va. Cir. LEXIS 1203
  - The plaintiff sued for failure to finish the construction of plaintiff' s home. One defendant had several LLC entities that he was a member of, but the case also

included a separate defendant who had no equity and was not a member in the LLC that the plaintiff wanted to pierce.

- The LLC in question observed corporate formalities, was well capitalized, and defendants had no control or check writing authority over LLC accounts. Did the court allow reverse veil piercing?
    - No. First, the court stated, no Virginia authority has held an individual liable for the debts of an entity to which he is a stranger and vice versa.
    - The court further stated none of the elements of reverse veil piercing were satisfied, including there being no evidence of fraud or injustice.
    - They also noted The Supreme Court of Virginia has repeatedly cautioned against "'turning every breach of contract into an actionable claim for fraud' (thereby opening the door for veil piercing) simply because of misrepresentations of the contractor entwined with a breach of the contract."

- Bank of Hampton Rds. v. DWH, LLC, 94 Va. Cir. 418 (2016)
    - The creditor had a judgement against the debtor, who owned a corporation. The debtor was also consultant for DWH LLC, an LLC wholly owned by his fiancée, who paid for all business expenses for the debtor and his corporation. The LLC bid for contracts on behalf of the corporation, received all payment for work done by the corporation and both entities conduct business from the same location.
    - The creditor sought to use the LLC's assets to cover the debt of the debtor (reverse veil pierce). Did the court allow it?
        - No. The court stated there was no veil to be pierced between the debtor and the LLC because the debtor had no interest in the LLC.
        - Virginia law does not support disregarding the legal separateness of two different entities, owned by two different individuals, in order to determine that they are de facto the same entity.
        - The court did note there may be alternative routes for the plaintiffs such as pleading additional facts about the de facto ownership or control of the LLC, successor liability and imputation of income

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FRAUDULENT CONVEYANCE CASE LAW

- Bernstein Bros. Mgmt. v. Miller, 44 Va. Cir. 69 (Cir. Ct. 1997)
  - An employee who worked for a company that collected rents was accused of embezzling $ 1,398,124 between 1981 and 1995. The company sought the return of funds distributed from the Defendant to others, including her family. It was proven Defendant was insolvent and there was no consideration in these transfers. Did the Court allow all payments over the 14-year period to be recovered?
    - No. An expert witness testified that even a simple spreadsheet would have detected the Defendant's embezzlement.
    - As a result, the court found the statute of limitations under § 8.01-253 applied, because the company should have discovered her thefts earlier. As a result, any gift made before 1991 was not recoverable
- Grayson v. Westwood Bldgs. L.P., 300 Va. 25 (2021)
  - The case involves a dispute between a landlord (Westwood Buildings L.P.) and several tenants and associated parties (Grayson et al.) over alleged fraudulent and voluntary conveyances. The landlord claimed that these conveyances prevented it from collecting significant rent owed by the tenants.
  - Did the Supreme Court uphold the trial courts granting of in personam judgements against the tenants?
    - No. The statutory remedy for fraudulent conveyance is simply to declare the conveyance void and return the asset to the transferor.
    - The court stated that while in personam judgement is a possible equitable remedy, it can only be used in extraordinary circumstances and is subject to some limitations: The in-personam-judgment exception applies to "recipients of fraudulent cash transfers" and not to "other participants or coconspirators" in the fraudulent scheme.
  - Can debtors legally prefer one creditor over another?
    - Yes. A debtor has the right to prefer one creditor to another. Giving such a preference is not fraudulent, though the debtor be insolvent, and the creditor is aware at the time that it will have the effect of defeating the collection of other debts
  - Can a bookkeeper be liable for their involvement in a fraudulent conveyance under the statute?
    - Generally, No. Here, the bookkeeper was not a debtor attempting to place the funds out of the reach of her creditors. Nor was she a transferee pocketing the money for herself. The fraudulent conveyance

statutes only apply to debtors who transfer and to those who receive from the conveyance.

- In re White, 28 B.R. 240, 243-44 (Bankr. E.D. Va. 1983)
    - White transferred a substantial portion of his assets to relatives and a family trust prior to filing for bankruptcy. He was insolvent at the time of the transfer and received nothing of legal value in return.
    - The trustee in bankruptcy sought to recover these transfers, alleging that they constituted fraudulent conveyances. Did the court agree?
        - Yes. Many badges of fraud were present here:
            - A close relationship between the parties involved in the transfer.
            - Inadequate consideration for the transfer.
            - The timing of the transfer in relation to the debtor's financial difficulties.
            - The retention of control or benefits of the transferred property by the debtor.
- Mathews v. Bond, 146 Va. 158 (1926)
    - If an insolvent debtor retains indefinite, exclusive possession or de facto ownership of the conveyed asset, does that constitute a fraudulent conveyance?
        - Yes, if the debtor has possession/ownership to such an extent that doing so effectively defeats the conveyance "in its entirety,".
- Bank of Com. v. Rosemary & Thyme, Inc., 218 Va. 781 (1978)
    - If an insolvent corporate debtor gives preference to a creditor of the corporation who is also a stockholder and director, does that permit an inference of fraud?
        - Yes, if the corporate debtor is under the "complete control" of the director. This "complete control," however, must exist to such an extent that the corporate debtor and the creditor-director are "one and the same." Absent that, a director of a corporate debtor may in good faith direct the corporation to pay its debts to him in preference to other creditors

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COLLECTIONS STATUTORY SUMMARIES

Referenced Lien Statutes

- § 15.2-104: Lien on real estate for local assessments must be recorded to affect bona fide purchasers.
- § 8.01-458: Judgments become liens on the defendant's real estate when recorded.
- § 8.01-459: Priority of liens determined by order of recording.
- § 8.01-462: Equity courts can enforce judgment liens and order the sale of real estate if rents and profits will not satisfy the judgment within five years.
- § 8.01-463: No enforcement against primary residence for judgments under $25,000 or $5,000 for community association assessments.

Referenced Levy Statutes

- § 55.1-321: Notice of sale must be served at least 60 days before the sale if the home is owner-occupied.
- § 55.1-320: Trustee must receive an affidavit confirming that notice was sent to the owner.
- § 55.1-322: Notice must be published in a local newspaper according to specific requirements.

Referenced Garnishment Statutes

- § 8.01-511.1: Garnishee not liable for non-compliance if the garnishment summons lacks sufficient information.
- § 8.01-512.4: Garnishment summonses must include a notice of exemptions and a claim form.
- § 8.01-512.5: Debtors are entitled to a hearing within seven business days after filing a claim for exemption.
- § 8.01-515: Garnishees must appear and answer in court or provide a written statement detailing any debts or properties of the debtor they hold.

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Protecting LLC Assets: Understanding Charging Orders and Asset Protection Strategies

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Collections

Pre-Judgement Process Overview

Before a judgement is granted, there are a few steps that are typically followed:

1) Demand For Payment – a formal letter or notice
2) Negotiation – creditors often attempt to avoid the collections process
3) File a Lawsuit – the General District Court covers small claims, while the Circuit Court covers larger claims
4) Court Hearing – the debtor has 21 days to respond after being served
5) Judgment – gives the creditor the right to collect the amount owed from the debtor

Collecting on a Judgement Overview

To collect on a judgement, there are a few steps that are typically followed:

1) Find the Debtor's Assets – Debtor interrogatories
2) Attach a Lien – This is the mechanism to gain ownership
3) Obtain the Assets – sale or seizure

Post Judgement Discovery

- Before assets can be accessed by Creditors, they must know what assets the debtor has.
- To aid in this inquiry, there are post-judgement discovery methods such as Debtor Interrogatories. § 8.01-506
- Debtor interrogatories are a way to get the Debtor to answer questions about the quantity and location of their assets and liabilities.
- These interrogatories are often sent out with a subpoena duces tecum (subpoena that requires an individual to produce documents, records, or other tangible evidence for a legal proceeding.)

Post Judgement Discovery (continued)

- If the debtor refuses to answer questions (or possibly appear) then they can be held in contempt.
- In Virginia, a creditor is only allowed to conduct debtor's interrogatories every six months on any one judgment debtor. § 8.01-506
- A judgment creditor is also allowed discovery on third parties that may owe the judgment debtor money. § 8.01-506

Ways to Collect on a Judgement

1. Lien on Real Property (i.e., house, condo, etc.)
2. Seizure of Personal Property (car, jewelry)
3. Garnishment of Intangible Personal Property (wages, etc.)

Lien Statutes

§ 15.2-104

A lien on real estate for local assessments, fees, rents, or charges (excluding real estate taxes) does not affect a bona fide purchaser without actual notice of the lien unless a statement of the lien, including the owner's name and the unpaid amount, is recorded in the judgment lien book or in the local treasurer's real estate tax lien records at the time of the property transfer.

§ 8.01-458	Judgments become liens on the defendant's real estate from the time they are recorded in the judgment lien docket.
§ 8.01-459	The priority of liens is determined by the order in which judgments are recorded.
§ 8.01-462	Equity courts have jurisdiction to enforce judgment liens and can order the sale of real estate if rents and profits will not satisfy the judgment within five years.
§ 8.01-463	No enforcement action can be taken against a primary residence for judgments under $25,000, or under $5,000 for community association assessments

Recording a Lien (Real Property)

Attachment Rules

- In Virginia, a judgment lien can only be attached to real estate, not personal property
- Real estate includes the debtor's house, condo, land, or similar kind of property interest.
- Creditors must record the judgment lien in the public records office of the city or county where the property is located. Judgement liens are county specific.
- Once filed, the lien applies to all real property owned or later acquired by the debtor in that jurisdiction, prompting creditors to record the judgment lien in multiple counties in case the debtor acquires property elsewhere (Virginia Code § 8.01-458).

Procedure

- In Virginia, a judgment from a circuit court is automatically recorded in the public land records where the circuit court is situated.
- For judgments from general district courts, creditors must manually record the judgment in the land records.
- This recorded judgment lasts for ten years and can be renewed.
- According to a new Virginia law effective January 1, 2022, judgments entered in a Virginia circuit court after July 1, 2021, have a 10-year limitation period and may be extended up to two additional 10-year periods, making a maximum limitation period of 30 years (Virginia Code § 8.01-446)

Uniform Enforcement of Foreign Judgments Act (UEFJA)

This act allows creditors to enforce a judgment obtained in another state without re-litigating the entire case. The process requires proof of the judgment, the debtor's last known address, and any applicable filing fees.

Most states, including Virginia, D.C., and Maryland, have adopted the UEFJA. The two main states who have not adopted it are California and Vermont. Enforcing a judgment in another state allows the creditor to attach a judgment lien to the debtor's property in that state.

Foreclosure of Real Property

- Creditors often wait for the debtor to sell the property or for another creditor to initiate foreclosure by filing a "Creditor's Bill in Equity."
- Once the judgement had attached, it continues to run interest at the judgment rate of 6% (or the contract interest rate) §6.2-302.
- Alternatively, the creditor can begin the foreclosure process, which is costly as it requires a separate lawsuit involving all interested parties.
- A commissioner will evaluate the property's potential profits, such as rent, to determine if they are sufficient to repay the judgment within five years.
- If not, the property may be sold at a public auction. This process can be lengthy and expensive, but if the debtor has sufficient equity, foreclosure may be beneficial.

In Virginia, there is no "right of redemption," meaning that once the property is sold, the debtor cannot reclaim it even if they later obtain the funds to pay the debt.

Statutory Foreclosure Requirements for Real Property

§ 55.1-321	The foreclosing lender must serve a notice of sale, usually by mail, no less than 60 days (previously, state law required only 14 days) before the sale if the home is owner-occupied and must include information about legal aid and how to contact a HUD-approved housing counselor.
§ 55.1-320	In the case of a deed of trust conveying owner-occupied residential real estate, the trustee of such deed of trust can't sell the property secured by the deed of trust without receiving an affidavit signed by the party that provided the notice confirming the notice was sent to the owner, with a copy of such notice attached to the affidavit.
§ 55.1-322	Notice must also be published in a local newspaper of general circulation as provided in the loan agreement, but not less than once per week for two weeks or three days if published on consecutive days. If the loan agreement doesn't provide publishing requirements, the notice must be published once per week for four weeks or on five consecutive days. The sale may be held eight days after the first publication and no more than 30 days after the last publication.

Levy of Personal Property

- Creditors can seize and sell the debtor’s personal property (e.g., vehicles, jewelry, appliances) to satisfy the judgment.
- The first step is obtaining a “Writ of Execution” or “Writ of Fieri Facias” (fi fa) from the court where the property is located.
- Once 21 days after the entry of judgment has passed, you can request that the Court issue a fi fa.
- The fi fa can be issued and delivered to the sheriff, while the judgment creditor investigates the existence of tangible and intangible property.
- It is sometimes a good strategy to send out blanket notices of lien immediately after getting judgment, in order to establish attachment of the lien and freeze money

The writ must include the total debt owed, including accrued interest. If the creditor seeks to seize property after 90 days, a new writ is needed.

Levy of Personal Property (continued)

- The writ allows the Sheriff's Office to "levy and seize" the property or "list and leave" it. Virginia Code §8.01-551; Virginia Code §8.01-553.
- For a "levy and seize," the creditor must post a surety bond to protect against wrongful levy, and the Sheriff can then seize and store the property until the foreclosure sale. Virginia Code §8.01-550.
  - This process is costly and may require hiring a bondsman and paying fees, including a percentage of auction proceeds
- Alternatively, the Sheriff can "list and leave" the property, which is less expensive but may pressure the debtor to pay due to the embarrassment of having labeled property.
- To attach the judgment lien to personal property, the judgment creditor must know the identity and location of the personal property

Whether the property is levied or listed, the court sets a return date 90 days from the writ filing date, during which the Sheriff's Office must complete the process.

Garnishment of Intangible Personal Property

Creditors can garnish intangible personal property like bank accounts, wages, rent, and accounts receivable. A judgment lien can also be placed on negotiable instruments like stocks, bonds, and debts.

1

The creditor must file a "Summons in Garnishment" (Virginia Code § 8.01-502), notifying the financial institution or entity holding the debtor's funds that the creditor intends to use those funds to satisfy the judgment

2

The summons must be served to both the garnishee and the debtor, with a court date set within 90 days for all garnishments except wages, which can extend to 180 days. Virginia Code §8.01-514

3

If uncontested, the court will issue an "order of payment." In Virginia, all unprotected funds in the judgment debtor's bank account can be seized, and the account frozen to take any future deposits made during the garnishment period.

Garnishments (Continued)

Garnishments may be refiled every 180 days until the debt is paid in full.

- A garnishment is actually a separate lawsuit. The garnishee can contest whether it owes the judgment debtor anything.
- Wage Garnishment
  - Wage garnishment is limited to the lesser of 25% of the debtor's disposable earnings or the amount by which the debtor's weekly disposable earnings exceed forty times the federal minimum wage ($290).
- Exemptions
  - Some personal items and/or amounts are exempt (See form provided)
  - Exemptions apply only to individual and not corporate debtors

Other Statutory Garnishment Provisions

§ 8.01-511.1	If a garnishment summons lacks sufficient information to identify the debtor, the garnishee is not liable for non-compliance. Accurate details, such as a social security number or address, are necessary for the garnishee to identify the debtor and respond accordingly.
§ 8.01-512.4	Garnishment summonses must include a notice of exemptions and a claim form, informing debtors of their rights to exempt certain properties from garnishment.
§ 8.01-512.5	Debtors are entitled to a hearing within seven business days after filing a claim for exemption from garnishment, with the court notifying all parties of the hearing details.
§ 8.01-515	Garnishees must either appear and answer in court or provide a written statement detailing any debts or properties of the debtor they hold. Payment into court can substitute for a written statement.

Case Law

Becker v. Commonwealth, 64 Va. App. 481, 485, 769 S.E.2d 683, 685 (2015)

Can a lawyer send a garnishment form to a garnishee (payroll administrator of the debtor's employer) to have wages withheld, when the garnishment has not yet been filed in court?

No. The court must approve the garnishment before wages can be withheld. This lawyer was found guilty of criminal contempt for misbehavior as an officer of the court, in violation of Va. Code Ann. § 18.2-456(4).

Bankruptcy

Bankruptcy can slow or halt the collections process

- In the event of bankruptcy, the "secured creditor's" rights in the "security property" are not affected by the bankruptcy.
- The secured creditor, while perhaps delayed from foreclosing against the property, will eventually collect as long as there is sufficient equity in the property.
- "General unsecured creditors," however, will share only in assets that are not already encumbered as security property for a secured lender
- After the automatic stay, Creditors are no longer allowed to sue the debtor, to obtain preferential payments from the debtor or to obtain new security property from the debtor.
- If a property owner files bankruptcy within 90 days after a lien is established, that lien may be a preference that can be avoided (set aside) by the bankruptcy court

Other Concerns

- Incorrect naming of parties
  - If your judgment is in a name different from the property owner, the judgment will not attach until you have the correct name on the judgement
  - Thus, if the property is in the name of an LLC or other entity as opposed to the debtor personally, there will be an issue
- Multiple Owners
  - Are the owners tenants in common, tenants by the entirety, etc.?

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Charging Orders

What are Charging Orders? How do they work?

A charging order is a **lien** on the judgment debtor's transferable interest in the LLC – **§ 13.1-1041.1(B)**

§ 13.1-1041.1 (A)
On application by a judgment creditor of a member or a member's assignee, a court having jurisdiction may *charge the transferable interest of a judgment debtor to satisfy the judgment*

a) The judgment creditor **only has the right to receive distributions** to which the judgment debtor would otherwise have been entitled with respect of the interest

§ 13.1-1041.1 (C)	Charging order does not deprive the member or member's assignee of a right under exemption laws with respect to the debtor's interest in the LLC
§ 13.1-1041.1 (D)	Charging order is the exclusive remedy for a judgment creditor can satisfy a judgment out of the judgment debtor's transferable interest in the LLC
§ 13.1-1041.1 (E)	No creditor of a member or a member's assignee shall have any right to obtain possession of, or legal or equitable remedies with respect to the property in the LLC

LLC vs. Partnership Charging Order Statutes

"Whether one entity is a partnership, and the other is a limited liability company is immaterial, as the Virginia Code contains applicable sections for each entity setting forth practically identical remedies."

*Wooten v. Lightburn, 2009 U.S. Dist. LEXIS 67707, at *5 (W.D. Va. July 14, 2009)*

LLCs and Partnerships are treated very similarly in terms of Charging Orders and remedies under § 13.1-1041.1 and § 50-73.46:1 respectively

History of Charging Orders

Old Common Law Remedies were Inadequate

- Prior to Charging Orders, the courts would resort to common law procedures for collection that were ill-suited for reaching partnership interests.
- Typically, despite the fact that individual partners do not have title in partnership property, partnership property would be seized under writs of execution.
- The debtor partner's interest in the partnership could then be sold and would often result in dissolution of the partnership, disruption of business operations, or the non-debtor members would be forced into a business relationship with someone they never agreed to be in business with.

Modern Charging Orders in Virginia provide more protections to debtors, and better reflect the entity structure of LLCs and Partnerships

Variation Across Jurisdictions: COPE

- COPE (Charging Order Protected Entity) LLCs offer robust protection against creditors. The COPE LLC is not just designed to protect members from liability for the LLC (as with all LLCs), but also to protect the assets inside the LLC from being affected by the indebtedness of any member.
- COPE protection does not stem from creation of a certain type of LLC but rather the protection of laws in certain jurisdictions, including Virginia
- In Virginia, a judge will give an order charging a debtor to pay creditors from the distributions of the LLC, but not allow the creditor to foreclose on or dissolve the entity to get at the asset.
- Charging Orders are the exclusive remedy for creditors to get at an LLC interest in Virginia (13.1-1041.1 (D)).

There are about 20 states who have COPE laws, including NV, AZ, and VA. These states thus offer stronger asset protections in LLCs. In some states, like CO, courts are more likely to allow foreclosure on single member LLCs .

LLCs vs. Corporations in Personal Judgements

Corporation

- Under, § 8.01 of the Virginia code, creditors may be able to foreclose on or force the sale of shares in a corporation.*
- The court may appoint a receiver under § 13.1-748 to market and sell those shares.
- The proceeds from the sale go toward satisfying the creditor's judgment.
- Any remaining funds after the judgment is fully satisfied are returned to the debtor, but they no longer own shares in the corporation.
- Restrictions on transfers (§ 13.1-649) can make it more difficult.

* See In re Cutright, No. 08-70160-SCS, 2012 Bankr. LEXIS 2419 (Bankr. E.D. Va. May 30, 2012)

LLC

- Unlike corporations, creditors cannot directly force the sale of a member's ownership interest in a Virginia LLC.
- Instead, creditors can levy upon monetary distributions that the LLC makes to the individual debtor/member.
- The decision on distributions is governed by the LLC's operating agreement or the discretion of its members.

Obtaining a Charging Order

1

A creditor secures a judgement, and seeks to satisfy the judgement via the debtor's partnership or LLC interest

2

The creditor's attorney drafts the Charging Order and submits the motion to the court for approval

3

This motion includes Defendants' names, entities in question, and the judgement outstanding at the time of the order

4

If the court grants the motion, Defendants must turn over all distributions from the entity until the judgement is satisfied.

Charging Order Case Law (VA)

Bildman v. Devine (100 Va. Cir. 63) (2018)
Under the Virginia LLC Act, can the court require the LLC that is the subject of the Charging Order to provide regular financial reporting of the LLC 's operations and distributions to the judgement creditors?

No. The court employed a strict reading of § 50-73.46:1(E) and § 13.1-1041.1 in finding that a charging order cannot require a defendant to provide financial reports to the judgement creditor

S. Bank & Tr. Co. v. Joshi (90 Va. Cir. 202) (2015)
Can a creditor place a Charging Order against an interest in a professional limited liability company (PLLC)?

Yes. Despite PLLCs being discussed distinctly from traditional LLCs in § 13.1-1101.1 and § 13.1-1102, the court found that a creditor can place a Charging Order against a PLLC in the same fashion as any other LLC

Charging Order Case Law (Continued)

<u>First Union Nat'l Bank v. Allen Lorey Family Ltd. P'ship (34 Va. Cir. 474) (1994)</u>

A money judgment was entered against two general partners of the partnership. A charging order was entered against the partnership interests of the two judgment debtors.

The creditor of the money judgment sought dissolution of the partnership by virtue of the charging order. **Did the Court grant the dissolution?**

No. The court found while Va. Code Ann. § 50-32 allowed an assignee by virtue of a charging order to petition for dissolution where there was an at-will partnership, Va. Code Ann. § 50-73.50 did not allow such a petition by an assignee, but only by or for a partner.

The statutory language did not allow a creditor of a partner in a limited partnership to dissolve the partnership merely by obtaining a judgment and charging order against a partner's interest.

Charging Order Case Law (Continued)

In re Talbut, (2016)

This was an Ch. 7 Ohio Bankruptcy proceeding that concerned VA law because the Trustee was trying to foreclose on and sell an interest in a VA LLC.

Under Virginia law, a judgment lien creditor could obtain a lien against Debtor's economic interest and § 544(a) of the Bankruptcy Code confers upon the Trustee those same rights and powers. **Did the court allow the sale?**

No. Non-Bankruptcy law does not permit the sale. Section 13.1-1041.1 expressly states that entry of a charging order is the "exclusive remedy" and "the judgment creditor has only the right to receive any distributions" that the member would have been entitled to.

The prior version of § 13.1-1041.1 also included language that "[t]he court may order a foreclosure of the interest subject to the charging order at any time." Va. Code Ann. § 13.1-1041.1(B) (2004). This language was deleted when the statute was amended in 2006.

Charging Order Case Law (CA)

Crocker v. Perroton, 208 Cal. App. 3d 1 (1989)
Under CA law, if a partnership interest can be transferred to the creditor without causing an interruption in business can it be done? If so, **does it require the consent of the other Partners**?

Yes, and Yes. The court ruled, charging order protection was originally enacted as a means of protecting the non-debtor partners and to ensure that partnership business remains uninterrupted, not so that a debtor-partner can escape paying his debts. However, non-debtor partners need to consent to the transfer.

Hellman v. Anderson, 233 Cal.App.3d 840 (1991)
Under CA law, if a partnership interest can be transferred to the creditor without causing an interruption in business can it be done? If so, **does it require the consent of the other Partners**?

Yes, and No. Despite the Crocker case being decided just two years prior, this court ruled that the transfer was allowed without the consent of the other partners.

Executory vs. Non-Executory Contracts

Executory

- An executory contract is a contract in which some or all of the obligations of one or both parties have not yet been fully performed. In other words, future performance is still due from one or more parties.
- Both parties have significant unperformed duties.
- The performance of these duties is central to the contract.
- Typical examples include leases, supply agreements, and employment contracts.

Non-Executory

- A non-executory contract is a contract in which all parties have fully performed their obligations, or there are no remaining obligations that significantly impact the agreement. In other words, the contract has been fully executed or no significant future performance is due from any party
- The primary obligations of one or both parties have been fulfilled.
- Any remaining obligations are non-material.
- Examples include fully executed sales agreements or contracts where services have already been provided and only payment remains.

Countryman Definition of Executory Contract

If there are unperformed obligations of both the debtor and the other party or parties, the court must determine whether, if not performed, non-performance would constitute a material breach excusing the other party from further performance. If so, the operating agreement is an executory contract.

Meiburger v. Endeka Enters., L.L.C. (In re Tsiaoushis), 383 B.R. 616 (Bankr. E.D. Va. 2007):

Some Circuit Courts have looked to state law to define substantial performance in order to determine the materiality of the breach, but the 4th circuit does not do so.

Butler v. Resident Care Innovation Corp., 241 B.R. 37, 43 (D.R.I. 1999)

Executory Contract Case Law

Davis v. Cleve Marsh Hunt Club, 242 Va. 29 (1991)

The Davises sold part of a marsh to the Hunt Club, a limited partnership. The contract had two parts, one for the land interest and one for a right of way across Davis's farm.

The land interest provision stated simply the Davises "agree to sell" and the Hunt Club "agree[s] to pay." The right of way agreement stated the Davises "hereby give" the right-of-way. **Which, if any, of these is executory**?

Only the land interest sale was considered executory. was considered executory. In that provision, the Davises agreed to sell, and the Hunt Club agreed to pay, indicating mutual ongoing obligations.

The language "hereby give" in the part of the contract pertaining to the right-of-way indicated a present grant, not an executory promise.

Executory Contract Case Law

In re Ehmann, 319 B.R. 200 (Bankr. D. Ariz. 2005)

This an Arizona case that was applied in VA in (In re Tsiaoushis), 383 B.R. 616.

If an LLC's operating agreement is deemed non-executory in a Ch.7 Bankruptcy Proceeding, which provision of the Bankruptcy code applies, and what difference does that make in determining an LLC Member's interest?

The court explained that if the operating agreement was an executory contract, § 365(e)(2), if applicable, would permit "the enforcement of state and contract law restrictions on the Trustee's rights and powers," but if it was not an executory contract, § 541(c)(1) would render "such restrictions or conditions unenforceable against the Trustee."

Thus, if an operating agreement is deemed non-executory, the limitations on the charging order remedy may be removed under certain circumstances.

Executory Contract Case Law

<u>In re Bootjack Dairy M&D, LLC</u>, 654 B.R. 368, (Bankr. D. Idaho 2023)

In Idaho, if an LLC enters into a Purchase and Sale Agreement (PSA) for real property as a seller, can it then declare bankruptcy and reject the contract as executory?

It can depend, but not here. In general, filing a bankruptcy case to reject a lease or executory contract is not bad faith. However, to properly seek bankruptcy protection and use the bankruptcy code, a debtor must have a valid bankruptcy purpose.

Here, the LLC was in fine financial condition and the dispute could be resolved in state court. Thus, despite the bankruptcy and the contract being executory, the seller could not get out of the PSA

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Veil Piercing

Statutory Limitations on 3rd Party Liability

Except as otherwise provided by this Code or as expressly provided in the articles of organization, no member, manager, organizer or other agent of a limited liability company, regardless of whether the limited liability company has a single member or multiple members, shall have any personal obligation for any liabilities of a limited liability company, whether such liabilities arise in contract, tort or otherwise, solely by reason of being a member, manager, organizer or agent of a limited liability company.

§ 13.1-1019

What is Veil Piercing?

- Veil Piercing is a legal principle that allows creditors and litigants to hold shareholders or members personally liable for the debts or obligations of a corporation or Limited Liability Company (LLC) in certain circumstances
- Under Virginia law, corporations and LLCs are considered separate legal entities, distinct from their shareholders or members. This separation provides limited liability protection, shielding the personal assets of shareholders and members from the debts and obligations of the business entity.
- However, in some situations, courts may decide to pierce the corporate veil, holding shareholders or members personally liable.
- Courts have emphasized the principle that piercing the corporate veil is an extraordinary remedy that should be applied sparingly
- Virginia law treats piercing the corporate veil of traditional corporations and other limited liability entities in the same manner (Moore v. Law Offices of Shapiro, Brown & Alt, LLP)

In Virginia, corporate veil piercing is an equitable remedy applied by courts when they determine that the separate legal existence of a corporation or LLC has been abused or used to perpetrate fraud, injustice, or illegal activity.

Veil Piercing Case Law (VA)

C.F. Trust, Inc. v. First Flight Ltd. Partnership, 306 Va. 380 (2001)

- The C.F. Trust case involved a claim by a creditor seeking to hold the members of an insolvent LLC personally liable for the LLC's debts.
- The court held that to pierce the corporate veil of an LLC in Virginia, the plaintiff must establish that (1) the entity was the "**alter ego**" or "instrumentality" of its members, and (2) the entity was used to perpetrate a **fraud, injustice, or illegal activity**.
- The "alter ego" principle applies when the unity of interest and ownership is such that the separate personalities of the entity and the individuals no longer exist and to adhere to that separateness would work an injustice.

The court emphasized that merely showing the domination or control of an entity by its members is insufficient to pierce the veil. The plaintiff must also demonstrate that the entity was used to perpetrate fraud, injustice, or an illegal act

What do Courts look at in evaluating Veil Piercing?

1. **Inadequate Capitalization**

   Does the entity have enough money to do business?

2. **Disregard of corporate formalities**

   Did they treat the entity as distinct? Is it run like a corporation?

3. **Commingling of Assets**

   Was the money in separate accounts and used only for corporate purposes?

4. **Fraud or Injustice**

   Was the entity used for illegal purposes?

Veil Piercing Case Law (Continued)

Cheatle v. Rudd's Co., 234 Va. 207 (1987)
Is inadequate capitalization alone sufficient to pierce the corporate veil?

→ **No**. If there is no showing of commingling personal and corporate assets, no fraud, and corporate formalities were maintained, then inadequate capitalization alone cannot justify piercing of the corporate veil.

(In re White), 412 B.R. 860 (2009)
Can the court pierce the LLC veil if the creditor has not yet gotten a judgement against the LLC?

→ **No**. Procedurally, a court may not pierce the LLC veil until after the requesting party obtains a judgment against the LLC.

Veil Piercing Case Law (Continued)

<u>Dana v. 313 Freemason, A Condo. Ass'n, 266 Va. 491, (2003)</u>
Two Partners marketed condos for sale, knowing the roof of the building continually leaked and had major structural defects.

They formed a corporation, but the corporation did not have any liquid assets and all corporate funds were deposited into a shareholder's personal checking account. **Did the Court pierce the corporate veil?**

Yes. The court determined the shareholders formed the corporation to evade personal liability while the condominium continued to be marketed with a known defective roof.

The inability of the corporation to satisfy the judgment against it was not the result of poor business decisions, mismanagement, or unexpected liabilities such that an expected profit never materialized. Instead, it was a deliberate decision. The court determined providing corporate protections here would amount to an injustice

Veil Piercing Case Law (Continued)

O'Hazza v. Executive Credit Corp., 246 Va. 111, (1993)

An equipment leasing company sought recovery of the unpaid balance of a loan made to a corporation, naming the corporation and appellant sole shareholders as defendants in the action.

The corporation had an initial capitalization of only $10,000, the shareholders had made loans to the corporation, and there was substantial financial and tax documentation for the corporation. **Did the Court pierce the corporate veil?**

No. The court determined the initial capitalization to be low, but not low enough to show impropriety as a matter of law. The loans made by shareholders similarly did not show any fraud (they were in good faith), and the significant business documentation showed a legitimate business purpose.

The court also noted that the election of the corporation as a subchapter S tax status did not suggest impropriety.

What is Reverse Veil Piercing?

- While corporate veil piercing allows creditors to hold shareholders or members personally liable for a corporation's or LLC's debts, reverse veil piercing is an inverse legal doctrine that permits creditors to reach the assets of a corporation or LLC to satisfy the personal debts of a shareholder or member.
  - I.e., Hold a corporation liable for the debts of its owner
- Reverse veil piercing is less common than traditional veil piercing and is often viewed with skepticism by courts due to the potential for harming innocent shareholders or members.
- Generally, courts should consider the same factors in deciding whether to apply either doctrine (A.G. Dillard, Inc. v. Stonehaus Constr., LLC)

Virginia courts may allow reverse veil piercing if there is a strong showing of fraud, injustice, or illegal activity and the rights of innocent shareholders or members are not adversely affected.

Reverse Veil Piercing Case Law (VA)

C.F. Tr., Inc. v. First Flight Ltd. P'ship, 266 Va. 3 (2003)

- This case was a continuation of the earlier C.F. Trust case, but concerned reverse veil piercing
- The court found nothing in § 50-73.1 which prohibited the court from piercing the veil of a limited partnership in reverse.
- In this case, Peterson, who controlled several entities, directed overpayments by the LP to a corporation he owned and used these funds to cover his personal expenses, frustrating his creditors.
- The court held that Peterson's entities were his alter ego and the separate corporate personalities no longer existed. This allowed the court to disregard the LP structure and pierce the veil.

In addition to the usual veil piercing standards, reverse veil piercing also requires a court weigh the impact on innocent partners or members, the impact on innocent creditors, and the availability of alternative remedies. Additionally, a litigant who seeks reverse veil piercing must prove the necessary standards by clear and convincing evidence.

Reverse Veil Piercing Case Law (Continued)

A.G. Dillard, Inc. v. Stonehaus Construction, LLC, 2016 Va. Unpub. LEXIS 16

A creditor sought to collect a judgement against a debtor's LLC by going after other, related LLCs the debtor had which had more assets. The creditor alleged that the defendant had siphoned funds from one LLC and moved it to a different LLC to evade collection. The related entities presented themselves to the public as a single entity and comingled all their assets.

The idea behind the action was to pierce the judgement LLC to get to the debtor, and then reverse pierce to reach the other LLCs. **Was a demurrer granted on the idea of reverse veil piercing?**

No. On appeal the Supreme Court reversed the circuit court's decision to sustain the demurrer. The court stated because the debtor was a member or manager of all the LLCs, the complaint alleged he siphoned funds to avoid collection, and there was a comingling of different entity's assets, the action could not be dismissed.

In essence, because the debtor exerted significant control over all entities and treated the as though they were a single entity, he did not deserve to get protection enough to sustain the demurrer.

Reverse Veil Piercing Case Law (Continued)

Krauss v. Apex Custom Homes, LLC, 2019 Va. Cir. LEXIS 1203

The plaintiff sued for failure to finish the construction of plaintiff' s home. One defendant had several LLC entities that he was a member of, but the case also included a separate defendant who had no equity and was not a member in the LLC that the plaintiff wanted to pierce.

The LLC in question observed corporate formalities, was well capitalized, and defendants had no control or check writing authority over LLC accounts. **Did the court allow reverse veil piercing?**

No. First, the court stated, no Virginia authority has held an individual liable for the debts of an entity to which he is a stranger and vice versa.

The court further stated none of the elements of reverse veil piercing were satisfied, including there being no evidence of fraud or injustice.

They also noted The Supreme Court of Virginia has repeatedly cautioned against "'turning every breach of contract into an actionable claim for fraud' (thereby opening the door for veil piercing) simply because of misrepresentations of the contractor entwined with a breach of the contract."

Reverse Veil Piercing Case Law (Continued)

Bank of Hampton Rds. v. DWH, LLC, 94 Va. Cir. 418 (2016)

The creditor had a judgement against the debtor, who owned a corporation. The debtor was also consultant for DWH LLC, an LLC wholly owned by his fiancée, who paid for all business expenses for the debtor and his corporation. The LLC bid for contracts on behalf of the corporation, received all payment for work done by the corporation and both entities conduct business from the same location.

The creditor sought to use the LLC's assets to cover the debt of the debtor (reverse veil pierce). **Did the court allow it?**

No. The court stated there was no veil to be pierced between the debtor and the LLC because the debtor had no interest in the LLC.

Virginia law does not support disregarding the legal separateness of two different entities, owned by two different individuals, in order to determine that they are de facto the same entity.

The court did note there may be alternative routes for the plaintiffs such as pleading additional facts about the de facto ownership or control of the LLC, successor liability and imputation of income

Business Liability Insurance

Business Liability Insurance can help protect the financial interests of companies and business owners if they face formal lawsuits or any third-party claims. While this is not a substitute for an asset protection plan, it is a necessity for some businesses. Below are some common types of BLI:

General liability insurance protects against bodily harm to others, property damage, and personal injury

Business income insurance protects against the loss of business income

Professional liability insurance protects against errors that your business has made in the products/services it sells

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Fraudulent Conveyance

What is a Fraudulent Conveyance?

In Virginia, a fraudulent conveyance is a transfer of property made with the intent to hinder, delay, or defraud creditors

§ 55.1-400

A fraudulent conveyance is a gift, conveyance, assignment, or transfer of, or charge upon, any estate, real or personal, made with intent to delay, hinder, or defraud creditors.

This section shall not affect the title of a purchaser for valuable consideration, unless it appears that he had notice of the fraudulent intent of his immediate grantor or of the fraud rendering void the title of such grantor.

§ 55.1-401	If a transferor is insolvent (incapable of meeting the current demands of creditors or having liabilities which, in total, exceed the book value of assets) at the time a transfer is made or becomes insolvent due to the transfer, without valuable consideration, then the transfer shall be voidable by prior creditors. This section does not require finding of an intent to hinder, delay or defraud on the part of the grantor or grantee.
§ 55.1-402	A complaint can be filed by a creditor to set aside a conveyance, declared void by Sections 55.1-400 or 55.1-401, before obtaining judgment or decree. Thus, a potential creditor need not wait until the underlying legal action has run its course before filing suit to challenge a debtor's convevance.

What is a Fraudulent Conveyance? (Continued)

§ 55.1-403	In any action brought by a creditor pursuant to Section 55.1-400 or 55.1-402, where a conveyance is declared void, the court "shall award counsel for the creditor reasonable attorney fees against the debtor." Furthermore, upon a finding of fraudulent conveyance pursuant to Section 55.1-400, the court may assess sanctions (including attorney fees) against all parties who participated in the conveyance
§ 55.1-404	A court may set aside a fraudulent conveyance or voluntary transfer pursuant to Section 55.1-400 on "its own motion, provided that all parties who have an interest in the property subject to the conveyance or transfer are given notice of the proceeding."

Statute of Limitations

Under Virginia law, a fraudulent conveyance has no specific statute of limitations but is governed by the concept of Laches. Laches is defined as the neglect or failure to assert a known right or claim for an unexplained period of time under circumstances prejudicial to the adverse party. See In re: Porter, 37 B.R. 56, 66 (E.D. Va.1984).

However, under Virginia law a voluntary conveyance has a statute of limitation of five years. Va.Code § 8.01-253

Voluntary vs. Fraudulent Conveyances

Voluntary

- A voluntary conveyance is the transfer of property from one party to another without consideration or for nominal consideration.
- This type of transfer is typically done as a gift or for estate planning purposes.
- The transferor does not intend to defraud creditors; the intent is usually benevolent, such as to provide for family members.
- Generally, voluntary conveyances are legal and valid as long as they do not harm creditors.
- § 8.01-253 applies: A lawsuit to void must be filed within five years of recording or discovery

Fraudulent

- A fraudulent conveyance is a transfer of property made with the intent to hinder, delay, or defraud creditors.
- This type of transfer is designed to put assets beyond the reach of creditors, often when the debtor is insolvent or facing significant financial difficulties.
- The primary purpose of the transfer is to avoid paying debts or fulfilling obligations to creditors.
- Similar to voluntary conveyances, fraudulent transfers often involve inadequate or no consideration.
- SOL is governed by Laches

Case Law

Bernstein Bros. Mgmt. v. Miller, 44 Va. Cir. 69, 69 (Cir. Ct. 1997)

An employee who worked for a company that collected rents was accused of embezzling $ 1,398,124 between 1981 and 1995. The company sought the return of funds distributed from the Defendant to others, including her family. It was proven Defendant was insolvent and there was no consideration in these transfers.

Did the Court allow all payments over the 14-year period to be recovered?

No. An expert witness testified that even a simple spreadsheet would have detected the Defendant's embezzlement.

As a result, the court found the statute of limitations under § 8.01-253 applied, because the company should have discovered her thefts earlier. As a result, any gift made before 1991 was not recoverable

Types of Fraudulent Conveyance

Actual Fraud (In Fact): Intentional transfer of property to defraud creditors based on the Debtor's subjective intent . The circumstances surrounding the conveyance are not such that the law conclusively infers a fraudulent intent from them, but where the parties have actually intended to delay, hinder or defraud the creditors or purchasers.

Arias v. Jokers Wild, *73 Va. Cir. 281, 302 (Cir. Ct. 2007)*

Constructive Fraud (In Law): The law itself conclusively infers the fraudulent intent from the intrinsic nature of the circumstances without an inquiry into the actual intent of the parties to the transaction.

Arias v. Jokers Wild, *73 Va. Cir. 281, 302 (Cir. Ct. 2007)*

Actual Fraudulent Conveyance

If a transfer is made with the specific intent to avoid satisfying a specific liability, then actual intent is present. Actual intent focuses on the mindset of the debtor at the time of the transfer. Regardless of the financial situation of the debtor, or the amount of the consideration received by the creditor, a showing of actual intent to defraud can be used to set aside any transfer. The actual intent test requires the existence of a connection between the debtor and the creditor at the time of the transfer.

Example: Dr. Brown runs over a woman and her poodle. Fearing an imminent lawsuit, Dr. Brown transfers $20,000 to his brother. At the moment the woman was run over, she became a present creditor. Dr. Brown had specific intent to defraud her, and the old lady can seek to set aside the transfer of $20,000.

Constructive Fraudulent Conveyance

In constructive (in law) fraudulent conveyances, there is usually no reasonably equivalent value in the transaction and there is either undercapitalization OR transfers by persons about to incur debts.

Whether there is equivalent value is based on a case by case, question of fact analysis.

Example: A debtor, who is struggling financially and unable to pay their debts, sells a property worth $100,000 to a friend for $1,000. They do not intend to defraud creditors; they just want to get money to help themselves stay afloat.

How Courts Evaluate Fraudulent Conveyance

In a fraudulent conveyance case, a court looks at the enumerated badges of fraud, as a part of a totality of circumstances analysis. These badges include:

- Relationship of the Parties
- Grantor's Insolvency
- Pursuit of Grantor by Creditors at Time of Conveyance
- Consideration
- Retention of Interest in the Thing Transferred

In a suit to set aside a fraudulent conveyance, proof of the fraudulent intent must be "clear, cogent and convincing." Hutcheson v. Savings Bank of Richmond, 129 Va. 281, 289 (1921). However, because "of the difficulty of establishing 'actual intent,' evidence of fraud may be, and generally must be, circumstantial." In re: Porter, 37 B.R. at 63.

Burden of Proof

Once a party introduces evidence to establish a badge of fraud, "the burden shifts, and the defendant must establish the bona fides of the transaction."

First National Bank of Bluefield v. Pressley, 176 Va. 25, 28 (1940).

Relationship of the Parties

The relationship between parties, by blood or marriage, calls upon the Court for careful and close scrutiny for any transaction. But a mere relationship in of itself is not conclusive evidence of a fraudulent conveyance.
Johnson v. Lucas, 103 Va. 36 (1904)

Hutcheson v. Savings Bank, 129 Va. 281 (1921)

- The relationship of a father and son did not constitute a badge of fraud when they did business with each other
- But, the Court scrutinized that the father and son did not complete the subject transaction in accordance with the accustomed usages of business:
  - There were no evidences of indebtedness for the conveyance (loans) from father to son.
  - The father allowed transaction payments to become delinquent; no payments were ever made to the father.
  - The transaction debts were not listed on the son's subsequent bankruptcy filing.
- Court determined this was a fraudulent conveyance.

Grantor's Insolvency

The mere fact that an insolvent debtor makes a conveyance is not conclusive evidence that the debtor perpetrated a fraud upon his creditors.
See McClintock v. Royall, 173 Va. 408 (1939)

Bank of Commerce v. Rosemary & Thyme, Inc., 218 Va. 781(1978)

In the case of insolvency, transactions in which the party that received payment was aware of the transaction's fraudulent nature are likely to be deemed fraudulent conveyances.

- However, the mere fact of payment of a valid debt by an insolvent corporation was insufficient to make the payment fraudulent even if it had the incidental effect of releasing other creditors
- This badge may be implicated if the debtor becomes insolvent because of the transfer or is already be insolvent when the transfer occurs

Pursuit by Creditors

The badges of fraud have been implicated when there was threat of litigation by creditors at the time of the transfer, in addition other elements of fraud. Westwood Bldgs. Ltd. P'ship v. Grayson, 96 Va. Cir. 312 (Fairfax County 2017)

Lawyers Title Ins. Corp. v. P.R.T. Enters., 65 Va. Cir. 271, 276 (2004)

The more that is owed, the more the strict the court will be in applying this factor. This is because more money owed means there is more motive to defraud or hinder creditors. For example, in this case the debtor admitted to owing millions of dollars to the pursuing creditors, putting the debtor in a precarious financial situation.

- The timeline of events (when the conveyance happened in relation to the pursuit or notification of/by creditors) is also scrutinized
- Was the property concealed from Creditors?

Lack of Consideration

Mere inadequacy of price is not grounds for setting aside a conveyance, unless so gross as to shock the conscience and furnish decisive evidence of fraud.
Young v. Willis, 82 Va. 291 (1886)

Grayson v. Westwood Bldgs. L.P., 300 Va. 25, 859 S.E.2d 651 (2021)

- Consideration deemed valuable at law' means, in effect, 'something,' or 'adequate consideration to support a contract.' The Virginia Code's language creates a standard that requires only that something of value be exchanged and does not require equivalence."

Flame S.A. v. Indus. Carriers, 39 F. Supp. 3d 769, 788 (E.D. Va. 2014)

- Any transaction must evidence fair market consideration with observance of corporate formalities and records, as opposed to parties who "intermingle their funds via sham transactions whereby funds are transferred between one company or another in disregard of corporate formalities and on an as-needed basis."

Retention of Interest

One of the badges whereby a fraudulent intent may be discovered is the circumstance that the grantor remains in possession of the granted property
Young v. Willis, 82 Va. 291 (1886)

Fox Rest Assocs., L.P. v. Little, 282 Va. 277, 286 (2011)

In this case a Manager of an LP was sued in a derivative action. He retained an interest in a jointly held bank account with his wife where he deposited funds from the company. He was also aware of the investor's dissatisfaction before the transfer and retained possession of office equipment that had supposedly been sold.

Creditor Remedies

1

The court may void the conveyance and return the fraudulently conveyed asset to the grantor. Plaintiff could then seek or try to enforce a judgement

2

The court may award the plaintiff creditor reasonable attorney's fees against the debtor.

3

The court may assess sanctions against anyone (parties, lawyers, professionals, etc.) who participated in the conveyance.

Case Law

Grayson v. Westwood Bldgs. L.P., 300 Va. 25, 859 S.E.2d 651 (2021)

The case involves a dispute between a landlord (Westwood Buildings L.P.) and several tenants and associated parties (Grayson et al.) over alleged fraudulent and voluntary conveyances. The landlord claimed that these conveyances prevented it from collecting significant rent owed by the tenants.

Did the Supreme Court uphold the trial courts granting of in personam judgements against the tenants?

No. The statutory remedy for fraudulent conveyance is simply to declare the conveyance void and return the asset to the transferor.

The court stated that while in personam judgement is a possible equitable remedy, it can only be used in extraordinary circumstances and is subject to some limitations: The in-personam-judgment exception applies to "recipients of fraudulent cash transfers" and not to "other participants or coconspirators" in the fraudulent scheme.

Case Law (Continued)

Grayson (Continued)
Can debtors legally prefer one creditor over another?

→

Yes. A debtor has the right to prefer one creditor to another. Giving such a preference is not fraudulent, though the debtor be insolvent, and the creditor is aware at the time that it will have the effect of defeating the collection of other debts

Grayson (Continued)
Can a bookkeeper be liable for their involvement in a fraudulent conveyance under the statute?

→

Generally, No. Here, the bookkeeper was not a debtor attempting to place the funds out of the reach of her creditors. Nor was she a transferee pocketing the money for herself. The fraudulent conveyance statutes only apply to debtors who transfer and to those who receive from the conveyance.

Case Law (Continued)

In re White, 28 B.R. 240, 243-44 (Bankr. E.D. Va. 1983)

White transferred a substantial portion of his assets to relatives and a family trust prior to filing for bankruptcy. He was insolvent at the time of the transfer and received nothing of legal value in return.

The trustee in bankruptcy sought to recover these transfers, alleging that they constituted fraudulent conveyances. **Did the court agree?**

Yes. Many badges of fraud were present here:

- A close relationship between the parties involved in the transfer.
- Inadequate consideration for the transfer.
- The timing of the transfer in relation to the debtor's financial difficulties.
- The retention of control or benefits of the transferred property by the debtor.

Case Law (Continued)

Mathews v. Bond, 146 Va. 158 (1926)
If an insolvent debtor retains indefinite, exclusive possession or de facto ownership of the conveyed asset, does that constitute a fraudulent conveyance?

Yes, if the debtor has possession/ownership to such an extent that doing so effectively defeats the conveyance "in its entirety,".

Bank of Com. v. Rosemary & Thyme, Inc., 218 Va. 781 (1978)
If an insolvent corporate debtor gives preference to a creditor of the corporation who is also a stockholder and director, does that permit an inference of fraud?

Yes, if the corporate debtor is under the "complete control" of the director. This "complete control," however, must exist to such an extent that the corporate debtor and the creditor-director are "one and the same." Absent that, a director of a corporate debtor may in good faith direct the corporation to pay its debts to him in preference to other creditors

Charging Order Protection Clauses

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Automatic Security Interest Clause

- Hinders the ability of potential creditors from seizing assets by granting an automatic security interest in each member's interest to the LLC, essentially creating a pre-existing lien on the member's interest
- Clause would apply when creditors attempt to seize LLC's assets due to member's personal financial difficulties
- The pre-existing lien held by the LLC would need to be satisfied before any claim could be made against the member's interest

Example:
"To further protect the assets of the LLC, the members agree to grant an automatic security interest in their respective membership interests to the LLC. The LLC shall file a UCC-1 financing statement to perfect this security interest."

This measure serves to hinder potential creditors of individual measures from seizing the assets of the LLC, ***as the creditors would need to satisfy the existing lien held by the LLC.***

Member Loan Back Provision

Provides an alternative mechanism for an affected member to satisfy a charging order without exposing the LLC's Assets to creditor by offering to loan the affected member an amount equal to the FMV of their interest

Example:
"In the event a Member's interest in the LLC is subject to a charging order or other adverse claim, the LLC may, at its sole discretion, offer to loan the affected Member an amount equal to the fair market value of the Member's interest, secured by the Member's interest in the LLC. The loan shall bear interest at a commercially reasonable rate and shall be repayable on terms and conditions determined by the LLC. The loan proceeds may be used by the Member to satisfy the charging order or other adverse claim."

Distribution in Kind

Deters creditors from pursuing a charging order remedy by allowing the LLC to make distributions in the form of non-liquid assets. Since the assets can be difficult for the creditor to liquidate or monetize, this may discourage a creditor from targeting the LLC's assets.

Example:

"If a Member's interest in the LLC becomes subject to a charging order, the LLC may, at its discretion, make distributions in kind to the affected Member, rather than in cash. Such distributions may consist of non-liquid assets, such as real property, equipment, or other illiquid assets, which may be difficult for the creditor to liquidate or monetize. ."