

Department of Legislative Services
Maryland General Assembly
2011 Session

FISCAL AND POLICY NOTE
Revised

Senate Bill 790

(Senator Raskin)

Judicial Proceedings

Limited Liability Company Act

This bill alters various provisions governing limited liability companies (LLCs).

The bill takes effect June 1, 2011.

Fiscal Summary

State Effect: The bill does not materially affect State finances or operations.

Local Effect: The bill does not materially affect local government finances or operations.

Small Business Effect: Minimal.

Analysis

Bill Summary/Current Law:

Freedom of Contract and Enforceability of Operating Agreements

The Bill: The bill specifies that, unless otherwise provided, the policy of the LLC Act is to give the maximum effect to the principles of freedom of contract and to the enforceability of operating agreements. It also states that a provision of the LLC Act that may be changed by the terms of an operating agreement may also be changed by the terms of the article of organization.

Current Law and Background: An LLC may be organized under the LLC laws and may conduct activities in any state related to any lawful business, purpose, investment, or activity, whether or not for profit, except the business of acting as an insurer.

Unless otherwise provided by law or its articles of incorporation, an LLC has, among others, the general power, whether or not set forth in its articles of incorporation, to make and alter operating agreements, not inconsistent with its articles of incorporation or with the laws of the State, for the administration and regulation of the affairs of the LLC. An LLC is required to set forth in its articles of organization any provision, not inconsistent with law, which the members elect to set out in the articles.

The Business Law Section of the Maryland State Bar Association indicates that the intent of these provisions is to “provide a set of default rules to govern the operation of an [LLC] in the absence of an operating agreement entered into by the members of the [LLC]” and allow “parties to negotiate and tailor the terms of the business entity to the needs and objectives of their particular business endeavor.”

Operating Agreements – In General

The Bill: The bill alters (indicated in italics below) the list of provisions that members of an LLC may include in an operating agreement. The bill specifies that members of an LLC may enter into an operating agreement to regulate or establish any aspect of the affairs of the LLC or the relations of its members, including provisions establishing:

- the right to have and a procedure for having a member’s interest in the LLC evidenced by a certificate issued by the LLC, *which may be issued in bearer form only if specifically allowed by the operating agreement;*
- the method by which the operating agreement may from time to time be amended, *which may include a requirement that an amendment be approved (1) by a person who is not a party to the operating agreement or who is not a member of the LLC or (2) on the satisfaction of other conditions specified in the operating agreement;* and
- *the rights of any person, including a person who is not a party to the operating agreement or who is not a member of the LLC, to the extent set forth in the operating agreement.*

Current Law: Current law states that members of an LLC may enter into an agreement to regulate or establish any aspect of the affairs of the LLC or the relations of its members, including provisions establishing:

- the right to have and a procedure for having a member's interest in the LLC evidenced by a certificate issued by the LLC; and
- the method by which the operating agreement may from time to time be amended.

Provisions of the LLC Act relating to LLC operating agreements do not expressly state that an agreement may include a provision establishing the rights of any person, including a person who is not a party to the operating agreement or who is not a member of the LLC, to the extent set forth in the operating agreement.

Amending an Operating Agreement

The Bill: The bill specifies that when an operating agreement provides for the manner in which the operating agreement may be amended, the operating agreement may be amended only in that manner. However, if the operating agreement requires that a specified person approve an amendment, the person may waive their approval. Moreover, if an operating agreement requires that specified conditions be met to amend the operating agreement, the conditions may be waived by a person for whose benefit the conditions were intended.

The bill also specifies that an amendment to an operating agreement need not be in writing unless (1) provisions of LLC law require that the specified amendment be in writing; or (2) the operating agreement specifically requires the amendment to be in writing.

The bill also clarifies that, when an amendment to an operating agreement must be evidenced by a writing, the writing must be signed by an authorized person of the LLC.

Current Law: LLC members may include provisions into an operating agreement establishing the method by which the operating agreement may from time to time be amended. If the operating agreement does not provide for the method by which the operating agreement may be amended, then all of the members must agree to any amendment of the operating agreement.

An amendment to an operating agreement must be evidenced by a writing signed by an authorized person if (1) the amendment was adopted without the unanimous consent of members; or (2) an interest in the LLC has been assigned to a person who has not been admitted as a member.

Enforcement, Execution, and Binding Effect of an Operating Agreement

The Bill: The bill specifies that an operating agreement of an LLC with one member is not unenforceable on the grounds that there is only one person who is a party to the operating agreement.

The bill also states that an LLC (1) is not required to execute its operating agreement; and (2) is bound by its operating agreement, regardless of whether the LLC has executed the operating agreement.

An operating agreement that is duly adopted or amended is binding on each person who is or becomes a member of the LLC and each person who is or becomes an assignee of a member of the LLC, regardless of whether the person has executed the operating agreement or amendment.

Current Law: A court may enforce an operating agreement by injunction or by granting such other relief which the court in its discretion determines to be fair and appropriate in the circumstances.

Consent of Members to Allow an LLC to Act

The Bill: The bill specifies that, whenever the LLC Act requires the unanimous consent of members to allow the LLC to act, the operating agreement may, nonetheless, provide that no consent of an LLC member or members is required.

The bill states, moreover, that an operating agreement may provide that the LLC action may be taken only with the consent of one or more persons who is or are not a member or members of the LLC. In this circumstance, the consent of that person or those persons is required in order for the LLC to take the action.

Current Law: Under current law, whenever the LLC Act requires the unanimous consent of an LLC's members to allow the LLC to act, the consent must be in writing. The members of an LLC may, in the operating agreement, provide that the action may be taken on consent of less than all of the members.

The LLC Act requires unanimous consent of all members (unless all other members have abandoned the business) to (1) assign the property of the LLC in trust for creditors or on the assignee's promise to pay the debts of the LLC; (2) dispose of the goodwill of the business; or (3) do any other act which would make it impossible to carry on the ordinary business of the LLC. Unanimous consent is also required to amend the articles of organization. Unanimous consent may also be required to allow an assignee an interest

in an LLC to become a member, abandon a proposed merger, dissolve an LLC, or continue an LLC after articles of dissolution have been filed.

LLC Membership – Generally and for Assignees

The Bill: The bill specifies that, when there are no remaining LLC members, the LLC's last remaining member's assignee may agree in writing to continue the LLC and to be admitted as a member or to appoint a designee as a member, effective as of the time the last remaining member ceased to be a member.

The bill also specifies that, after the formation of an LLC, an assignee of interest in an LLC may be admitted as a member of the LLC under the following circumstances:

- in accordance with the terms of the operating agreement providing for the admission of a member;
- by unanimous consent of the members; or
- if there are no remaining members of the LLC at the time the assignee obtains the interest, on terms that the assignee may determine.

The bill states that an operating agreement may provide that the last remaining member's assignee is obligated to agree in writing to continue the LLC and to be admitted as a member or to appoint a designee as a member, effective as of the time the last remaining member ceased to be a member.

Current Law: The LLC Act specifies that a person becomes a member of an LLC (1) at the time the LLC is formed; or (2) at any later time specified in the operating agreement.

After formation of an LLC, a person may be admitted as a member in the following two ways:

- in the case of a person acquiring a membership interest directly from the LLC, upon compliance with the operating agreement or, if the operating agreement does not so provide, upon the unanimous consent of the members; or
- in the case of an assignee of an interest of a member who has the power, by statute, to grant the assignee the right to become a member, upon the exercise of that power and compliance with any conditions limiting the grant or exercise of that power.

An assignee of an interest in an LLC may become a member if (1) the assignor gives the assignee that right under authority described in the operating agreement; (2) the members unanimously consent; or (3) unless otherwise provided in the operating agreement, the LLC has no members and all of the assignees of members elect to become members.

In the current LLC Act provisions that address an LLC with no remaining members, an LLC may continue its existence if the last remaining member's personal representative or successor agrees in writing to continue the LLC and to be admitted as a member or to appoint a designee as a member, effective as of the time the last remaining member ceased to be a member. An operating agreement may provide that the last remaining member's personal representative or successor be obligated to agree in writing to continue the LLC and be admitted as a member. There is no reference under current law to an assignee's right or obligation to continue the LLC and be admitted as a member.

The Maryland State Bar Association's (MSBA) Business Law Section advises that the intent of these changes is to "provide consistent treatment of the rights of assignees throughout the [LLC Act]."

Assignment of Interest

Assignee Rights

The Bill: The bill clarifies that an assignment, unless otherwise provided in the operating agreement, entitles the assignee to receive, to the extent assigned, only the assignor's share of profits, losses, and distributions.

Current Law: Under the current LLC Act, an assignment, unless otherwise provided in the operating agreement, entitles the assignee to receive, to the extent assigned, only the distributions to which the assignor would be entitled.

Assignor Liability and Member Rights

The Bill: Unless otherwise provided in the operating agreement, if an assignee of an interest in an LLC becomes a member of the LLC, the assignor is not released from the assignor's liability to the LLC for nonperformance of any promises set forth in the articles of organization or operating agreement to contribute cash or property or to perform services.

Current Law and Background: The LLC Act already specifies that, if an assignee of an interest in an LLC becomes a member, the assignor is not released from the assignor's liability, by statute, for nonperformance of any promises in the articles of incorporation or operating agreement to contribute cash or property or to perform services. The only

change is the qualification that an operating agreement may specify that an assignor is released from liability if an assignee becomes a member of the LLC.

The LLC Act currently specifies that a person ceases to be a member of an LLC – unless otherwise provided in the operating agreement or with the consent of all other members – if the person makes an assignment for the benefit of creditors.

MSBA’s Business Law Section advises that the intent of the change to current law is that, “unless otherwise provided in the operating agreement, a partial assignment of a member’s economic interest would allow the member to retain the same noneconomic rights in the [LLC] held previously by the member.” In adding a provision addressing a member’s pledge or granting of a security interest, lien or other encumbrance in or against all or part of a member’s interest, the intent is to specify that such action does not affect a member’s noneconomic rights.

Creditors and Attachment of Interests in an LLC

The Bill: The bill addresses (1) the terms under which a creditor may obtain an order charging an interest of the debtor in the LLC; and (2) the effect of the charging order on the member/debtor’s rights and interest in the LLC.

The bill authorizes a court, on application by a creditor of a debtor who holds an interest in an LLC, to charge the interest. The bill defines “creditor” as a person for whom a court may issue an attachment under Title 3, Subtitle 3 of the Courts Article. A “debtor” is defined as a person whose property or credits are subject to attachment under Title 3, Subtitle 3 of the Courts Article.

The court may appoint a receiver for the distributions due to the debtor with respect to the LLC and to make all other orders, directions, accounts, and inquiries that the debtor would have been entitled to make or that the circumstances of the case may require. The bill specifies that a court may, at any time, order foreclosure of the interest. A purchaser of the interest at foreclosure has only those rights of an assignee. Before a foreclosure, the interest charged may be redeemed with property (1) other than property of the LLC, by the debtor; (2) other than property of the LLC, by one or more of the members other than the debtor; or (3) of the LLC, with the consent of all of the members whose interests are not so charged.

The bill also specifies that the LLC Act does not deprive a debtor of a right under exemption laws with respect to the interest of the debtor in the LLC. Moreover, the bill clarifies that the LLC Act provides the exclusive remedy by which a creditor of a person holding an interest in an LLC may attach the interest or otherwise affect the rights of a member in the LLC.

Current Law and Background: The LLC Act:

- allows a “judgment creditor of a member” to obtain an order charging the interest of a member in the LLC with the payment of the unsatisfied amount of the judgment with interest;
- specifies that to the extent so charged, the judgment creditor has only the rights of an assignee of the member’s interest in the LLC; and
- specifies that the LLC Act does not deprive a member of the benefit of any exemption laws applicable to the member’s interest in the LLC.

MSBA’s Business Law Section advises that the broader definition of creditor allows “anyone who has a right to attach the property of someone who holds an interest in a [LLC] to obtain a charging order.” The Business Law Section also explains that, under the bill, “a person may obtain a charging order against a person who is not a member of the [LLC] but who holds an interest in the [LLC].”

Additional Information

Prior Introductions: None.

Cross File: HB 637 (Delegate Feldman) - Economic Matters.

Information Source(s): Maryland State Bar Association, Judiciary (Administrative Office of the Courts), Department of Legislative Services

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