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Lack of Perfection

People throw away what they could have by insisting on perfection, which they cannot have, and looking for it where they will never find it.

- Author, Edith Schaeffer

It seems that family practitioners have trouble with businesses owned by a party to a divorce. Oftentimes the Judgment of Divorce will grant a party a lien on the spouse's business without the Court having jurisdiction over it. In other words, if the business is not a party, what authority does the Court have to encumber it?

In Michigan, there are numerous forms of businesses and ownership interests which can be created. Limited Liability companies, Corporations, Limited Partnerships to name a few. Clearly, a Judge could compel a litigant to execute the necessary documents to encumber their business. However, what if the business is also owned in part by a third party? The answer is found in basic business law.

Counsel who have had experience with commercial lending will recognize that a determination of corporate authority is necessary for a valid lien. Typically, this will be accomplished by a corporate resolution which authorizes a member or corporate officer to execute the loan documents. This is necessary to prove that in addition to a properly perfected lien, that the signatory had authority to sign.

Such issues as: provisions for meetings of the board (MCL 450.1521), numerosity for a quorum (MCL 450.1522), officer authority under the bylaws (MCL 450.1531), if an LLC, whether it is managed by managers (MCL 450.4203) all must be considered. Without corporate authorization, the lien may be unenforceable.

Of great concern is that the lien claimant may only have perfected against the membership interest and not the spouse's limited liability company. MCL 450.4507(1) states:

On application to a court of competent jurisdiction by any judgment creditor of a member the court may

charge the membership interest of the member with payment of the unsatisfied amount of judgment with interest. To the extent the membership interest is so charged, the judgment creditor has only the rights of an assignee of the membership interest. This act does not deprive any member of the benefit of any exemption laws applicable to his or her membership interest.

When a charging order is entered, the judgment creditor only receives an *assignee's* interest in the LLCs under MCL 450.4506. The assignee cannot exercise the member's rights in the LLC, nor are they entitled to any benefit other than distribution from the LLC. If the LLC does not pay a distribution, the spouse would be left with what is effectively an unenforceable lien.

An example will illustrate this problem. Assume that the business is a single asset LLC owned by the spouse and his mother. The Judgment of Divorce provides that a lien is granted against the LLC and the spouse's membership interest in it. After entry of the Judgment of Divorce, you attempt to perfect but the spouse indicates that he cannot encumber the LLC's assets without authority from his mother (which she conveniently refuses to provide). Further, though the LLC previously provided cash flow to the spouse, it has been previously by the members that they are going to be using the surplus cash to service the mortgage. Here, the Court had no jurisdiction over the LLC so its order for lien is unenforceable. Additionally, though the Court had granted a lien on the membership interest, it is no longer paying distributions to the members. The result is you have an unperfected lien on the business and a perfected lien on the membership interest which pays nothing. Obviously the Court would still have other enforcement powers over the spouse but that does not get your client paid or protect the collateral from refinance or other lien claimants.

It is recommended that in cases involving a business, counsel should evaluate and determine the extent of the spouse's corporate authority. Alternatively, retain seasoned business counsel to review the business provisions of the Judgment of Divorce and to prepare the necessary documents *before* the entry of the Judgment.

