

## **Charging Order Limitations – You Can't Charge What They Don't Own**

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In North Carolina, a creditor who obtains a judgment against an individual with an ownership interest in a limited liability company or limited liability partnership may enforce its unsatisfied judgment by petitioning the court for a charging order.

As its name suggests, a charging order "charges" the LLC or LLP with the repayment of an unsatisfied judgment by requiring it to pay the judgment creditor the distributions it would otherwise pay the judgment debtor. Essentially, the judgment creditor becomes the holder and beneficiary of the economic interest in the LLC or LLP.

Charging orders are useful because they allow judgment creditors to reach interests often out of reach due to the many protections afforded to LLC members. But as a recent case from the North Carolina Business Court reveals, a judgment debtor can complicate a creditor's efforts to successfully charge an economic interest by transferring the interest. A creditor can't obtain a charging order on a membership interest that a debtor no longer owns, nor can a creditor force an LLC or LLP to satisfy a judgment on behalf of an employee with no membership interest.

In December 2019, two creditors obtained a judgment against an individual who, at the time, was a certified public accountant with an interest in the accounting firm Rives & Associates, LLP. Following judgment, the CPA's license was suspended. The suspension impacted his ownership in the LLP.

In April 2020, the judgment creditors, unaware of the potential issues with the CPA's ownership interest in the LLP, moved to charge his interest in the LLP and other businesses. In May 2020, the CPA told the judgment creditors that there had been discussions between himself and the LLP about the repurchase or cancellation of his ownership interest, but no transfer had been finalized. In June 2020, the court heard the motion. No mention of the potential transfer of the ownership interest was made at the hearing by either party. The court entered an order charging the CPA's interest in the LLP.

Later, the judgment creditors discovered that the CPA had transferred his interest in the LLP before entry of the charging order and possibly even before the CPA had informed them of the possibility of

the transfer. As a result, the judgment creditors pursued an order to enforce the charging order against the LLP. The creditors contended the transfer was a sham and the court could still enforce the order against the CPA's interest, which they were not convinced he irrevocably surrendered. They believed he was still receiving payment from the LLP – payments that the charging order could intercept to apply to the judgment.

The court disagreed, holding that the CPA had transferred his interest before entry of the charging order. Consequently, the CPA could not have received any payments from the LLP on his interest and, therefore, could not have violated the charging order by failing to remit payments (as there were none). The court reached this conclusion even though the CPA held himself out as a partner in the practice long after the charging order and the transfer of his partnership interest. For example, the CPA signed tax documents as a partner of the LLP in 2022.

The court held that false representations on tax documents might violate other laws but did not violate the charging order, as the CPA had no interest in the partnership. The judgment creditors were left with no interest to pursue, despite the CPA's continued involvement with the LLP. (This decision did not address whether the transfer of the membership interest was a voidable or fraudulent transfer under North Carolina law.)

But all hope was not lost. The court entered an order preventing the CPA from transferring any of the other business interests he held. While the judgment creditors could not pursue the LLP interests, they retained the opportunity to collect from the CPA's other business ventures.

This case highlights the challenges that may arise in the enforcement of charging orders and the importance of truly understanding the assets and interests of your judgment debtor. Creditors who choose to pursue charging orders should have a clear understanding of the existence and nature of membership interests.

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