

Equitable Distribution: When does the marital LLC have to be joined as a party?

The equitable distribution statutes only give trial courts the authority to distribute marital property. This means equitable distribution is all about – and only about – identifying property owned by either or both spouses on the date of separation and determining how it should be distributed between those two people.

Marital property may include ownership interests in businesses and corporations. Just as parties can own stock in a traditional C corporation, parties also can own an LLC or an interest in an LLC. And just as a court would not be required to join, for example, Exxon Corporation or Google before distributing stock owned by the parties, a court is not required to join an LLC in an ED case if the court simply distributes the marital ownership interest in the LLC between the parties.

But just as a C corporation is a legal entity, an LLC also is a person in the eyes of the law. So just as a court cannot enter orders affecting the property or personal rights of an individual without first acquiring jurisdiction over that individual and affording that person due process, a trial court cannot enter orders affecting the ‘person’ or the property of the LLC without first acquiring jurisdiction over the LLC by making it a party to the ED action.

Two recent opinions from the court of appeals illustrate this distinction.

[Montague v. Montague, 767 SE2d 71 \(NC App 2014\)](#)

This opinion is an example of the most common ED scenario involving an LLC. Joinder of the LLC was not even discussed by the appellate court because there clearly was no need to make the LLC a party. The former spouses were the sole owners of the LLC and the only issue before the trial court was how to classify, value and distribute the marital and divisible property interest in that LLC and in the funds paid from the LLC to the husband following the date of separation. Neither party claimed that property titled in the name of the LLC should be classified as marital property or distributed by the court, and neither party asked the court to order the LLC, or to order the parties in their capacity as managers of the LLC, to do anything.

While there certainly must have been need for a significant amount of evidence about the finances, daily operations and management of the LLC in order for the court to classify, value and distribute the LLC and the funds distributed by the LLC following separation, the trial court had no need to enter any order directly affecting property owned by the LLC or directly affecting the corporate structure of the LLC. Instead, evidence in the possession of the LLC could be gathered through the use of subpoenas, just as evidence is gathered from non-parties in other types of civil cases. There certainly is no need to join the recipient of a subpoena as a party to a civil case. See Rules of Civil

Procedure, G.S. 1A-1, Rule 45.

[Campbell v. Campbell, 773 SE2d 93 \(NC App 2015\)](#)

The situation was more complicated in this case. The trial court was requested to enter an injunction to protect the value and business integrity of the LLC while the ED case was pending. While the ultimate goal in the ED case was to distribute the marital ownership interest in the LLC, the trial court attempted to protect the marital interest by entering orders that required action by the LLC, ordered the transfer of funds belonging to the LLC, and otherwise affected the 'person' of the LLC by altering the management structure pending the final outcome of the ED case.

The court of appeals explained:

...[T]he trial court ordered Defendant to transfer \$350,000.00 of TSG assets without first adding TSG as a party. The trial court also effectively ordered TSG to act by ordering the parties, as the only members of TSG, to appoint Dr. Tharp as an interim controlling manager of TSG, and it specifically ordered TSG to act by ordering TSG to indemnify and pay Dr. Tharp and to post an unsecured bond during the pendency of the preliminary injunction. Finally, the trial court affected the management structure of TSG by finding that Defendant was not a manager of TSG, even though TSG's filings consistently listed Defendant as a manager of TSG and TSG's attorney repeatedly testified that Defendant was a manager, albeit not one "necessary to the function of the company."

In holding that the LLC must be joined before such orders will be valid, the [Campbell](#) opinion states:

The courts are not free, for the sake of convenience, to completely ignore the existence of a legal entity, such as [an] LLC." ... "A corporation, even one closely held, is recognized as a separate legal entity ... [even when its members are] engaged in litigation which is personal in nature[.]" ... "When the separate legal entity has not been made a party to an action, the trial court does not have the authority to order that entity to act. ... Moreover, even where a named party to an action is a member-manager of an LLC, the assets of which are contested in a pending equitable distribution action, "[t]he trial court exceed [s] its authority when it order[s] [that named party] to transfer the assets of the LLC" without first adding the LLC as a party to the action.

More to Come....

Sometimes a party will allege that property actually owned by another person or entity - such as an LLC - nevertheless is marital property because one or both parties were the 'equitable' owners of that property on the date of separation. Parties become 'equitable' owners when the court determines that it is unjust or otherwise inequitable for the legal owner of the property to retain ownership of the property.

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This will be the topic of my next blog post, but of course, the legal owner must be joined and afforded due process before that property can be declared marital property and distributed to other people.