An Examination of the Charging Order under Kentucky’s LLC and Partnership Acts

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The widespread use of the LLC and, to a lesser degree, general and limited partnerships has necessitated an increased awareness of the charging order. Today, in an environment of economic contraction and business failures, the import of the charging order has greatly increased. Part I of the article is focused upon the application and implications of the statutory formulae employed in Kentucky. While the charging order statutes in Kentucky are unique, they incorporate language employed in many states, so the guidance provided has application outside of the Commonwealth. Part II of the article addresses the federal tax treatment of the charging order, the application of the Uniform Commercial Code, and the charging order in bankruptcy.
An Examination of the Charging Order Under Kentucky’s LLC and Partnership Acts (Part I)

Thomas E. Rutledge and Sarah Sloan Wilson

INTRODUCTION

The charging order is the exclusive remedy by which a judgment creditor of a member or partner (or an assignee/transferee thereof) may collect on the stream of distributions from limited liability companies (“LLCs”) or partnerships (both general and limited) organized in Kentucky. Serving primarily to protect the asset partitioning function of the venture, the charging order has a secondary effect—to protect the in personam delectus rule embodied in LLC and partnership law.

The rise of the LLC and the recent modernizations of partnership law have contributed to the greater use of these forms. In addition, the recent economic downturn and the need to collect on judgments have prompted a flurry of interest in charging orders. Consequently, attorneys advising creditors or debtors, as well as the courts issuing and implementing charging orders, need to understand this chimerical remedy.

Part I of this Article focuses on state-law issues incident to the charging order, while Part II is devoted to the charging order in other areas of law such as taxation, bankruptcy, and conflicts. In the first section of Part I, the authors state the law of charging orders generally. The second section discusses the reach of the charging order, including the rule of exclusivity and the existence of exemption laws. Finally, section three reviews the implications of the charging order procedure for the parties involved, as well as the company itself.

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I. Charging Orders Generally

The charging order is a remedy provided to the judgment creditor of a member or assignee by which the creditor may attach the distributions (interim and liquidating) made to a member or assignee, thereby diverting that income stream in satisfaction of the judgment. The charging order is a rather involved concept that may morph through redemption and foreclosure, the effect of which is relativistic. Since its adoption in 1994, the charging order provision of Kentucky’s LLC Act has been repeatedly amended, namely in 1998, in 2007, and in 2010. The 2007 amendments were aimed at precluding a result similar to that rendered in Hubbard v. Talbott Tavern, Inc., where a charging order was treated as an assignment of the underlying LLC interest, which triggered the member’s disassociation from the company. In 2010, the charging order provisions were supplemented to (a) make express that the entity is not a party to the proceeding in which an order is entered against the judgment debtor, and (b) authorize that notice of the issuance of the charging order may be by the awarding court or as it otherwise directs. Similarly, each of Kentucky’s partnership and limited

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3 In other words, the implications of a charging order—for example, the process of redemption and foreclosure—may be viewed differently depending upon whose perspective (LLC/partnership, member/partner, assignee/transferee, or creditor) is being examined.


9 See infra Section III.A.1.

partnership acts contains charging order provisions.\textsuperscript{11} There is, however, no such concept in Kentucky's corporate acts.\textsuperscript{12}

Essentially, the charging order is a lien attaching to any distributions that might be made to a member or assignee.\textsuperscript{13} The objective of the charging order is to secure the judgment creditor's receipt of those distributions while, at the same time, precluding that judgment creditor from interfering with the activities of the LLC as a going concern. While the charging order

\begin{itemize}
  \item \textsuperscript{11} Ky. Rev. Stat. Ann. § 362.285 (West Supp. 2010) (Kentucky Uniform Partnership Act (KyUPA)); Ky. Rev. Stat. Ann. § 362.481 (West Supp. 2010) (Kentucky Revised Uniform Limited Partnership Act (KyRULPA)); Ky. Rev. Stat. Ann. § 362.1-504 (West Supp. 2010) (Kentucky Revised Uniform Partnership Act (KyRUPA)) of 2006); Ky. Rev. Stat. Ann. § 362.2-703 (West Supp. 2010) (Kentucky Uniform Limited Partnership Act (KyULPA) of 2006). The charging order has its genesis in partnership law. For reviews of the charging orders as adopted in section 28 of the Uniform Partnership Act, see Alan R. Bromberg, Crane and Bromberg on Partnership § 43 (1968); J. Gordon Gose, The Charging Order Under the Uniform Partnership Act, 28 Wash. L. Rev. & St. B.J. 1 (1953); and Elliot Axelrod, The Charging Order—Rights of a Partner’s Creditor, 36 Ark. L. Rev. 81 (1983). Given the similarities among the charging order provisions for LLCs, partnerships, and limited partnerships in Kentucky, this Article will discuss the LLC provisions in the text, but will cite to the relevant portions of the other acts, as well as indicate parenthetically any noteworthy distinctions. Exhibit A to this Article sets forth a side-by-side comparison of the various statutes; Exhibits will be appended to Part II of this Article. The outlier situations are those limited partnerships organized under either Kentucky’s 1970 adoption of the Uniform Limited Partnership Act (amended 1997) or the predecessor law. Should a judgment debtor have a claim against one who is a partner in a limited partnership governed by either statute, consideration will need to be given to the substantive charging order provisions of the controlling act while keeping in mind the “linkage” to general partnership law. See, e.g., Ky. Rev. Stat. Ann. § 362.690 (West 2006) (repealed 1988).

  \item \textsuperscript{12} The charging order is not, outside of Nevada, a concept employed in corporate law. See generally Thomas E. Rutledge, Nevada’s Corporate Charging Order: Less There Than Meets the Eye, 11 J. Passthrough Entities 21 (2008); see also Thomas E. Rutledge, Postscript, 12 J. Passthrough Entities 48 (2010). Outside of the “traditional” unincorporated forms, the charging order has been included as well in cooperatives formed under the Uniform Limited Cooperative Association Act. See UNE, LTD. COOP. ASS’N ACT § 605, 6B U.L.A. 233 (2008). An atypical charging order is utilized in the Uniform Statutory Trust Entity Act (USTA). See UNE, STATUTORY TRUST ENTITY ACT § 606, 6B U.L.A. 84 (Supp. 2010); see also Thomas E. Rutledge & Ellisa O. Habbart, The Uniform Statutory Trust Entity Act: A Review, 65 Bus. Law 1055, 1088–90 (2010). The charging order has traditionally existed to preserve the asset partitioning function of the business organization. See infra note 15 and accompanying text. In the USTA, in contrast, the charging order exists to preclude creation of, in effect, a self-settled spendthrift trust through a governing instrument that precludes involuntary alienability of the beneficial interest. When alienability is limited, the judgment creditor of the beneficial owner judgment debtor may access all distributions as they are made through the charging order.

also protects the *in personam delectus* rule otherwise embodied in LLC law, its *sine qua non* is asset partitioning and the preservation of the venture’s assets and operations. The charging order is subject to redemption, and the LLC interest to which the charging order relates is subject to foreclosure.

The issuance of a charging order presupposes a judgment. The charging order may be issued by any “court of competent jurisdiction,” a class broader than only the court that issued the original judgment. As such, a charging order may be issued by the court of a state in which a foreign judgment has been domesticated. The amendments made in 2010 clarify that the LLC itself is not a necessary party to an action in which a charging order may be issued.

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order is sought. Once granted, the charging order may be served on the LLC in care of its registered agent.

### A. Appointment of a Receiver

A court may appoint a receiver to receive the distributions made with respect to the judgment debtor’s LLC interest. The receiver is simply a mechanism for the implementation of the charging order and is not required—the obligations of the LLC are neither heightened nor lowered by reason of a receiver’s appointment.

The faculty of the receiver is narrow and is restricted to passive receipt on behalf of the judgment creditor. While likely dictum, the following observation made in *Wyoming National Bank v. Bennett*, as to the notion of a charging order receiver, is noteworthy:

> A receiver appointed under this Act would not have the usual powers of a receiver, possessing the rights of the insolvent for the purpose of administering his estate for the benefit of the creditors under the direction

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of the Court. His right under this Act is not to administer but simply receive the share of the insolvent partner in the profits of the concern.25

B. “Other Orders”

The Kentucky LLC Act authorizes the court issuing the charging order to issue “all other orders, directions, accounts, and inquiries.”26 From this language it may appear that the court has the capacity to order the LLC to make distributions or otherwise interfere with its internal operations. That is, however, the wrong reading. The court’s authority to so act is limited to those actions “the judgment creditor might have made.”27 As the judgment creditor has no right to participate in the LLC’s management, neither does the court have that authority. The court’s authority is restricted to orders that assure the judgment creditor’s receipt of the distributions that would otherwise be made to the judgment debtor. This authority extends to enforcing the right to receive a declared but unpaid distribution28 and to challenge a waste of company assets.29

II. The Charging Order’s Reach

Although the Kentucky LLC statute stipulates that the charging order is a judgment creditor’s “exclusive remedy” as against the member’s limited liability company interest, in certain contexts this rule has not prevailed.30 For example, a judgment creditor may seek equitable remedies, such as piercing, in certain circumstances. Moreover, as will be discussed, one


27 See Ky. Rev. Stat. Ann. § 275.235 (West 2006) (“At the time a member becomes entitled to receive a distribution, the member shall have the status of, and shall be entitled to all remedies available to, a creditor of the [LLC] with respect to the distribution.”).

28 See, e.g., Windom Nat’l Bank v. Klein, 254 N.W. 602, 605 (Minn. 1934) (holding receiver for charging order had standing to challenge dissipation of partnership assets); Taylor v. S & M Lamp Co., 12 Cal. Rptr. 323, 329 (Dist. Ct. App. 1961) (allowing holder of charging order to challenge disposition of partnership property “without a fair and adequate consideration or for the purpose of defrauding creditors of the partnership or of individual partners”); Cent. Petroleum Corp. v. Korman, 177 N.Y.S.2d 761, 764 (Sup. Ct. 1958) (holding as improper a transfer by a limited partnership of which judgment debtors were general partners of its assets to a corporation the shares of which were held in trust by certain limited partners for the limited partnership and ordering that conveyance be rescinded).

foreign jurisdiction has allowed a turn-over of a single-member’s entire LLC interest. In the bankruptcy context too, exclusivity may be overridden by a bankruptcy trustee’s right to directly access an LLC’s assets.

In addition, to the extent the exclusivity rule applies, an exemption law may preclude certain amounts from being deemed “distributions” subject to a charging order, thus preventing a judgment creditor from accessing them (subject, of course, to the aforementioned exclusivity exceptions).

In the exclusivity and exemption contexts especially, courts and legislatures have struggled to balance, on one hand, the right of a judgment creditor to recover the amount of the underlying judgment and, on the other, the LLC’s asset partitioning function and, to a lesser extent, the *in personam delectus* rule.

A. Exceptions to Exclusivity

1. *A Turn-Over Order as an Alternative to the Charging Order.*—The charging order is the exclusive remedy of a judgment creditor vis-à-vis the judgment debtor’s limited liability company interest. However, while the charging order is the exclusive means of reaching the limited liability company interest, it is not the exclusive remedy for reaching the proceeds thereof. The benefit of the charging order is that it binds the LLC to pay the distribution to the judgment creditor; there is no risk of the judgment debtor dissipating or otherwise applying any funds distributed. Still, while it would not bind the LLC, a general turn-over order against the judgment debtor requiring the transfer to the judgment creditor of distributions received is permitted.

2. *Piercing Exception to Exclusivity.*—It does not appear that a Kentucky court has directly addressed the question of reverse piercing a business organization in order to make its assets available to satisfy an owner’s debt to a third-party. Assuming that reverse piercing is available as a remedy, there is the question as to whether, in the context of an LLC, reverse piercing is precluded by the “exclusivity” component of the charging order provision. While the suggestion that where there is a complete unity

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33 In a typical (forward) piercing case, the effort is to access shareholder/owner personal assets to satisfy a debt of the business entity.
34 See, e.g., *C.F. Trust, Inc. v. First Flight Ltd. P’ship*, 580 S.E.2d 806, 811 (Va. 2003) (holding that reverse piercing is possible under Virginia law and listing similar determinations of other jurisdictions).
of ultimate beneficial ownership and the judgment debtor justifies making
the assets of the venture available to satisfy the judgment creditor has been
rejected by one California court, the court’s opinion in no way suggested
that the elements necessary for piercing (other than perhaps the conclusory
statement that it would be unjust to the judgment creditor) were present.
Piercing, forward or reverse, is an equitable remedy that calls for setting
aside the asset partitioning that is otherwise provided for by statute. In
circumstances in which piercing is appropriate, there is no policy basis for
permitting the exclusivity provision to preclude that result.

3. Olmstead: Turn-Over of a Single-Member LLC’s Entire Interest.— The
decision of the Florida Supreme Court in Olmstead v. FTC addressed the
question of whether, in the context of a single member LLC (“SMLLC”),
the judgment creditor (namely the FTC) of the sole member was limited
to the rights incident to a charging order; or, in the alternative, could the
creditor obtain a valid order requiring the members, pursuant to other
remedy laws of Florida, to surrender all “right, title and interest” in the
LLC. If the former, the FTC could expect to realize nothing, as Olmstead
would determine whether, when, and in what amounts the LLC would
make distributions, with a reasonable assessment that distributions would
not be forthcoming. If the latter, the FTC would exercise control of the
LLC’s assets, presumably liquidating them to satisfy its judgment.
The decision turned initially on the fact that the charging order
provision of the Florida LLC Act did not provide that the charging order
was the exclusive remedy available to the judgment creditor of a member.


Based upon the lack of a declaration of exclusivity, the court determined that the application of the generally applicable remedy statute requiring a turn-over of the judgment creditor’s property, in this instance the entire interest in the LLC, did no violence to the LLC Act as the LLC had no other members whose interests needed to be protected.\footnote{Under Florida law, the approval of all incumbent members other than the transferor is required to admit the transferee as a member of the LLC. See \textit{Fla. Stat. Ann.} \textsection{} 608.432 (West 2007). In a single-member LLC the set of other incumbent members is null. \textit{Id.}}

The \textit{Olmstead} decision’s failures are numerous, even as one appreciates the desire to undercut the asset protection efforts of a scam artist. Those failures include:

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  \item the failure to recognize the prior rulings that held the charging order to be the exclusive remedy even in the absence of a statutory declaration of exclusivity;\footnote{See \textit{Givens v. Nat’l Loan Investors}, L.P., 724 So. 2d 610, 612 (Fla. Dist. Ct. App. 1998) (holding that Florida’s RULPA charging order is the remedy for the judgment creditor of a limited partner); \textit{Atl. Mobile Homes, Inc. v. LeFever}, 481 So. 2d 1002, 1003 (Fla. Dist. Ct. App. 1986) (Under the Florida UPA “the statutory charging order is the only means by which a judgment creditor can reach the debtor’s partnership interest”); \textit{see also} \textit{Myrick v. Second Nat’l Bank of Clearwater}, 335 So. 2d 343, 345 (Fla. Dist. Ct. App. 1976) (stating that under Florida UPA a judgment creditor must begin with a charging order before other collection mechanisms may be employed).}
  \item and the (incorrect) categorization of the rule of \textit{in personam delectus} as the \textit{sine qua non} for the charging order.\footnote{In \textit{Albright}, 291 B.R. at 539.}
\end{itemize}

Given Kentucky’s express declaration of exclusivity, an \textit{Olmstead}-type challenge should be rejected.\footnote{At the same time, in appropriate circumstances, a reverse-pierce of the SMLLC should be available, and a lenient standard for ordering a foreclosure sale should be applied. \textit{See also infra} Part III.C.5.}

4. \textit{Bankruptcy.---In re Albright} addressed the question of whether the bankruptcy trustee of the SMLLC could exercise complete control over the company, or rather, was restricted to the rights of the holders of a charging order.\footnote{\textit{In re Albright}, 291 B.R. 538 (Bankr. D. Colo. 2003); \textit{see also} \textit{Thomas E. Rutledge & Thomas Earl Geu, The Albright Decision—Why a SMLLC is Not an Appropriate Asset Protection Vehicle}, 5 BUS. ENTITIES 16 (2003).} The trustee sought to access directly the LLC’s assets as part of Albright’s bankruptcy estate, while Albright wanted her estate to include only those distributions (presumably none) authorized by her.\footnote{In re \textit{Albright}, 291 B.R. at 539.}
The court determined that Albright’s bankruptcy estate included her right to control the LLC and that the trustee could exercise that control to access the SMLLC’s assets.\footnote{47}{Id. at 541.}

Thus, despite the exclusivity rule, a judgment creditor may pursue certain narrow alternate means to recover the amount due on the underlying judgment. Given that courts and legislatures have developed ways to circumvent exclusivity—most notably, the Florida Supreme Court’s decision in \textit{Olmstead}—counsel of both parties should consider these exceptions and their applicability (or non-applicability) to a client’s case. Reliance on the charging order alone could lead to an uncomfortable surprise in the event a court applies one of the exceptions discussed. For example, a judgment creditor may fail to pursue an alternate means of recovering the underlying judgment; or, a debtor may be more vulnerable to attack than the terms of the charging order suggests.

\textbf{B. Exemption Laws}


Where the member views the current distribution as “salary” (it may be characterized for tax purposes as an Internal Revenue Code § 707(c) “guaranteed payment[ ]”\footnote{51}{See I.R.C. § 707(c) (2006).}), he or she may seek to argue that at least some portion thereof is exempt from the charging order by reason of Kentucky Revised Statute (KRS) section 275.060(5) and the limits set forth in KRS section 427.010(2).\footnote{52}{See Ky. Rev. Stat. Ann. § 427.010(2) (West 2006) (setting limits on portion of “aggregate disposable earnings” that may be garnished); see also Ky. Rev. Stat. Ann. § 427.005(1) (West 2006) (defining “earnings”); Ky. Rev. Stat. Ann. § 427.005(2) (West 2006) (defining “disposable earnings”).}
Initially, it must be recognized that the exemption from the definition of what constitutes a “distribution” of reasonable compensatory payments in KRS section 275.225(7) is expressly limited to that provision and does not serve to exempt compensatory payments from being “distributions.”

In Roberts v. Frank Carrithers & Bros., the Kentucky Supreme Court considered a statute exempting from attachment ninety percent of the “salary, wages or income earned by labor” in the context of gain realized in the sales of tobacco derived through a sharecroppers’ arrangement. In rejecting the debtor’s assertion that the tobacco constituted his wages and income for the year, the court wrote:

It appears that he is a farmer, and in growing the crop of tobacco in controversy was conducting a business upon his own account, and not as a servant or employee of another. . . . A salary is the consideration paid or agreed to be paid to a person at regular, fixed periods, in consideration for his services, and wages has a similar meaning, except that salary is ordinarily used when speaking of the employments of a more dignified character.

Both salary and wages are terms invariably used in defining the consideration which an employer bestows upon one who is serving him in consideration for his services, and is usually a consideration in money, and is never applied in describing the gain, profit, or recompense which accrues to one who is conducting a business of his own and upon his own account.

While this decision is rather dated, it supports the conclusion that the garnishment limits do not apply to distributions by an LLC to its members. While there is limited law from foreign jurisdictions that reaches the opposite conclusion, those decisions are dependent upon the construction of a particular state’s exemption statute.

Thus, the parameters of what constitutes a distribution under a charging order may vary depending upon state law. Counsel to the judgment creditor should be prepared in the event a debtor attempts to exclude certain sums as “salary” such that they are exempt from the definition of distributions subject to the charging order.

54 202 S.W. 659 (Ky. 1918).
55 Id. at 660.
56 Id. at 661; see also Borkowski v. Commonwealth, 139 S.W.3d 531 (Ky. Ct. App. 2004) (applying section 220 of the Restatement (Second) of Agency and holding that member of an LLC was not an employee entitled to unemployment insurance benefits).
58 See PB Real Estate, Inc. v. Dem II Props., 719 A.2d 73 (Conn. App. Ct. 1998) (rejecting effort by two members of LLC to characterize as other than “distributions” funds received from the LLC).
III. Application

A. Implications of the Issuance of a Charging Order

1. For the Judgment Debtor.—As long as the charging order is in place, excepting any payments that may still be received by operation of any applicable exemption statute, no distributions will be made by the LLC to the judgment debtor. Any distributions that would otherwise go to the judgment debtor are to be passed by the LLC to the judgment creditor (or the court appointed receiver, if any). At the same time, any distributions made on the judgment debtor’s behalf to the judgment creditor will have the same impact on the judgment debtor’s capital contribution and the capital accounts.59 If not exempt from taxation (e.g., return of basis), the judgment debtor will bear the tax liability on the payments diverted pursuant to the charging order. The judgment debtor remains a member of the LLC with all the rights related thereto, including the right to participate in the management and affairs of the company. The member, by reason of a charging order, has not “assigned” his LLC interest.60

The decision in Hubbard v. Talbott Tavern, Inc.,61 as it relates to charging orders, was not a correct application of the law and was overruled in 2007 by legislative act. In this case, the Kentucky Court of Appeals upheld a trial court order that “assigned” to the judgment creditor the judgment debtor’s LLC interest in each of three LLCs, and further, directed that the judgment debtor be dissociated and cease to be a member of each of the LLCs. The court also held that the assignments of the LLC interests would continue until the judgment was satisfied. The trial court justified the order of dissociation on the basis of KRS section 275.280(1)(d)(1), which provides that members are dissociated when they “make[] an assignment for the benefit of creditors.” The charging order statute then in effect did not use the word or otherwise authorize an assignment.62 In 2007, the

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59 See Ky. Rev. Stat. Ann. § 275.185(1)(e)1 (West Supp. 2010) (stating that an LLC is obligated to maintain record of capital contributions made and to be made by the members).


62 Even were a charging order an “assignment,” it would not fall within the “makes an assignment for the benefit of creditors” language of KRS section 275.280(d)(1). This provision must be read pari passu with all of the subsections of KRS section 275.280(d) as to what is the “assignment for the benefit of creditors,” essentially the state law equivalency of bankruptcy but without discharge of unsatisfied indebtedness. See Black’s Law Dictionary 129 (8th ed. 2004) (defining “assignment for benefit of creditors”); see also 1 Larry E. Ribstein & Robert R. Keatinge, Ribstein and Keatinge on Limited Liability Companies § 7.8 n.3 (2d ed. 2010) (“A mere pledge or encumbrance, without more, should not be characterized as an assignment
title of KRS section 275.260 was changed from “Judicial assignment of member’s company interest” to “Member’s transferable interest subject to charging order.” With this change in title, the prior (inaccurate) suggestion that a charging order constitutes an assignment was removed. Of greater importance was the following addition to the charging order: “A charging order does not of itself constitute an assignment of the [LLC] interest.” In consequence, it is not possible to equate a charging order with an assignment, and it is clear that absent a provision to that effect in the controlling operating agreement, the entry of a charging order does not affect the judgment debtor member’s dissociation from the LLC.

2. For the Company.—The charging order provisions of the LLC statute expressly provide that the judgment creditor holding a charging order has only the rights of the assignee and specifically has “no right to participate in the management or to cause the dissolution of the [LLC].” As such, the holder of a charging order is not in a position to inspect the records of the LLC, to attend meetings of or vote with respect to its conduct and affairs, to vote with respect to any amendment of the operating agreement, to because the pledgee’s or creditor’s rights last only until the debt is discharged.”). The subsequent bankruptcy and death of the member were relied upon by the Court of Appeals to support the dissociations, but that court failed to address the initial incorrect order of dissociation. See also Rutledge, supra note 6, at 252-53.

64 Ky. Rev. Stat. Ann. § 275.260(3) (West Supp. 2010). A careful reading of the LLC Act shows this addition to be something of a redundancy. Section 275.255(3), as of the time of the Talbott Tavern decision, provided that a lien on an LLC interest did not constitute an assignment. Once a charging order is understood to be a lien, it is clear that a charging order does not effect an assignment.


68 The operating agreement, except as it may provide for third-party beneficiaries, is an
benefit from any fiduciary duties owed by the members or managers, to benefit from any obligation of good faith and fair dealing owed by the members and managers, or to initiate or participate in an action to enforce any rights under the operating agreement.

The LLC is obligated to transfer to the judgment creditor (or any receiver appointed by the court to act on the judgment creditor’s behalf) all distributions that would otherwise be paid to the judgment debtor on account of his interest in the LLC. Those distributions may be interim or liquidating, and for these purposes include distributions that the member may otherwise contemplate (they may even be expressly labeled) as “salary” or other current compensation for services rendered. To the extent that it should disburse the funds directly to the judgment debtor rather than the judgment creditor, the LLC will be in violation of the charging order and will be subject to such sanctions as the issuing court should determine appropriate.

3. For the Judgment Creditor.—From the point that the LLC has notice of the charging order, the judgment creditor may expect to receive any distributions that would otherwise have been paid to the judgment debtor. Still, the judgment creditor has only the rights of an assignee. The judgment creditor holding a charging order has no voice in the management of the LLC and is without any capacity to compel a distribution in order to agreement among the members. See Ky. Rev. Stat. Ann. § 275.015(20) (West Supp. 2010); see also Ky. Rev. Stat. Ann. § 275.003(3) (West Supp. 2010). The holder of a charging order is not thereby an assignee much less a member. As such, the charging order holder has no voice in the amendment of the operating agreement.


71 The obligation of good faith and fair dealing informs other, including fiduciary, duties that exist; of itself, it creates no duties. See, e.g., Nemec v. Shrader, 991 A.2d 1120 (Del. 2010).

72 Not being a party to the operating agreement, the holder of a charging order has no standing to bring an action for its enforcement.

73 See also Rutledge, supra note 6, at 259; supra notes 48-52 and accompanying text.


75 See also supra notes 61-65 and accompanying text.
satisfy the judgment. The income tax treatment of the payments received will be determined under other law.\textsuperscript{76}

\textbf{B. Redemption of the Charging Order}

The LLC interest subject to a charging order may be redeemed by the judgment debtor, by the other members in the venture, or by the LLC.\textsuperscript{77} The right to redeem the charging order must be exercised prior to foreclosure.\textsuperscript{78}

It is relatively clear that the purpose of the redemption mechanism is to permit either the LLC or the remaining members to avoid the consequences of a foreclosure.\textsuperscript{79} For example, consider an LLC in which the active involvement of a particular member is central to its ongoing operations and the maintenance of its goodwill. Should the judgment creditor foreclose on that member’s interest, she will thereafter be stripped of any economic participation in the venture. By means of redemption, either the venture or some subset of its fellow members can avoid that eventuality. Consequently, the venture should be afforded notice of any application to foreclose upon the limited liability company interest.\textsuperscript{80}

That said, shockingly little is resolved as to the character and effect of redemption. Possibly, in consideration for a payment to the judgment creditor, the benefits afforded the judgment creditor by the charging order are released. The subsequent relationship between the redeemer and the judgment debtor is not addressed in the statute or in any published ruling. Consequently, all that can be said about the redemption, beyond the fact of its possibility, is in the nature of informed supposition and inference.

\textsuperscript{76} Compare I.R.C. § 104(a) (2006) (payments received in compensation for physical injuries are exempt from taxation), with I.R.C. § 104(a)(2) (2006) (payments received as punitive damages are taxable as ordinary income).


\textsuperscript{80} See id.
1. **Implications for the LLC.**—The default rule that the redemption of a charging order requires the consent of all members other than the judgment debtor is not specifically identified as being subject to modification in an operating agreement (written or otherwise), but a modification should be enforceable. The statute is silent as to the mechanism by which the judgment debtor, the (to-be-former) judgment creditor and the redeemer give notice to the LLC of the redemption.

The statute also does not address (a) the status of the former judgment debtor’s limited liability company interest vis-à-vis the redeemer’s claim, and (b) the nature of the redeemer’s claim against the former judgment debtor.

2. **Implications for the Judgment Creditor.**—Upon redemption, the judgment creditor will receive the redemption payment in satisfaction of the judgment (or an agreed portion thereof) and will cease to be the beneficiary of the charging order. The income tax implications of the funds received in connection with the redemption should track that of any payments received from the LLC in satisfaction of the judgment.

3. **Implications for the Judgment Debtor.**—Where the judgment debtor is the redeemer, he will be freed to the effect of the charging order and any distributions made with respect to the formerly charged LLC interest will be paid to him as a member.

The situation is far less clear where the redemption is done by the other members or by the LLC. Partnership experts have opined as follows, albeit without the support of case authority:

If the partnership or other partners redeem, they should be viewed as succeeding to the judgment creditor’s rights under the charging order. Although the statutory language on redemption is unclear and there is little authority on point, the redeeming partnership or partner owns only the right to be repaid the redemption price from the debtor partner’s future distributions and not the actual interest.

The statute is also silent as to (a) the judgment debtor’s interest in the previously charged LLC interests vis-à-vis any rights therein now vested in the redeemer(s), (b) the judgment debtor’s status as a member in the LLC, and (c) the nature of the redeemer’s claim against the judgment debtor. The essential unresolved question is whether the redeemer acquires the judgment creditor’s claim or the judgment debtor’s interest in the LLC. There is a dearth of guidance as to the tax treatment of the judgment

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debtor regarding the redemption consideration paid to the judgment creditor. Still, for prospective tax purposes, the now-redeemed judgment debtor is no longer a “partner” and the redeemer becomes, as to those LLC interests, a “partner.”

C. Foreclosing on the Charging Order

A charging order is a lien, and in certain instances the lien may be foreclosed upon; note that this is a foreclosure under state organizational law as distinct from a foreclosure under the Uniform Commercial Code (UCC). (The inter-relationship of the foreclosure provisions of the UCC and a charging order is a matter that has been oft discussed amongst academics and academic-leaning practitioners, but never resolved.) Foreclosure on the LLC interest subject to a charging order may be ordered by the court at any time,84 but when foreclosure is appropriate is not defined by statute. Typically, foreclosure will be deemed appropriate (and there are statutes in other jurisdictions which indicate that this is the rule) when the stream of distributions from the venture will not in any reasonable period of time satisfy the judgment and, it is at least implied, a sale by foreclosure would generate a better rate of satisfaction for the judgment creditor.85 Foreclosure should be ordered in only limited circumstances, but upon that order, while the purchaser becomes the titleholder of the LLC interest, the purchaser only obtains the rights of an assignee.86

1. Implications for the LLC.—Upon foreclosure, the judgment debtor may be dissociated from the LLC and cease (absent a contrary provision in

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85 See Gose, supra note 11, at 16 n.51 (“There is actually no authority whatsoever as to when a [foreclosure] sale should be ordered. Necessarily the order must fall in the area of those ‘which the circumstances of the case require.’ The apparent situations in which sale would be necessary are those in which, owing to the size of the claim or the absence of current liquid income, an order to pay over the debtor partner’s share of current income and other moneys would not be effective.”); see also Stewart v. Lanier Park Med. Office Bldg., Ltd., 578 S.E.2d 572, 574 (Ga. Ct. App. 2003) (citing Nigri v. Lotz, 453 S.E.2d 780 (Ga. Ct. App. 1995)); FDIC v. Birchwood Builders, Inc., 573 A.2d 182, 185 (N.J. Super. Ct. App. Div. 1990).

the operating agreement) to enjoy any right to participate in the LLC’s management.\textsuperscript{87} The LLC will need to convey all distributions that would have been made to the judgment debtor to the foreclosure sale purchaser. The LLC is also required to send to the judgment debtor a Form K-1 for all allocations through the date the foreclosure is effective.

2. Implications for the Judgment Creditor.—Upon foreclosure, the judgment is satisfied to the extent of the payment (often a credit bid by the judgment creditor) made to acquire the judgment and any other consideration, and the judgment creditor succeeds as an assignee to the judgment debtor’s LLC interest. While the purchaser at the foreclosure sale will have the right to receive all the distributions the judgment debtor was entitled to receive from the LLC, \textsuperscript{88} he is otherwise a stranger to the LLC. Absent admission as a member of the LLC,\textsuperscript{89} the purchaser is not entitled to inspect the books and records of the LLC, has no right to participate in the management of the LLC, has no voice in the enforcement or the amendment of the operating agreement, and is owed neither fiduciary obligations nor an obligation of good faith and fair dealing.\textsuperscript{90}

3. Implications for the Judgment Debtor.—Upon foreclosure, the judgment debtor is relieved of ownership of the charged LLC interest and has no right to receive distributions or other economic rights with respect thereto. The judgment debtor will remain a member of the LLC unless and until expulsion by the remaining members.\textsuperscript{91} By private ordering, an operating

\textsuperscript{87} See also Ky. Rev. Stat. Ann. § 275.280(1)(c)2 (West Supp. 2010). Pursuant to amendments adopted in 2011, if the foreclosed member was the sole member, foreclosure will effect an automatic dissociation. See H.B. 331, § 15, 2011 Gen. Assemb., Reg. Sess. (Ky. 2011); see also infra note 100.


\textsuperscript{90} See supra notes 66 through 72 and accompanying text.

agreement may provide for the termination of all member rights upon the
transfer of all economic rights, including upon foreclosure of the charging
order.

4. Gaining Control of the Multiple Member LLC’s Underlying Assets to Satisfy the
Judgment Creditor.—There is no mechanism by which a judgment creditor,
either as the holder of a charging order or alternatively upon the foreclosure
of the LLC interests (presumably done by a credit bid at a sale on the
courthouse steps), may either directly compel a distribution of LLC assets
for its benefit or compel the liquidation of the LLC with the distribution
of all assets to the various stakeholders.

Under the LLC Act, upon foreclosure of the charging order, the acquirer
thereof is a mere assignee of the judgment debtor’s LLC interests. While the
purchaser, as an assignee, will have the right to receive whatever
distributions, whether interim or liquidating, would have been made to
the assignor from whom the LLC interest was acquired, it is express that
an assignee does not have the right to participate in the management of
the LLC. Under the LLC Act, an assignee does not have the right to
move for judicial dissolution of the LLC; rather, the right to move for
judicial dissolution is restricted to members. Further, the right to move
for judicial dissolution is restricted to the basis “that it is not reasonably
practicable to carry on the business of the [LLC] in conformity with the

Uniform Limited Partnership Act, a partner, general or limited, ceases to be a partner upon as-
signment of their interest in the partnership without the requirement of further action by the
dictions the member would be expelled automatically upon the foreclosure with the necessity

92 See supra notes 88-90 and accompanying text.

interest at the foreclosure sale has the rights of an assignee.”); Ky. Rev. Stat. Ann. § 275.255(1)
(c) (West Supp. 2010) (“An assignment of a limited liability company interest shall not dis-
solve the limited liability company or entitle the assignee to participate in the management
and affairs of the limited liability company or to become or exercise any rights of a member
other than the right to receive distributions pursuant to subsection (1)(b) of this section.”);
foreclosure purchaser has the rights of a transferee); Ky. Rev. Stat. Ann. §§ 362.1-503(i)(a),
Ann. § 362.2-702(i)(c), (2) (West Supp. 2010) (detailing the rights of a transferee).

94 See Ky. Rev. Stat. Ann. § 275.290(1) (West 2006) (stating that the LLC may be dis-
solved “in a proceeding by a member”).
operating agreement.” Presumably this right must be exercised by one who is a party to that operating agreement, and an assignee is not.

An article in Probate and Property, written from the perspective of asset protection, lamented that in certain exceptional circumstances it would be possible for a judgment creditor of a member to bring about the dissolution of an LLC organized under the 2006 Revised Uniform Limited Liability Company Act. On closer analysis, this is not an actual risk.

5. Gaining Control of the Single-Member LLC's Underlying Assets to Satisfy the Judgment Creditor.—Unlike the situation in a multiple-member LLC, there is a route by which the judgment creditor may access the LLC’s assets, rather than only a stream of distributions from the LLC, to satisfy the underlying judgment. Note that this is a multi-step process and does not result from the mere issuance of a charging order.

The holder of a charging order against the sole member of an SMLLC has no more right to participate in the LLC’s management than she would have were it a multiple-member LLC. If the court orders a foreclosure on the SMLLC, absent redemption, the judgment creditor will become the assignee of the interest (assuming for these purposes that the judgment creditor will be the purchaser). Being the assignee of the last member, the judgment creditor may unilaterally elect herself into member status. At this juncture, the former judgment creditor holding the passive rights of the charging order holder has morphed into the sole member of the LLC, possessing the right (subject to claims of the LLC’s creditors) to directly access the LLC’s assets to satisfy the judgment.

96 See Elizabeth M. Schurig & Amy P. Jetel, The Alarming Potential for Foreclosure and Dissolution by an LLC Member’s Personal Creditors, PROB. & PROP., May-June 2006, at 42, 47.
98 See supra notes 66 through 72 and accompanying text.
99 See Ky. Rev. Stat. Ann. § 275.285(4)(b) (West Supp. 2010); see also Rutledge, supra note 7, at 245-46. Prior to 2011 the statute was ambiguous on this point. A member, having transferred all of her interest in the LLC (as would happen upon foreclosure), may be dissociated by a majority-in-interest of the remaining members. See Ky. Rev. Stat. Ann. § 275.280(1)(c)(2) (West Supp. 2010). But what is the situation when “other members” is a null set? Is the better interpretation that dissociation is automatic, or rather is there simply no mechanism by which dissociation of the member may be accomplished? In 2011 the statute was amended to address this ambiguity, providing now, inter alia, that upon the transfer of all of a sole member’s interest in the LLC (as would happen upon foreclosure) the member is automatically dissociated. See Ky. Rev. Stat. Ann. § 275.280(3)(c)2, 3 (West Supp. 2010) (amended by H.B. 331, 2011 Gen. Assemb., Reg. Sess. (Ky. 2011)).
Part I of this Article explored the charging order, its reach, and its implications for clients, practitioners, and judges. As the exclusive remedy by which a judgment creditor of a member or partner may collect on distributions from LLCs or partnerships, the charging order plays a pivotal (and, many would argue, an increased) role in protecting entity assets. Part II of this Article addresses the taxation of distribution subject to a charging order, charging orders in bankruptcy and charging orders in conflict of laws.
An Examination of the Charging Order Under Kentucky’s LLC and Partnership Acts (Part II)

Thomas E. Rutledge and Sarah Sloan Wilson

INTRODUCTION

In Part I of this Article, the authors explored the charging order, its reach, and its implications for clients, practitioners, and judges. As the exclusive remedy by which a judgment creditor of a member or partner may collect on distributions from limited liability companies (“LLCs”) or partnerships (both general and limited), the charging order plays a pivotal (and, many would argue, an increased) role in protecting entity assets. The primary function of the charging order is asset partitioning; its secondary function protects the in personam delectus rule embodied in LLC and partnership law.

This Article is drafted with the practitioner and court in mind. As charging orders become more common, attorneys will need to understand not only the “who, what, when, where, and why” of charging orders (Part I), but they also must consider the interplay between charging orders and other areas of law (Part II). While by no means exhaustive, Part II of this Article presents some of the tax, bankruptcy, and conflict of laws problems that may be faced by practitioners and offers some advice on how to approach them.

In the first section of Part II, the authors explore the federal tax concerns present in the charging order context. The second section discusses the impact bankruptcy plays on the effectiveness of a charging order. Finally, section three reviews conflict of laws problems. In total, while Part I reviewed the basics of charging orders, Part II expands the scope to include proper consideration of the intersection of other areas of law which may very well affect the charging order remedy.

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2 Sarah Sloan Wilson is an associate with Stoll Keenon Ogden PLLC, in the Lexington, Kentucky, office. A 2009 graduate of the University of Kentucky College of Law, where she served as the Editor-in-Chief of the Kentucky Law Journal, she is a former clerk (2009-10) to the Hon. Eugene E. Siler, Jr., Circuit Judge, the United States Court of Appeals for the Sixth Circuit.
I. Federal Tax and Recording Concerns

A. Tax Treatment of Judgment Debtor and Judgment Creditor

While the charging order is in place, the judgment debtor remains a member in the LLC, and he continues to be a “partner” for purposes of the Internal Revenue Code (“Code”). As such, he bears the tax liability arising out of the allocations of the partnership items of income, gain, loss, deduction, and credit. Notwithstanding the suggestions of certain practitioners in the “asset protection” field, it is the judgment debtor whose LLC interest is subject to the charging order, and not the judgment creditor, who bears the tax liability with respect to allocations made from the charged LLC interest.

The taxation of the funds directed to the judgment creditor by a charging order is not expressly addressed by the Code, but the consensus answer is that the member or partner who is charged remains a “partner” for all purposes of the tax code (just as they are for purposes of state law) and is responsible for all taxes due on allocated income. The fact that the distribution, if and when made, will be paid over to the judgment creditor does not affect who bears the initial tax liability.

Consider ABC partnership. It distributes all of its earnings each year, so we are not concerned with a distribution this year to a partner of a prior year’s after-tax dollars. B is the defendant in a suit and loses. B’s judgment creditor (“Creditor”) is seeking to collect on the judgment. B’s assets are illiquid, and B’s only source of current income is the distributions made by ABC. Creditor applies for and receives a charging order that directs ABC to pay to her B’s distributions from ABC. In the current year, $40,000 is paid by ABC to Creditor in partial satisfaction of the judgment.

So what happens when the time comes to prepare the K-1? Notwithstanding assertions to the contrary, B’s K-1 should reflect an

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4. For these purposes it is assumed that the LLC in question is, for purposes of federal tax classification regulations, a “partnership” or a “disregarded entity.”

5. Essentially, the judgment debtor must satisfy the debt with after-tax, and not pre-tax, dollars.


7. For example, the website of one company in the asset protection industry asserts:

The Internal Revenue Service has also held in Revenue Ruling 77-137 that the creditor with the charging order is treated as a substituted limited partner for tax purposes. As a result, the judgment-creditor is
allocation of $40,000 for which she bears the tax liability, and Creditor should not receive a K-1. Absent extraordinary circumstances, Creditor is not a partner and is not receiving either a portion of partnership income or a guaranteed payment. Rather, Creditor is receiving B’s property to satisfy a judgment. The resolution is based, in part, on IRS General Counsel Memorandum 36960 (1977) and Revenue Ruling 77-137,8 each of which states that the test for who bears the tax liability is who possesses dominion and control over the partnership interest giving rise to the allocable income.9

Creditor holds a right to receive from ABC the distributions that would go to B, a right that will be extinguished when the judgment is satisfied. At that point, B will again receive the distributions. In the meantime, B has not lost the right to participate in the management of ABC, Creditor has no control over ABC or its assets, Creditor is not substituted for B as a partner,10 and B is not bound to exercise her management rights for the benefit of Creditor.11 On these facts, Creditor does not have “dominion and control” over B’s interest in ABC. Creditor has not become, for tax purposes, a substitute partner, and the initial tax liability on the distributions shifted to Creditor remains with B.12

saddled with the tax consequences resulting from ownership without the capacity to force dissolution of the partnership or distributions from the partnership.

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11 Cf. I.R.S. Priv. Ltr. Rul. 84-40-081 (July 6, 1984) (concluding that assignor agreed to vote retained voting rights in accordance with assignee’s written instructions).

12 See Carter G. Bishop & Daniel S. Kleinberger, Limited Liability Companies—Tax and Business Law ¶ 8.07[1][a][ii] (1994); Keatinge, supra note 8 (“[W]here the charging order is similar to a garnishment, the debtor/partner will probably be treated as the partner, required to include the distributive share of income and loss and entitled to a deduction if the payment of the judgment would give rise to a deduction.”); Christopher M. Riser, Tax Consequences of Charging Orders, Asset Protection J., Winter 1999, at 14, 14.
B. The IRS Factor

Not surprisingly, the IRS may try to circumvent the charging order. For example, in the ABC hypothetical, assume also that B is the managing member of the LLC and, under terms of the operating agreement, receives a guaranteed payment of $10,000 per month and up to $40,000 per year of non-guaranteed distributions. Thus, B has two sources of potential income—his $10,000 monthly payment and $40,000 per year of non-guaranteed distributions. Assume also that ABC holds substantial assets worth over $2.5 million. Under the terms of the charging order, and assuming that the $10,000 guaranteed payment was exempted from the charging order, Creditor would be limited to attaching to the $40,000 in distributions if and when made.

Assume instead that the partnership agreement does not require the distribution of all its earnings each year. Setting aside any tax implications of this provision for the judgment debtor, what can Creditor do? The answer is not much—he is still limited to receiving distributions under the terms of the charging order. If nothing is distributed, Creditor has little recourse but to wait for distributions or to foreclose on the charging order interest.

Assume, however, that Creditor is not a plaintiff recovering on a court judgment but the Internal Revenue Service (“Service”). Assume B owes back taxes in the amount of $2 million plus interest. Assume again that the member is entitled to a guaranteed payment of $10,000 per month and $40,000 per year of non-guaranteed distributions. Assume also that the Service levies against both B’s guaranteed payment and B’s LLC interest, and that ABC pays over $10,000 a month to the Service. Pursuant to the provision in the operating agreement that makes distributions purely discretionary, ABC refuses to make any further distributions. As noted previously, if the Service was a normal judgment creditor, the charging order would protect the LLC in this case.

But will the Service be limited to the terms of the charging order that require only that the creditor receive the distributions to which B is entitled? The answer is by no means clear. At least one recent Chief Counsel Memorandum, while not entitled to precedential weight, has suggested that the Service is not so limited.

In the memorandum, the Chief Counsel allowed the Service to levy against income generated by personal injury contingent fee arrangements

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13 See supra notes 7 through 12 and accompanying text.
14 See supra Part I, notes 49 through 58 and accompanying text. The authors, by excluding the guaranteed payout from the charging order, do not intend to imply that to be the correct outcome, but do so here to simplify the illustration being made.
15 See supra Part I, notes 84-100 and accompanying text.
paid by a single member LLC (SMLLC) law firm to its member. While refusing to allow the Service to levy against the LLC assets directly, it concluded that a levy against the taxpayer’s “property” under Code section 6331 would be permissible. In determining what “property” was included under section 6331, the memorandum reasoned that the taxpayer had a property “right to receive income from the LLC,” which, under state law, includes a statutory right “to be repaid his capital contribution and to share equally in the [LLC’s] profits.” The memorandum thus determined that the Service, by serving a notice of levy on the LLC, obligated the LLC to turn over contingent fee sums. It explained that the sums were “fixed and determinable”—and thus owed to the member—“following successful litigation and after setting aside a reserve for overhead expenses.”

Moreover, the memorandum suggested that the member’s net profits could be subject to a continuing wage levy: “there is a possibility that the Service can characterize the profits [the member] receives from the LLC as income subject to a continuing wage or salary levy under I.R.C. § 6331(e).” Thus, it is possible that the Service could argue that discretionary distributions to B are “salary or wages,” at least in the SMLLC context. Provided the operating agreement did not characterize distributions as remunerative, motivated by the member’s “continuing needs,” or “paid out to the delinquent taxpayer on a recurring basis,” however, ABC should be able to withstand a levy. What is clear is that the Service will argue for a broad interpretation of salary or wages, one that could potentially include distributions.

More importantly, considering the amount B owes to the IRS (upwards of $2 million dollars), the IRS will likely attempt to reach the LLC’s assets, which (in the ABC hypothetical) are worth substantially more than either the distributions or the monthly salary allocations. IRS General Counsel has rejected this argument at least twice; however, given the Olmstead

18 Id.
21 Id. at 7.
22 Id. at 8.
23 Id.
24 Id. at 10.
25 Id. at 11.
26 Id. at 11.
27 See id. at 6. In a 1999 tax advice memorandum, the Counsel limited the Service’s collection efforts to the property of the taxpayer, which did not include the property of an SMLLC. I.R.S. Tech. Adv. Mem. 9999-98-00 (July 30, 1999). “The mere fact that the LLC entity is disregarded for federal tax purposes does not entitle the Service to disregard the entity for purposes of collection.” Id. However, the memorandum acknowledged that “the Service may have several collection options including collecting the taxpayer’s distributive interest in the LLC, or collecting from the assets of the LLC on the basis that it is the alter ego of the
decision, as well as the government’s need to generate federal income tax receipts and collect on judgments, it is possible that the IRS may reconsider this position. As a matter of state law, a member of an LLC in Kentucky has no property interest in the property of the LLC.\textsuperscript{28} Thus, the Service should not be successful in levying against the LLC’s assets in Kentucky outside the context of a possible alter ego lien.\textsuperscript{29}

C. Tax Treatment upon Foreclosure

From the foreclosure, the acquirer, for tax purposes, will be the “partner” receiving a Form K-1 and allocations of the items of income, gain, loss, deduction, and credit.\textsuperscript{30} As such, the acquirer at the foreclosure taxpayer.” \textit{Id.} Under the charging order, the Service could recover the distributions owed the member. And, given the \textit{Olmstead} decision’s subversion of the charging order in the SMLLC context, it is even possible that the Service could mount a successful attempt to levy against the LLC’s assets under an alter ego theory. This argument, however, should not prevail in the multi-member LLC (MMLLC) context.


\textsuperscript{29} See Rev. Rul. 73-74, 1973-1 C.B. 602 (concluding that since a partnership checking account is an asset of the partnership and not the property of an individual partner, it is not subject to levy to satisfy a tax assessed against that individual partner). In the 1999 memorandum, the Service explained that the refusal to disregard the LLC entity for collection purposes is not “inconsistent” with the Service’s disregard of the LLC for federal tax purposes, citing to West Virginia law which provided, as does Kentucky, that a member has no transferable interest in property of the LLC. I.R.S. Tech. Adv. Mem. 9999-98-00 (July 30, 1999); compare W. Va. Code § 31 B-5-501(a) (LexisNexis 2009) with Ky. Rev. Stat. Ann. § 275.240 (West 2006).

\textsuperscript{30} The 1999 memorandum left open the possibility of an alter ego lien, based on “reliance on state law principles permitting a creditor to disregard a business entity . . . where the entity is being used to evade payment of taxes.” I.R.S. Tech. Adv. Mem. 9999-98-00 (July 30, 1999) (citing Wolfe v. United States, 798 F.2d 1241, 1244 (9th Cir. 1986), amended on other grounds 806 F.2d 1410 (9th Cir. 1986); Valley Fin., Inc. v. United States, 629 F.2d 162, 171-72 (D.C. Cir. 1980); Hollowell v. Orleans Reg’l Hosp., No. Civ.A. 95-4029, 1998 WL 283298 (E.D. La. May 29, 1998)). Specifically, the memorandum stated that

\textit{[t]he Service can, on a case-by-case basis, consider collection of a tax liability of a member of a single member LLC, from the LLC’s assets, where there are sufficient grounds for “piercing the LLC veil.” Such grounds would include where the taxpayer is using the LLC form to shield assets from the Service, such as where income earned by the taxpayer is being paid directly to the LLC. Although it will be helpful to establish that the taxpayer and the LLC are not practically operating as separate entities, we believe that the most influential factor in litigation may be that the LLC is being used to evade the payment of taxes.}

\textit{Id.; see also} I.R.S. Gen. Couns. Mem. 2008-36-002 (Apr. 23, 2008) (The taxpayer “correctly observed that absent an alter-ego relationship, the Service may not levy upon the LLC’s assets to satisfy the single-owner’s debts.”); supra Part I, notes 33-37 and accompanying text.

\textsuperscript{31} Rev. Rul. 77-137, 1977-1 C.B. 178; \textit{see also} Rev. Rul. 77-332, 1977-2 C.B. 483 (discussing non-CPAs in accounting firms who for state law purposes are not partners but who are partners for tax purposes). Assuming the foreclosure sale takes place during the partnership’s
will bear the risk of phantom income to the extent the LLC does not make distributions.

D. Recording Concerns

The charging order is a judicial, not voluntary, lien, and as such falls outside the scope of UCC Article 9. While the Secretary of State would accept and file a UCC-1 naming the judgment debtor as the debtor, that filing would, strictly speaking, have no effect even though it is not of itself inaccurate. At the same time, an Article 9 filing that identified the LLC as being the debtor would be erroneous as it is not the LLC identified in the charging order that is indebted to the judgment creditor, but rather the judgment debtor who is as well a member. The charging order lien applies not to the property generally of the LLC, on which the member has no claim,32 but rather to that subset of the property to be distributed to the member.33

II. Bankruptcy Concerns

A. Is Either the Judgment Lien or the Charging Order Subject to Discharge in Bankruptcy?

A charging order “constitutes a lien on and the right to receive distributions made with respect to the judgment debtor’s limited liability company interest.”34 In order for that lien to be perfected, the charging order needs to be obtained prior to the filing of the bankruptcy petition.35 A mere application for a charging order only starts the judicial process.


35 Raiton v. G & R Props. (In re Raiton), 139 B.R. 931, 935 (B.A.P. 9th Cir 1992) (“A charging order entered pursuant to California’s Uniform Partnership Act § 15028 replaces a levy of execution and provides the judgment creditor with a lien on the partnership property.”); In re Stocks, 110 B.R. 65, 67 (Bankr. N.D. Fla. 1989); Krauth v. First Cont’l Dev-Con, Inc., 351 So. 2d 1106, 1108 (Fla. Dist. Ct. App. 1977); City of Arkansas v. Anderson, 752 P.2d 673, 684 (Kan. 1988) (issuance and service of the charging order upon the partnership creates a lien on the debtor partner’s partnership interest); see also Pischke v. Murray (In re Pischke), 11 B.R. 913, 918 (Bankr. E.D. Va. 1981) (“[T]he defendant judgment lien holders shall obtain priority, if at all, in the sequence in which they were granted charging orders by a court of competent
for perfecting a lien against a partnership interest; perfection of the lien occurs when a court actually enters a charging order.\textsuperscript{36} The \textit{Rooker-Feldman} doctrine prevents the bankruptcy court from reviewing state court judgments, so the bankruptcy court may not review either the underlying judgment against the debtor or the propriety of the court’s award of a charging order in the creditor’s favor.\textsuperscript{37} A discharge under 11 U.S.C. §§ 727, 1141, 1228(a), 1228(b), or 1328(b) does not discharge a debtor from any final judgment, unreviewable order, or consent order or decree entered in any court of the United States or of any state.\textsuperscript{38} Therefore, a charging order, which is both an unreviewable order and a perfected lien, should not be discharged in bankruptcy. Be aware, however, that older acts (and some newer) may not contain the “constitutes a lien” language.\textsuperscript{39} In those instances, the charging order may not constitute a pre-petition lien, and the judgment creditor holding a charging order risks having the underlying judgment discharged.\textsuperscript{40}

\textsuperscript{36} \textit{In re Jaffe}, 235 B.R. 490, 492 (Bankr. S.D. Fla. 1999); O’Neil v. Miller (\textit{In re Bridge-man}), 197 B.R. 19, 22 (Bankr. D. Conn. 1996) (“[T]he action of the deputy sheriff simply to leave a copy of the order of attachment in the hands of [the debtor’s partner] was ineffective to lien the Debtor’s partnership interest . . . . The in-court statements of the parties . . . could not, and did not . . . constitute a charging order, in the absence of an order entered by the court.”).


B. Is Either the Judgment Lien or the Charging Order Subject to Characterization as a Preference Subject to Bankruptcy Code § 547?41

Both the charging order and the underlying judgment lien are subject to characterization as preferences. For example, in In re Joseph M. Eaton Builders, Inc.,42 the court characterized a partial payment made in satisfaction of a judgment lien as a preference on the basis that the underlying mechanics lien was invalid. In what is therefore likely dictum, the court stated: “[b]ecause the judgment lien itself was obtained within the 90-day preference period, it is subject to the Trustee’s avoiding powers, as is the payment itself which was based upon that judgment.”43

Providing what may be a more nuanced analysis, the decision rendered in In re Deborah Lou Bangert44 observed:

Since § 101(54) includes both voluntary and involuntary transfers, the fixing of a judicial lien on a debtor’s property may constitute a preference if the other § 547(b) requirements are met. . . . “When personal property [as here] is involved, it is almost the universal rule that a mere entry of

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41 The Bankruptcy Code provides, in relevant part, as follows:

b) Except as provided in subsection [] (c) . . . of this section, the trustee may avoid any transfer of an interest of the debtor in property—
(1) to or for the benefit of a creditor;
(2) for or on account of an antecedent debt owed by the debtor before such transfer was made;
(3) made while the debtor was insolvent;
(4) made—
(A) on or within 90 days before the date of the filing of the petition; or
(B) between ninety days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider; and
(5) that enables such creditor to receive more than such creditor would receive if—
(A) the case were a case under chapter 7 of this title;
(B) the transfer had not been made; and
(C) such creditor received payment of such debt to the extent provided by the provisions of this title.

11 U.S.C. § 547(b) (2006) (emphasis added). The pivotal question, of course, is whether the entry of the charging order or the entry of the underlying judgment lien is a transfer for preference purposes.

43 Id. at 58 n.1.
judgment does not create a lien. In such cases, it is only the enforcement of the judgment that can possibly give rise to a preference.\textsuperscript{45}

Thus, there is a risk of “preference” characterization unless both the underlying judgment lien as well as the enforcement method, i.e., entry of the charging order, are entered outside the 90-day preference period. It is not enough that a judicial lien be entered against the debtor prior to the preference period. Rather, the judgment creditor must seek (and have been granted) the enforcement right in the form of the charging order.

Addressing a charging order, the court in \textit{In re Bridgeman} observed as to a hypothetical charging order:

\begin{quote}
[S]uch order would have been entered [eleven] days prior to the Debtor’s bankruptcy filing, would not relate back to the date of the judgment, to any valid attachment or property execution, and would be avoidable as a preferential transfer, pursuant to Bankruptcy Code § 547.\textsuperscript{46}
\end{quote}

Bankruptcy courts are unlikely to relate back a charging order to the date of its underlying judgment. Consequently, if the order was entered within the 90-day performance period, it will be avoidable by the trustee as a preferential transfer.

\textbf{C. Are Payments Made Pursuant to a Charging Order Subject to Characterization asPreferences Subject to Bankruptcy Code § 547?}

In two words, “it depends” (on the characterization of the charging order). Just as the judgment lien or charging order itself may be subject to characterization as a preference subject to section 547 of the Bankruptcy Code, so too may payments made pursuant to such an order if entered during the insolvency period. However, if the underlying charging order is not a preference (i.e., if it was entered prior to the insolvency period), then any future payments made pursuant to it are likewise not preferential transfers. This rule applies even to payments made within the 90-day period.

The issue here is whether there has been a “transfer” of an interest of the debtor in property. Once a charging order has been entered, the judgment creditor—and not the debtor—holds the legal right to receive the distributions that would otherwise have gone to the judgment debtor. As discussed in Part I, the charging order provision of the LLC Act expressly provides that the judgment creditor holding a charging order has the rights of an assignee. While an assignee specifically has “no right to participate in

\textsuperscript{45} \textit{Id.} (quoting ALAN N. RESNICK & HENRY J. SOMMER, \textit{4 Collier on Bankruptcy}, ¶ 547.03[A] (15th ed. 1993)).

the management or to cause the dissolution of the [LLC].”47 An assignee does possess the right to receive any distributions the LLC member and debtor is entitled to receive. The transfer of the right to receive distributions occurs at the time of the entry of the charging order, and not at the time of the distribution.

In J. Neubauer v. Mercantile-Safe Deposit & Trust Company,48 a bank loaned a general partnership $4 million secured by a personal guaranty by one of the partners.49 After the notes fell into default, the bank sought and won a judgment against the partner and then secured a charging order on the underlying liability.50 Subsequently, the debtor filed for bankruptcy, and sought to avoid the charging order as a preferential transfer.51 The bankruptcy court held that the order was not a preferential transfer because it was entered prior to the 90-day period, despite the debtor’s collateral attack on the underlying judgment.52

On appeal to the district court, the bankruptcy judge’s decision was upheld. The district court explained that the charging order “quite plainly identifies the lienor, the property subject to the lien and the specific amount of the lien. It is this Charging Order which remained in effect at the time of the bankruptcy filing.”53 While not explicitly stating that the distributions pursuant to the charging order would likewise not be preferences, the court implied just such a conclusion. Otherwise, the charging order itself would have absolutely no value.

In addition, a subsequent court has cited Neubauer for the proposition that distributions pursuant to a charging order filed pre-petition are not avoidable as preferences, because the “transfer of an interest in property of the debtor occurred when the charging order was created” and not when

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49 Id. at *1.
50 Id.
51 Id.
52 Id. at *1-2.
53 Id. at *4 n.6.
the distributions are made.\textsuperscript{54} In \textit{In re Keeler},\textsuperscript{55} a bankruptcy court addressed the specific question of "whether a charging order obtained by a judgment creditor upon the interests of a judgment debtor in a partnership survives an order of discharge in a subsequent bankruptcy case brought by that debtor."\textsuperscript{56}

In \textit{Keeler}, a judgment creditor secured a charging order against the debtor's interest in a general partnership prior to the 90-day period.\textsuperscript{57} After the bankruptcy case was administratively closed, the debtor requested a reopening on the grounds that distributions pursuant to the charging order violated the order of discharge.\textsuperscript{58} Essentially, the debtor wanted to require the judgment creditor to "pay over" these distributions to him. The court rejected this argument in a cogent opinion that began by discussing the terms of the December 20, 1989, charging order, which was based on an underlying judgment and remained unpaid on the filing date of the bankruptcy petition. The court then reviewed the distributions at issue:

On September 13, 2000, [the escrow agent] filed an answer to the order to show cause in which [it] states that [it] acted as an escrow agent for [the general partnership] of which the debtor is one of the general partners. [The general partnership's] sole asset is asserted to be a limited partnership interest . . . which in turn makes a distribution to [the general partnership] approximately twice a year. These funds are deposited and disbursed by [the] escrow agent to the partners of [the general partnership].

[The judgment creditor] has had a charging order against the Partnership Interests for several years and as a consequence [the escrow agent] has made the distributions attributable to those interests to [the judgment creditor]. Also, according to [the escrow agent], these distributions have been the subject of repeated litigation in the courts of Maryland including several interpleader actions filed by [the] escrow agent. Under a consent order entered in the Circuit Court of Montgomery County, [the escrow agent] has been paying all distributions that would be owed to the debtor, to [the judgment creditor] including distributions in January and July of 1999, preceding the debtor's bankruptcy filing. The February, 2000 distribution was retained by [the escrow agent] pending "resolution of the bankruptcy."

After receiving a copy of the discharge order, [the escrow agent] paid the February, 2000 distribution to [the judgment creditor] in accordance with the prior state interpleader consent order. On July 27, 2000, [the general partnership] received another distribution and [the escrow agent] has held monies otherwise distributable on account of the Partnership Interests,

\textsuperscript{55} \textit{Id.} at 442.
\textsuperscript{56} \textit{Id.} at 444.
\textsuperscript{57} \textit{Id.}
\textsuperscript{58} \textit{Id.}
because of the debtor’s request to reopen and Debtor’s Motion filed in this case.\footnote{59}

The district court then specifically rejected the debtor’s argument that “a charging order is akin to a garnishment of future income under which, as money became available to [the general partnership], the debtor’s distribution was attached by the charging order in favor of [the judgment creditor].”\footnote{60} The court reasoned as follows:

Notwithstanding debtor’s argument to the contrary, a lien is established upon the debtor’s interest in the partnership at the time a levy is effectuated by the obtaining of the charging order . . . .

Although the debtor attempts to characterize the monies which became available for distribution from [the general partnership] post-discharge as future income of the debtor which would be protected against the continuing effect of a writ of garnishment, in fact and law the distributions were on account of the Partnership Interests, which interests had been liened by the charging order . . . .

[Although any action to collect upon the lien was stayed during the bankruptcy case, the lien itself “rode through” the bankruptcy case and remains viable upon property captured before the case commenced. Consequently, the rights of the holder of the lien remain unaffected after the bankruptcy case, including the right to collect income due to the partner (debtor) on account of the Partnership Interests.\footnote{61}]

\textit{Keeler} strongly supports the argument that distributions pursuant to a charging order—provided the order itself is not a preference—are not transfers at all, much less preferential ones subject to section 547 of the Bankruptcy Code.\footnote{62}

However, applying \textit{Keeler}, the LLC may not actually remit distributions to a judgment creditor during the pendency of the bankruptcy action. Instead, as occurred in \textit{Keeler}, the monies are held until the action had concluded. Still, the fact that the distributions are not avoidable will be good news for the judgment creditor and bad news, of course, for the judgment debtor.

\footnote{59}{Id. at 444-45.}
\footnote{60}{Id. at 445.}
\footnote{61}{Id. at 447-48 (internal citations omitted).}
\footnote{62}{See also Raiton v. G & R Props. (\textit{In re Raiton}), 139 B.R. 931, 936 (B.A.P. 9th Cir. 1992) (reversing bankruptcy court, and holding that charging order entered pursuant to California state law provides a judgment creditor with a valid lien on the partnership property). Note, however, that the precedential weight of this Bankruptcy Appellate Panel (“BAP”) decision is unclear and varies among the circuits. Currently, the First, Sixth, Eighth, Ninth, and Tenth Circuits utilize BAP courts, which are panel decisions by bankruptcy judges. BAP appeals are usually faster given that they are reviewed by experts in bankruptcy law (as opposed to normal district judges, who may have no or little experience with the intricacies of the bankruptcy code). The BAP court derives its authority from the Bankruptcy Reform Acts of 1978 and 1994. Like any other decision, they may be appealed to the circuit court.}
It is useful to contrast this analysis with that of the bankruptcy courts in the context of wage garnishments, as did the Keeler court. In wage garnishment cases, bankruptcy courts have consistently held that where the writ of garnishment is served outside the 90-day preference period, the lien attaches at the time the writ is served; however, amounts collected thereunder constitute preferential transfers if made within the 90-day preference period. These courts explain that such payments are preferential transfers because the transfer does not occur until the debtor acquires an interest in his wages by earning them. Keeler and Neubauer suggest that charging orders should be analyzed differently.

III. Conflict of Laws Concerns

There is surprisingly little guidance in the form of published decisions as to the choice-of-law issues that arise in connection with charging orders. Assume Partnership is formed and has its principal place of business in State A. Individual in Partnership resides in State B. Individual transacts business in State C independently of any activities of the Partnership. A State C judgment is entered against Individual based on his activities in State C. Are the judgment creditor’s rights vis-à-vis Individual’s interest in Partnerships governed by the laws of A, B, or C? Assume the laws of C permit foreclosure on the charging order lien while the laws of A do not permit foreclosure. While it is clear that the laws of A define the attributes of individual’s interest in Partnership, it is debatable whether A or C has the most significant interest in the issue.

One should not assume uniformity across state lines. The formula employed in the charging order provision of the Kentucky LLC Act is unique to Kentucky. Other states have different rules. For example, in certain states, a charging order on an LLC interest is not subject to foreclosure. Under Florida law, FIRUPA and FIULPA recite that a

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64 Given the dearth of precedential authority on this issue, a court’s decision regarding preferences is by no means certain in the charging order context. It is possible that a court could conclude instead that a member’s rights to distributions do not arise until the member is entitled to receive them, either by virtue of the operating agreement or by the decision of the management of the LLC, and that, as a result, the assignee or judgment creditor’s rights do not arise until that date. Thus, one could argue that this right to receive distributions is a preferential transfer. This is the argument explicitly (and, in the authors’ opinion, properly) dismissed by the bankruptcy court in Keeler. It has also been the prevailing argument in at least one BAP decision. See In re Raiton, 139 B.R. at 936. Still, as it is not uncommon for various bankruptcy courts to disagree on issues, and because no higher court has addressed the issue, counsel should be prepared to either argue (or combat) such a position and courts should be prepared for such problems to arise.
65 See Restatement (Second) of Conflicts § 6; see also Carter G. Bishop, LLC Charging Orders: A Jurisdictional & Governing Law Quagmire, 12 BUS. ENTITIES 14 (2010).
charging order is the exclusive remedy; however, the Florida LLC Act does not contain similar language, and on that basis it was held to not control, in the context of an SMLLC, the general remedies statute.67

CONCLUSION

As charging orders become more prevalent, courts and practitioners will be forced to address this sometimes chimerical remedy. Given the lack of uniformity, courts and practitioners must first consult applicable state law to determine the procedure, effect, and implications of the charging order. In addition, problems of federal taxation, bankruptcy, and conflict of laws may arise. Thus, the parties involved need to understand both the procedures applicable to obtaining a charging order, as well as the intersection between that remedy and other areas of the law. While not an exhaustive review of these “other areas,” this Part highlights some problems that might arise in the taxation, bankruptcy, and conflict of laws arenas, and offers practical advice as to how to approach them.
Exhibit A

Cross-Statute Comparison of Charging Order Provisions

<table>
<thead>
<tr>
<th></th>
<th>KyLLCA¹</th>
<th>KyRUPA²</th>
<th>KyULPA³</th>
<th>KyUPA⁴</th>
<th>KyRULPA⁵</th>
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</thead>
<tbody>
<tr>
<td><strong>Charging Order Statute (KRS section)</strong></td>
<td>275.260</td>
<td>362.1-504</td>
<td>362.2-703</td>
<td>362.285</td>
<td>362.481</td>
</tr>
<tr>
<td><strong>Exclusivity</strong></td>
<td>Yes⁶</td>
<td>Yes⁷</td>
<td>Yes⁸</td>
<td>Yes⁹</td>
<td>Yes⁴⁶</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>(after 2010 Amendments; previously silent)⁷⁵</td>
<td></td>
</tr>
<tr>
<td><strong>Holder of Charging Order has Rights of Assignee</strong></td>
<td>Yes¹¹</td>
<td>Yes¹²</td>
<td>Yes¹³</td>
<td>Yes¹⁴</td>
<td>Yes¹⁵</td>
</tr>
<tr>
<td></td>
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<td></td>
<td></td>
<td>(after 2010 Amendments; previously silent)⁷⁴</td>
<td></td>
</tr>
<tr>
<td><strong>Express Reference to Interest on Underlying Judgment</strong></td>
<td>No¹⁶</td>
<td>No¹⁷</td>
<td>No¹⁸</td>
<td>No¹⁹ (Previously Yes)²⁰</td>
<td>No (Previously Yes)²⁰</td>
</tr>
<tr>
<td><strong>Receiver</strong></td>
<td>Yes²¹</td>
<td>Yes²²</td>
<td>Yes²³</td>
<td>Yes²⁴</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>(after 2010 Amendments; previously silent)²³</td>
<td></td>
</tr>
<tr>
<td><strong>Additional Court Orders</strong></td>
<td>Yes²⁶</td>
<td>Yes²⁷</td>
<td>Yes²⁸</td>
<td>Yes²⁹</td>
<td>Yes³⁰</td>
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<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>(after 2010 Amendments; previously silent)²⁹</td>
<td></td>
</tr>
<tr>
<td><strong>Charging Order Constitutes a Lien</strong></td>
<td>Yes¹¹</td>
<td>Yes¹²</td>
<td>Yes¹³</td>
<td>Yes¹⁴</td>
<td>Yes¹⁵</td>
</tr>
</tbody>
</table>
1. The Kentucky Limited Liability Company Act.


4. The Kentucky Uniform Partnership Act.

5. The Kentucky Revised Uniform Limited Partnership Act.

6. “This section provides the exclusive remedy by which the judgment creditor of a member or the assignee of a member may satisfy a judgment out of the judgment debtor’s [LLC] interest.” Ky. Rev. Stat. Ann. § 275.260(1) (West Supp. 2010).

7. “This section provides the exclusive remedy by which the judgment creditor of a partner or the transferee of a partner may satisfy a judgment out of the judgment debtor’s transferable interest.” Ky. Rev. Stat. Ann. § 362.1-504(1) (West Supp. 2010).

8. “This section provides the exclusive remedy by which the judgment creditor of a partner or the transferee of a partner may satisfy a judgment out of the judgment debtor’s transferable interest.” Ky. Rev. Stat. Ann. § 362.2-703(1) (West Supp. 2010).

9. Under the prior law there was, however, abundant case law to the effect that the charging order was the exclusive remedy of the judgment creditor. See, e.g., Pischke v. Murray (In re Pischke), 11 B.R. 913 (Bankr. E.D. Va. 1981); Baum v. Baum, 335 P.2d 481 (Cal. 1959); Atl. Mobile Homes, Inc. v. LeFever, 481 So. 2d 1002 (Fla. Dist. Ct. App. 1986).

10. Under the prior law there was, however, abundant case law to the effect that the charging order was the exclusive remedy of the judgment creditor. See, e.g., Pischke v. Murray (In re Pischke), 11 B.R. 913 (Bankr. E.D. Va. 1981); Baum v. Baum, 335 P.2d 481 (Cal. 1959); Atl. Mobile Homes, Inc. v. LeFever, 481 So. 2d 1002 (Fla. Dist. Ct. App. 1986).

“To the extent so charged, the judgment creditor has only the rights of a transferee and shall have no right to participate in the management of or to cause the dissolution of the partnership.” Ky. Rev. Stat. Ann. § 362.1-504(2) (West Supp. 2010); see also Ky. Rev. Stat. Ann. § 362.1-503(1)(a), (2) (West Supp. 2010) (detailing the rights of a transferee).

13 “To the extent so charged, the judgment creditor has only the rights of a transferee, and shall have no right to participate in the management or to cause the dissolution of the partnership.” Ky. Rev. Stat. Ann. § 362.2-703(2) (West Supp. 2010); see also Ky. Rev. Stat. Ann. § 362.1-702(1)(c), (2) (West Supp. 2010) (detailing the rights of a transferee).

14 “To the extent so charged, the judgment creditor has only the rights of a transferee and shall have no right to participate in the management of or to cause the dissolution of the partnership.” Ky. Rev. Stat. Ann. § 362.285(2) (West Supp. 2010); see also Ky. Rev. Stat. Ann. § 362.280(1) (West 2006) (detailing the rights of a transferee).


17 Id.

18 Id.


21 “The court may appoint a receiver of the share of the distributions due or to become due to the judgment debtor in respect of the limited liability company interest and make all other orders, directions, accounts, and inquiries the judgment creditor might have made or which the circumstances of the case may require to give effect to the charging order.” Ky. Rev. Stat. Ann. § 275.260(2) (West Supp. 2010).

22 “The court may appoint a receiver of the share of the distributions due or to become due to the judgment debtor in respect of the partnership and make all other orders, directions, accounts, and inquiries the judgment debtor might have made or which the circumstances of the case may require to give effect to the charging order.” Ky. Rev. Stat. Ann. § 362.1-504(2) (West Supp. 2010).

23 “The court may appoint a receiver of the share of the distributions due or to become due to the judgment debtor in respect of the partnership . . . .” Ky. Rev. Stat. Ann. § 362.2-703(2) (West Supp. 2010).

24 “And may then or later appoint a receiver of his share of the profits, and of any other money due or to fall due to him in respect of the partnership, and make all other orders, directions, accounts and inquiries which the debtor partner might have made, or which the circumstances of the case may require.” Ky. Rev. Stat. Ann. § 362.285 (West 2006) (prior to amendment in 2010).

25 Under KyUPA/KyRULPA, limited partnership law is “linked” to general partnership law. In effect, when a question arises with respect to a limited partnership, and the answer is not set forth in the limited partnership act, references are made to the general partnership act. See Ky. Rev. Stat. Ann. § 362.523 (West 2006). As such, it is possible to argue that the charging order provision of KyRULPA, itself being silent as to the ability to appoint a receiver with
respect to a charged interest in a limited partnership, should be supplemented by reference to
KRS section 362.285 and its express provision that a receiver may be appointed. There is no
Kentucky case law as to this issue.


28 “The court may . . . make all other orders, directions, accounts, and inquiries the
debtor partner might have made or which the circumstances of the case may require to give

29 “And may then or later appoint a receiver of his share of the profits, and of any other money due or to fall due to him in respect of the partnership, and make all other orders, directions, accounts and inquiries which the debtor partner might have made, or which the circumstances of the case may require.” Ky. Rev. Stat. Ann. § 362.285 (West 2006).

30 “The court may . . . make all other orders, directions, accounts, and inquiries the
debtor partner might have made or which the circumstances of the case may require to give

31 “A charging order constitutes a lien on and the right to receive distributions made
Supp. 2010).

32 “A charging order constitutes a lien on and the right to receive distributions made
§ 362.1-504(3) (West Supp. 2010).

33 “A charging order constitutes a lien on and the right to receive distributions made
with respect to the judgment debtor’s transferable interest . . . .” Ky. Rev. Stat. Ann. § 362.2-703(3)
(West Supp. 2010).


36 The provisions to the effect that a charging order does not constitute an assignment
that appear in the LLC Act, KyRUPA, and KyULPA were enacted in 2007 in order to overrule

37 “A charging order does not of itself constitute an assignment of the [LLC] interest.”

38 “A charging order does not of itself constitute an assignment of the transferable

39 “A charging order does not of itself constitute an assignment of the transferable


42 “At any time before foreclosure, the charged limited liability company interest may be

43 “At any time before foreclosure, an interest charged may be redeemed . . . .” Ky. Rev.


“And may then or later appoint a receiver of his share of the profits, and of any other money due or to fall due to him in respect of the partnership, and make all other orders, directions, accounts and inquiries which the debtor partner might have made, or which the circumstances of the case may require.” Ky. Rev. Stat. Ann. § 362.285 (West 2006) (repealed 2008).

“This section does not deprive a member or a member’s assignee of the benefit of any exemption laws applicable to the member’s or assignee’s limited liability company interest.” Ky. Rev. Stat. Ann. § 275.260(5) (West Supp. 2010).

“This subchapter does not deprive a partner or a partner’s transferee of a right under exemption laws with respect to the partner’s or transferee’s interest in the partnership.” Ky. Rev. Stat. Ann. § 362.1-504(6) (West Supp. 2010).

“This subchapter does not deprive any partner or a partner’s transferee of the benefit of any exemption laws applicable to the partner’s or transferee’s transferable interest.” Ky. Rev. Stat. Ann. § 362.2-703(6) (West Supp. 2010).

The prior law provided “Nothing in KRS 362.150 to 362.360 shall be held to deprive a partner of his right, if any, under the exemption laws, as regards his interest in the partnership.” Ky. Rev. Stat. Ann. § 362.285(3) (West 2006) (prior to amendment in 2010).

On _______, judgment in the amount of $_____ was rendered by this Court against __________________ (the “Defendant”) in favor of ___________________ (the “Plaintiff”). The Court, having considered the pleadings, the evidence, and the argument of counsel with respect to the issuance of a charging order against ____________, a [partnership] [limited partnership] [limited liability company] (the [“Partnership”] [“Company”]) in which the Defendant is a [partner] [member], finds that:

1. Defendant is a [partner] [member] in ___________; and
2. Plaintiff is entitled to a charging order against Defendant’s interest in ____________.

It is therefore ORDERED that:

1. The interest of Defendant in the [Partnership] [Company] is subject to a charging order in favor of and for the benefit of Plaintiff;
2. Distributions owed or payable to Defendant by the [Partnership] [Company] shall be paid directly to Plaintiff; and
3. The Defendant will be discharged from its obligations to Plaintiff to the extent of any amounts so paid to Plaintiff, until the judgment against Defendant entered in this case is paid in full.

This Charging Order shall remain binding upon the [Partnership] [Company] until further action of this Court.

Signed on ________________.

______________________________

Prepared by:

______________________________

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