



Limited Liability Companies' Member's Interests and Charging Orders: Nevada's Exclusive Remedy for Judgment Creditor

By Elizabeth Sorokac and Jacqueline N. Walton

The state of Nevada offers many economic benefits for individuals and businesses, including the lack of state corporate and personal income tax, favorable business laws, and other favorable tax benefits for businesses. One benefit of Nevada's business laws to both individuals and businesses is the charging order remedy. A charging order is a statutory remedy available to a judgment creditor of a member of a Nevada limited liability company ("LLC") whereby the judgment creditor may seek an order from a court to charge the member's interest in the LLC with the amount of a judgment. See NRS 86.401(1).

The history of the charging order

Charging orders were originally established by statute to serve as a solution to common law remedies that were not effective in reaching partnership interest. *Weddell v. H2O, Inc.*, 271 P.3d 743, 749 (Nev. 2012), (citing *Green v. Bellerive* 763 A.2d 252, 256 (Md.Ct.Spec.App.2000)). Originating in England, the charging order concept was first adopted in the United States with the 1914 Uniform Partnership Act. *Id.*; see also Jay D. Adkisson, Carter G. Bishop & Thomas E. Rutledge, *Recent Developments in Charging Orders*, BUSINESS LAW TODAY, February 2013. Since then, the charging order concept has been extended from partnerships to limited liability companies and, in Nevada, to corporations. See NRS 87A.480, 88.535 and 78.746.

Member's interest in a limited liability company

In 1991, Nevada became the fifth state to officially recognize the limited liability company as a form of legal entity through the adoption of Assembly Bill 655. *Weddell*, 271 P.3d at 749; see also Keith Paul Bishop & Jeffrey P. Zucker, *Bishop and Zucker on Nevada Corporations and Limited Liability Companies*, 16.1 & n.7 (2011). An LLC is governed

by Chapter 86 of the Nevada Revised Statutes, its articles of organization, and its operating agreement, to the extent one exists. Pursuant to NRS 86.801, a member of an LLC is "the owner of a member's interest in a limited liability company or a noneconomic member." A member's interest is defined as "a share of the economic interests in a limited liability company, including profits, losses and distributions of assets." NRS 86.091. A member's interest in an LLC is considered the personal property of the member. NRS 86.351(1).

Subject to the LLC's articles of organization and operating agreement, members of an LLC are vested with management rights in proportion to each member's capital contribution to the LLC. NRS 86.291.

Judgment creditors' rights under a charging order

A charging order is the exclusive remedy for a judgment creditor seeking to satisfy the debt of a member of an LLC, regardless of whether the LLC is a single- or multiple-member LLC. The judgment creditor seeks a charging order from a court and, if issued, the charging order directs the LLC to make distributions directly to the judgment creditor that would otherwise be made to the debtor member. Specifically, NRS 86.401(1) provides:

On application to a court of competent jurisdiction by any judgment creditor of a member, the court may charge the member's interest with payment of the unsatisfied amount of the judgment with interest. To the extent so charged, the judgment creditor has only the rights of an assignee of the member's interest.

A charging order does not allow the judgment creditor to reach the LLC's assets or step into the member's shoes, as the judgment creditor only has the rights of an assignee of the member's interest through the charging order. *Weddell*, 271 P.3d at 749-50; see also NRS 86.401(1); *Green*, 763 A.2d at 259. Upon the issuance of the charging order and as an assignee of the member's share of the profit of the LLC thereunder, the judgment creditor is not entitled to participate in

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the management of the LLC nor does it obtain any interest in the assets of the LLC through the charging order. On the other hand, the debtor member no longer has any rights to distributions from the LLC (due to the charging order), but the debtor member does retain all other rights as a member, including the right to continue managing the LLC, if applicable. *Weddell*, 271 P.3d at 750.

Nevada Revised Statute 86.401(2) specifically provides that no other remedy is available to the judgment creditor in its efforts to satisfy an unsatisfied judgment against a member with the debtor's member interest. This exclusion includes, but is not limited to, the foreclosure on the member's interest by the judgment creditor that is successful in obtaining a charging order.

Practice tips

Determination of governing law. Not all states offer the same protections as Nevada to those with member interests in an LLC. For example, some states' statutes allow the foreclosure by the judgment creditor on a member's interest while others do not expressly provide a charging order as the judgment creditor's exclusive remedy. Thus, organizing in Nevada is the first step toward protecting the LLC from other individuals or entities (other than the chosen members of the LLC) in exerting ownership or management rights in the LLC.

Bankruptcy. One note of caution is that in the bankruptcy context, state law does not control if the Bankruptcy Code directs a contrary outcome. *See, e.g., In re B&M Land and Livestock, LLC*, 498 B.R. 262 (2013) (concluding that where a debtor has a membership interest in a single-member LLC and files for bankruptcy, the trustee's rights include the right to manage the entity).

Drafting agreements to address the charging order. In drafting an LLC's operating agreement, it is important to consider whether to include provisions in anticipation of a charging order, such as an involuntary transfer provision (where the other members of an LLC may purchase the debtor's member's membership interest upon the issuance of a charging order) or an automatic dissolution clause (whereby the LLC automatically dissolves upon the issuance of a charging order). Further, provisions of NRS 86.401 do not supersede any agreement between the judgment creditor and the member. The judgment creditor and member may negotiate an agreement for the payment of the debt, which may include the sale of the debtor member's membership interest. However, clauses in operating agreements limiting and/or restricting a member's ability to transfer or sell its membership interest are common and must be considered in any agreement regarding the payment of the judgment.

Alternative entities. Other forms of legal entities offer similar protections to an LLC, including the lack of availability of equitable remedies (i.e., charging order exclusive remedy). However, in the case of a corporation, the alter-ego doctrine may be available under certain circumstances. *See* NRS §78.746. **G**

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