

Department of Legislative Services
Maryland General Assembly
2012 Session

FISCAL AND POLICY NOTE

House Bill 777
Economic Matters

(Delegate Feldman)

Judicial Proceedings

Corporations and Associations - Limited Liability Act - Revisions

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 directly affect governmental operations or finances.

Local Effect: The bill does not directly affect local governmental operations or finances.

Small Business Effect: Potential meaningful. The bill has numerous provisions which may affect how an LLC, some of which may be a small business, operates its business. The extent of the impact of these provisions cannot be reliably estimated.

Analysis

Bill Summary/Current Law: The bill defines “unless otherwise agreed” as unless otherwise stated in the articles of organization, in the operating agreement, or by unanimous consent of the members and any other person whose consent is required by the operating agreement, and makes conforming changes throughout the Limited Liability Company Act.

The bill also repeals the definition of the term “interest,” replaces it with the more specific defined terms “economic interest,” “membership interest,” and “noneconomic interest,” and makes conforming changes to substitute the appropriate term for references to a member’s “interest” throughout the Limited Liability Company Act.

Articles of Organization

The Bill: The bill repeals the requirement that the articles of organization of an LLC must include the purpose for which the LLC is formed. The bill alters one of the requirements for an amendment to the articles of incorporation by specifying that the amendment must be approved by the members “unless otherwise agreed.”

Current Law: The articles of organization for an LLC must set forth the name of the LLC, the purpose for which the LLC is formed, the address of its principal office in the State and the name and address of its resident agent, and any other provision consistent with law which the members elect to set out in the articles of organization. An amendment to the articles must be in writing, unanimously approved by the members, executed in accordance with the LLC Act, and filed with the State Department of Assessments and Taxation.

Conversion of a Partnership to an LLC

The Bill: The bill authorizes a conversion to be abandoned by (1) a vote of the partners in the manner provided in the partnership agreement for amendments to the agreement; or (2) unanimous agreement of the partners, if no such provision is made in the partnership agreement.

Current Law: A partnership may convert to an LLC by filing articles of organization that meet specified requirements and include specified information. The terms and conditions of a conversion of a general or limited partnership to an LLC must be approved by the partners in the manner provided in the partnership agreement for amendments to the agreement, or if no such provision exists, by unanimous agreement of the partners. There is no statute governing the abandonment of a conversion.

Operating Agreement

The Bill: The bill expands the list of provisions that may be included in an operating agreement to include procedures relating to specified meeting notice requirements and voting rights. The bill also specifies that members may establish the rights of the members to assign all or a portion of their *membership* interest; the right and procedure for having a member’s *membership* interest evidenced by a certificate issued by the LLC; or the procedure for assignment, pledge, or transfer of any *membership* interest represented by the certificate.

The bill clarifies that an amendment to an operating agreement must be evidenced by a writing signed by an authorized person if an *economic* interest in the LLC has been assigned to a nonmember.

Current Law: Except for requirements that specified consents be in writing, 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 the rights of the members to assign all or a portion of their interests in the LLC; 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 a procedure for assignment, pledge, or transfer of any interest represented by the certificate.

An amendment to an operating agreement must be evidenced by a writing signed by an authorized person of the LLC if an amendment was adopted without the unanimous consent of the members or an interest in the LLC has been assigned to a nonmember.

Consent by Members:

The Bill: The bill authorizes a meeting of the members to be called by the written request of members holding at least 25% of the interests in profits of the LLC. The bill authorizes members of an LLC to participate in a meeting by means of conference telephone or other communications equipment or by remote communication if specified requirements are met.

Additionally, a member may not take any of the following actions without the consent of members holding *at least two-thirds* of the interest in profits of the LLC: (1) dispose of all or substantially all of the business or property of the LLC; or (2) approve a merger.

The bill also prohibits a member from taking any of the following actions without the members' *unanimous consent*: (1) institute a voluntary proceeding under the federal bankruptcy code; (2) assign the property of the LLC in trust for creditors or on the assignee's promise to pay the debts of the LLC; (3) alter the allocation of profit or loss to the members of the LLC; (4) alter the allocation of or the manner of computing distributions payable to LLC members; and (5) do any other act that would make it impossible to carry on the ordinary business of the LLC.

Current Law: Unless otherwise provided by the LLC's operating agreement, members must vote in proportion to their respective interest in the LLC's profits. Any decision regarding the LLC's affairs requires the consent of members holding at least a majority of the interests in the LLC's profits.

Unless the members unanimously consent or unless all other members have abandoned the business, no member has authority 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.

Proxy Voting

The Bill: The bill authorizes a member to authorize another person to act as proxy for the member. The bill establishes procedures by which a member may assign a proxy. A proxy is revocable by a member at any time without condition or qualification unless the proxy states that it is irrevocable and the proxy is coupled with an interest. An interest with which a proxy may be coupled includes an interest in the membership interest to be voted under the proxy or another general interest in the LLC or its assets or liabilities. The provisions appear to be modeled after the Maryland General Corporation Law relating to proxy votes.

Current Law: A stockholder of a corporation may authorize another person to act as proxy for the stockholder.

Information Regarding Affairs of the LLC

The Bill: The bill requires that any member inspecting and copying, in person or by agent, specified information regarding the LLC do so for a purpose reasonably related to the member's membership interest. The bill requires that any member wishing to perform such an inspection make the request in writing and state the purpose of the inspection. The bill clarifies that an LLC's articles of organization or the operating agreement may set forth reasonable standards regarding what information and documents are to be furnished, as well as the time and location and at whose expense.

The bill authorizes an LLC to keep confidential, for a reasonable period of time, specified information unless a member seeking the information has executed a confidentiality or nondisclosure agreement reasonably acceptable to the LLC.

Current Law: A member may inspect and copy, in person or by agent, from time to time on reasonable written demand, specified information. The rights to inspect and copy records of an LLC may be subject to reasonable standards as provided in the LLC's articles of organization or operating agreement.

Assignment of Interest

The Bill: Unless otherwise agreed, only an economic interest may be assigned. The bill clarifies that an economic interest may be assigned wholly or partly. An assignment of an *economic* interest in an LLC does not entitle the assignee to exercise any rights of a member, including the noneconomic interest of the assignor.

The bill also clarifies that by assigning all of a member's economic interest, the member forfeits the member's noneconomic interest in the LLC. However, a pledge or grant of a

security interest, lien, or other encumbrance in or against all or a part of an economic interest does not cause the member to cease to be a member or affect the member's noneconomic interest in the LLC.

Current Law: Unless otherwise provided in the operating agreement, an interest in an LLC is assignable in whole or in part. An assignment of an interest in an LLC does not dissolve the LLC or, unless otherwise provided in the operating agreement, entitle the assignee to become a member or exercise any rights of a member.

Withdrawal of a Member

The Bill: The bill specifies that, unless otherwise agreed, a member may withdraw from an LLC prior to the dissolution and winding up of the LLC by giving at least six months prior written notice to the other members at their respective addresses as shown on the LLC's books and records.

Current Law: A member may withdraw by giving not less than six months' prior written notice to the other members at their respective addresses as shown on the LLC's books, unless the operating agreement provides that the member does not have the right or power to withdraw or the operating agreement specifies another time for or other conditions of withdrawal.

Rights of Creditor

The Bill: The bill specifies that, on application by a creditor of a debtor holding an *economic* interest in an LLC, a court having jurisdiction may charge the *economic* interest of the debtor in the LLC for the unsatisfied amount of the debt. The bill clarifies that a charging order placed against an economic interest of a debtor in the LLC requires the LLC to pay the creditor only any distributions that would otherwise be paid to the debtor. Any such charging order does not affect the noneconomic interest of a debtor. Unless otherwise agreed, a court may order foreclosure of the economic interest subject to the charging order and order its sale on a showing that the distributions will not pay the amount owed to a creditor in a reasonable time.

The bill specifies that, before a foreclosure on an economic interest under a charging order, the economic interest may be redeemed with property of the LLC *with the consent of the members as provided in the operating agreement*. If the operating agreement does not address the issue, all members whose economic interests are not so charged must consent.

Current Law: A creditor of a debtor holding an interest in an LLC may apply to a court having jurisdiction to place a charging order on the debtor's interest. A charging order

constitutes a lien on the interest of the debtor on which the court may order foreclosure of the interest at any time.

Before such a foreclosure, an interest may be redeemed with specified property, including property of the LLC if all members with interests not so charged agree.

Abandonment of Merger

The Bill: Unless the articles of merger preclude the right to abandon a merger, the bill authorizes members of an LLC to abandon a proposed merger, before the articles' effective date, with the consent of members holding at least two-thirds of the interest in profits of the LLC or a lesser vote as specified in the operating agreement of the LLC.

Current Law: Unless the articles of merger preclude the right to abandon a merger, a proposed merger may be abandoned before the effective date of the articles if there is unanimous consent of the LLC's members.

Small Business Effect: The bill has numerous provisions which may affect how an LLC, some of which may be a small business, operates its business. The extent of the impact of these provisions may be meaningful. For example, the current LLC Act's default position regarding members' consent of transactions such as the consolidation and sale of all or substantially all of the assets of the business is a simple majority. Under the bill, such transactions would require two-thirds consent. The additional consent required in performing such a transaction may be meaningful.

Additional Information

Prior Introductions: None.

Cross File: SB 855 (Senator Raskin) - Judicial Proceedings.

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

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