

## MARYLAND LIMITED LIABILITY COMPANY REVISION ACT OF 2011

### Report of the Maryland State Bar Association Business Law Section Committee on Unincorporated Business Associations

The Business Law Section of the Maryland State Bar Association strives to stay abreast of the needs of its members and their clients in the Maryland business community. To that end, the Business Law Section's Committee on Unincorporated Business Associations (the "Committee") undertook an extensive review of the Maryland Limited Liability Company Act (the "Act"). The Committee identified certain issues in the Act that require revision to clarify the original intent of the legislation and ensure accurate and consistent application of the Act. These revisions are set forth in the attached version of the Maryland Limited Liability Company Revision Act of 2011 (the "Revision Act") and fully explained in the Commentary following the Revision Act. This Report provides a brief overview of some of the key provisions of the Revision Act.

The Act provides a form of business entity for parties organizing businesses in Maryland that is based in contract and thereby allows parties to negotiate and tailor the terms of the business entity to the needs and objectives of their particular business endeavor. A core purpose of the Act is to provide a set of default rules to govern the operation of a limited liability company in the absence of an operating agreement entered into by the members of the limited liability company. Accordingly, the Revision Act adds § 4A-102(a) that underscores the principle of freedom of contract and the enforceability of operating agreements. In addition, § 4A-102(b) clarifies that any provision of the Act that may be changed under the operating agreement also may be changed under the articles of organization.

The Revision Act also clarifies the amendment process applicable to operating agreements and the parties bound by the operating agreement and any amendments. For example, the Revision Act provides that the parties may include a process for amending the operating agreement in the operating agreement itself or in the articles of organization. If the parties provide for such a process, however, that process must be followed in order for an amendment to the operating agreement to be duly authorized. In addition, the Revision Act clarifies that, unless prohibited by the operating agreement or articles of organization, oral amendments to the operating are permissible if all members of the limited liability company approve the amendment and there are no assignees of an interest in the limited liability company who are not also members. Moreover, the Revision Act explains when parties are bound by a duly authorized or adopted operating agreement or amendment even if they did not execute the operating agreement or amendment.

Several provisions of the Revision Act address the assignment of an interest of a member of the limited liability company and the rights and obligations of the assignor and assignee in that context. For example, the Revision Act amends § 4A-603 to clarify that an assignment of a member's interest in the limited liability company entitles the assignee to receive, to the extent assigned, only the assignor's share of profits, losses and distributions. In addition, that section is amended to explain that a member ceases to be a member of the limited liability company and to have the power to exercise any rights or

powers of a member upon assignment of all of the member's interest in a limited liability company. Accordingly, the intent of this section 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 non-economic rights in the limited liability company held previously by the member. This section further provides that a pledge of or granting of a security interest, lien or other encumbrance in or against, any or all of a member's interest does not affect a member's non-economic rights. These provisions may be changed by the operating agreement or the articles of organization.

The Revision Act also amends § 4A-604 to explain the circumstances under which an assignee may become a member of the limited liability company. For example, the parties may delineate the conditions under which an assignee may become a member in the operating agreement or articles of organization; alternatively, the default rule under the Revision Act continues to require the unanimous consent of all members of the limited liability company in order for an assignee to become a member. In addition, the amendments to § 4A-604 clarify that, if there are no remaining members of the limited liability company at the time, or as a result, of the assignment of an interest to the assignee, the assignee may establish the terms for the admission of the assignee as a member in the context of the assignee agreeing to continue the limited liability company under § 4A-902(b)(1) of this title. The Revision Act amends § 4A-601(b) by cross-referencing § 4A-604(a) to govern the admission of an assignee as a member of the limited liability company. This amendment, as well as the cross-reference to § 4A-902(b)(1), provides consistent treatment of the rights of assignees throughout the Act.

Finally, the Revision Act addresses the terms under which a third party may obtain a charging order against an interest of a member of the limited liability company and the effect of that charging order on the member's rights and interest in the limited liability company. Specifically, the Revision Act incorporates several modifications. First, under the prior Act, only judgment creditors were allowed to obtain charging orders. The amended section uses a broader definition of "judgment creditor" to allow anyone who has the right to attach the property of someone who holds an interest in a limited liability company to obtain a charging order. Second, amended § 4A-607 allows a court to foreclose on the underlying interest. If as a result of the foreclosure, the limited liability company no longer has members, the person who acquires the last interest foreclosed upon can elect to become a member of the limited liability company in accordance with § 4A-604 and § 4A-902(b)(1). Third, a person may obtain a charging order against a person who is not a member of the limited liability company but who holds an interest in the limited liability company. Finally, the amended section clarifies that it provides the exclusive remedy available to any judgment creditors of any person who hold an interest in a limited liability company.

Overall, the Committee believes that the Revision Act clarifies and strengthens the original purpose of the Act and will benefit significantly members of the Maryland business community and the lawyers, judges and other parties working with them.