Maine's New LLC Act: Authority, Dissociation, Assignments and Charging Orders

Article 2 in a Series of 3

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This second article in a three-part series about Maine's new LLC Act discusses authority (apparent and decisional), transfers of interests, membership, security interests, and charging orders in a limited liability company.[1] The first article discussed key definitions, formation and the primacy of the LLC agreement. Of these topics, none matters as much as the primacy of the LLC agreement. The primacy of the LLC agreement matters most because, once the new act takes effect, the LLC agreement will govern nearly every topic we discuss in these articles. The provisions of the new act govern a matter only if the LLC agreement does not address it. As you read through this article, keep that in mind. Most of the new act provisions we discuss apply only if the LLC agreement[2] does not address them. Accordingly, every time an attorney drafts an LLC agreement, the attorney should review it by a checklist of issues that can be addressed in the agreement. If the attorney does not address the issue in the agreement, the attorney should make certain the members consciously adopt the applicable provisions of the new act.

Some provisions of the new act apply without regard to the provisions of the LLC agreement. Among these are new act provisions concerning relations of the members to persons dealing with the LLC. These provisions speak to, among other things, the next article topic: apparent authority.

Authority

The Current Act

An LLC formed under the current act files Articles of Organization designating members or managers responsible for the management of the LLC.[3] If the Articles designate the members as persons responsible for the management of the LLC, the LLC is a member-run LLC. Each member in a member-run LLC has the authority to bind the company with third parties.[4] If the Articles designate the managers as persons responsible for the management of the LLC, the LLC is a manager-run LLC. Each manager of a manager-managed LLC has authority to bind the LLC.[5] Thus, the designation in the Articles of Organization establishes apparent authority in either the members or the managers. Apparent authority is "the authority held by an agent or other actor to affect a principal's legal relations with third parties when a third party reasonably believes the actor has authority to act on behalf of the principal and that belief is traceable to the principal's manifestations."[6] In our LLC world, apparent authority arises from a third party's reasonable belief that a person has the power to bind the LLC if and only if that belief is based on a manifestation of the LLC. Under the current act, this manifestation is made by the designation. If the LLC designates that managers manage the LLC, then each manager has apparent authority; otherwise, each member has apparent authority.[7] A third party can rely on this apparent authority except in three cases: (1) the agent lacks actual authority to bind the LLC and the third party has knowledge[8] of that fact;[9] (2) the agent is attempting to bind the LLC in a transaction that is not a transaction in the ordinary course of the LLC's business;[10] and (3) the act of the agent (member or manager) contravenes a restriction on the agent's authority and the third party has knowledge of that restriction.[11]

The designation in the Articles of Organization also establishes decisional authority.[12] [An agent acts with decisional (actual) authority under common law when, at the time that the agent takes an action that has legal consequences for the principal, the agent reasonably believes, based on the principal's manifestations to the agent, that the principal wishes the agent to so act.[13]] As noted, however, decisional authority for an LLC under the current act arises from the designation in the articles.

Under the current act, there is no means to establish either apparent authority or decisional authority other than the management designation in the Articles. Accordingly, apparent authority and decisional authority in an LLC formed under the current act are inevitably linked. Apparent authority can be established as well under common law and decisional authority can be modified under the LLC agreement, but, at best, the members can merely augment or alter the authority established under the Articles.

Most LLC statutes link apparent and decisional authority this way.[14] However, the trend in LLC statute drafting is to de-link apparent and decisional authority.[15] To accomplish this de-linking, the decisional authority is established under the LLC agreement, not by a publicly filed designation. The new act takes this approach.

The New Act

Under the new act, apparent authority stands by itself. The new act provides for a publicly-filed document that establishes and defines apparent authority called a Statement of Authority, but each LLC determines for itself whether or not to file a Statement of Authority.[16] The LLC may function perfectly well without a Statement of Authority. However, for reasons discussed below, we strongly recommend that most LLCs formed or operating under the new act should file a Statement of Authority.

De-linking apparent and decisional authority advances the policy of permitting members to tailor LLC arrangements to fit the LLC's business goals.[17] It advances the policy by giving members broad latitude in defining both apparent and decisional authority without requiring that one follow the other. It allows members to grant certain persons limited apparent authority for convenience, but no decisional authority. The members may also give certain persons apparent and decisional authority in certain aspects of the business. For example, a manager of a real estate development company may only have authority to enter into leases with a term of less than five years, while others only have authority to enter into contracts with property managers.

If a Statement of Authority is on file with the Secretary of State, that statement establishes and defines apparent authority for the LLC.[18] The LLC may augment[19] that authority, creating apparent authority through an LLC Agreement (delivered to the third party), by consent of members delivered to a third party, or by common law of agency (creating a basis for a third party's reasonable belief that an agent may bind the LLC). The Statement of Authority is conclusive evidence of authority as to a third party giving value in reliance on the statement, unless, when the third party gives value, it has knowledge[20] to the contrary.[21]

If a Statement of Authority is not on file, then any member, manager, president or treasurer has authority to bind the LLC.[22] Clearly, the LLC should not use this provision unless it intends to grant authority so broadly. Each person holding any of these positions has authority to bind the LLC in all matters, absent knowledge of the third party that such person lacks authority. For this reason, we recommend that each LLC should, as a matter of practice, have a Statement of Authority on file. Hopefully, the Secretary of State will permit organizers to file the initial Statement of Authority together with the initial Certificate of Formation for no additional fee.

An LLC can establish apparent authority by the LLC agreement,[23] consent of members,[24] or under the common law of agency[25] even in the absence of a Statement of Authority. However, none of these documents modifies the broad apparent authority given to each member, manager, president and treasurer under Section 1541(4), unless that document or statement is given or made to the third party. Filing a Statement of Authority is the best way to terminate, modify or otherwise define this apparent authority.

The Statement of Authority may be amended by filing an amendment with the Secretary of State.[26] The Statement may be canceled by a filing as well.[27] Additionally, the filing may be canceled by filing a certificate of cancellation of the certificate of formation.[28] Be advised, however, that if the LLC is a party to a merger, its Statement of Authority is not canceled. Counsel to the surviving LLC that is a party to a merger should cancel any merged LLCs' Statements of Authority and update the surviving entity's Statement of Authority.

Transition Rule

The current act requires that each LLC file Articles of Organization designating the LLC as member-run or manager-run. As noted above, this designation creates authority under the current act.[29] When the current act is repealed on July 1, 2011, this designation no longer establishes agency *per se.* Under the new act, taking effect on July 1st, the Statement of Authority is the only public filing that *per se* establishes any kind of authority.[30] Yet, people will still rely on the Articles of Organization on file with the Maine Secretary of State as though they continue to establish authority. Under the circumstances, we believe that the designation in the Articles of Organization should have some meaning after the new act takes effect. However, we also believe that we should be true to the agency provisions of the new act. Accordingly, we drafted a transition rule under which the designation of the management structure in each LLC's current Articles of Organization operates as a Statement of Authority.[31] All managers of manager-run LLCs have apparent authority; all members of member-run LLCs have apparent authority.[32] As a result, the same parties who had apparent authority under the current act will have apparent authority under the new act. There is no need to file a new Statement of Authority for an LLC existing as of July 1, 2011, unless the LLC wants to identify new officers or persons as having apparent authority and/or to more precisely define the authority vested in its agents.

Decisional (Actual) Authority

Decisional authority is independent of apparent authority. The activities and affairs of the LLC are under the direction and subject to the oversight of its members.[33] Under the new act, the LLC agreement defines decisional authority.[34] Virtually any arrangement is allowed. If the LLC agreement does not address a matter, the majority of members decide on matters that are in the ordinary course of the LLC's business;[35] unanimous consent is required in certain instances.[36] Clearly, if the LLC members want management to be governed by persons other than members according to the new act, management should be addressed in the LLC agreement. It is a checklist item for the LLC agreement.

Membership – The LLC Agreement Controls

Admission to Membership

A company must have at least one member to be formed.[37] The LLC must also have an LLC agreement.[38] The simplest way to admit a member in connection with forming an LLC is to record the admission in the LLC agreement. An LLC agreement dated as of the date of the Certificate of Formation, which records the admission of at least one member, is the simplest and cleanest way to form an LLC and admit a member. Not only does this process properly admit a member, it also firmly establishes the formation date under Section 1531.[39] We strongly recommend this approach.

Members may also be admitted in connection with the formation of the LLC after the date of the initial LLC agreement. This usually happens when the LLC is formed and the organizers contemplate imminent investments by several yet to be identified investors. Sometimes the investors are not identified simply because the persons with the money have not selected entities through which they will invest by the time the company is formed. Sometimes, the identity of some but not all of the investors is known when the company is formed. In any case, the LLC agreement should clearly define the terms under which the investors shall be admitted. In the absence of such terms, a member will be admitted when its admission is reflected in the records of the company.[40] Clearly, for the benefit of both the company and the investor, it makes sense to spell out the terms of admission in the LLC agreement or an amendment to the same.

Likewise, the LLC agreement should precisely define the terms and conditions under which a new member is admitted after the LLC is formed. If the LLC agreement does not provide for admission of members following formation, except in certain cases described below, a person is admitted only if all members consent.[41]

A person may be admitted without unanimous consent (in the absence of applicable LLC agreement provisions to the contrary) when an LLC merges with another LLC.[42] The members of the terminating LLC become members of the surviving LLC. Members should be wary of this admission provision in the new act. If the LLC agreement allows a merger to be approved by a consent of less than all of the members and is silent on the matter of admission of members, then persons may be admitted to membership by merger under less onerous rules than those that apply to admission generally.

A person also may be admitted in the unusual circumstance when the last member dissociates without a successor.[43] Since an LLC must have at least one member to continue to exist as an LLC, it is helpful to have a procedure for appointing a member to avoid an unintended dissolution of the LLC. In such a case, the new act supplies a rule that allows holders of transferable interests to appoint a successor member.[44] This is an important rule when the last member dies, for example.

A person may be admitted without making a contribution or holding a transferable interest.[45] Certain lenders, for example, may hold a membership interest solely for the purpose of voting on a voluntary bankruptcy filing by the LLC. However, if the LLC admits a person in exchange for the promise to make a contribution, the promise to make the contribution is not enforceable unless it is in writing.[46] This statutory requirement may not be changed by the LLC agreement.[47]

Allocations and

Distributions

The current act supplies rules for allocations of profits and losses and for distributions. These rules apply only if the LLC Operating Agreement does not address allocations and/or distributions.

As to allocations, the Current Act provides that profits and losses are allocated *pro rata*.[48] That is, each member receives an equal share of profits and losses. This default rule almost certainly is at odds with Treasury Regulations governing partnership allocations. Under these regulations, if the Operating Agreement fails to address allocations of profits and losses, partnership allocations must be made in accordance with the each partner's interests in the partnership.[49] This is known as the PIP Rule. Determining allocations under the PIP Rule is very complex.[50] Allocating *pro rata* will not work, except in rare cases.[51]

As to distributions, the current act provides that cash is distributed *pro rata*.[52] This rule applies without regard to each partner's contributions. So, for example, if A and B form an LLC with contributions of $2,000 and $8,000 respectively, A and B share in interim distributions equally, rather than in proportion to their unreturned capital contributions, 20 and 80 percent, as may be intended by the parties. Liquidating distributions return contributed capital to the members, and the balance is distributed *pro rata*, again rather than in proportion to their unreturned capital contributions, 20 and 80 percent.

The new act is silent as to allocations. Treasury Regulations concerning partnership allocations govern in the absence of applicable LLC agreement provisions. We strongly urge practitioners to properly draft allocation provisions in the LLC agreement. Drafting allocation provisions for a partnership agreement is an article topic in itself, so we will not cover it in much detail here. However, we want to stress that care should be taken to make certain the allocations have substantial economic effect.[53] If you are unsure whether your allocations have substantial economic effect, seek the advice of competent tax counsel. In addition, if your agreement calls for liquidating distributions in accordance with positive capital account balances, then, in addition to making certain that the allocations have substantial economic effect, you will want to make certain that the allocations produce the desired economic result. Again, if you are unsure, seek advice of competent tax counsel. Your malpractice insurance carrier will thank you for it.

Distributions under the new act are governed by the LLC agreement.[54] If the LLC agreement does not provide for distributions, interim distributions are made to the members in proportion to their unreturned capital contributions;[55] liquidating distributions are made to holders of transferable interests in proportion to unreturned capital, to the extent thereof, then to those holders in proportions in which they shared interim distributions.[56] Using the previous example, if A and B form an LLC with contributions of $2,000 and $8,000 respectively, under the new act, A and B share in interim distributions in proportion to their unreturned capital contributions, or 20 and 80 percent. Liquidating distributions in such a case would be made to holders of transferable interests in proportion to unreturned capital, $2,000 and $8,000, with the balance distributed to the members, 20 and 80 percent. Clearly, for a number of reasons, including to properly reflect the intent of the members, it is wise to carefully draft distribution provisions for the LLC agreement. Further, it is important to make certain that those distribution provisions agree with allocation provisions, and vice versa.[57]

A person receiving a distribution may keep the distribution, even if creditors of the LLC are not paid off in full, unless the distribution is improper. A distribution is improper if, taking the distribution into account, (1) the LLC is unable to pay its debts as they become due in the usual course of its business, or (2) the LLC's liabilities (excluding certain nonrecourse liabilities) exceeds the fair value of LLC assets (other than those securing certain nonrecourse liabilities).[58]

The new act takes a slightly different approach from the current act in determining whether a distribution was improper. Under the new act, a distribution is improper only if, immediately following the distribution, the LLC's liabilities (excluding certain nonrecourse liabilities) exceed the fair value of LLC assets (other than those securing certain nonrecourse liabilities).[59] In other words, LLC members need only determine on a balance sheet basis whether the distribution is permitted. Eliminating the "pay its debts as they come due" test allows the LLC and its members to rely on an objective test for determining the propriety of distributions.

Transferable Interests and Member Rights

The current act and the new act define interests and rights of interest holders and members similarly. Each defines interests with reference to economic features – allocations and distributions. In the current act, these interests are "limited liability company interests;"[60] the new act calls them "transferable interests."[61]

Likewise, the current act and the new act each defines rights in terms of management and voting rights, rights to LLC information, and other features associated with membership in the LLC. In both cases, the rights are referenced in terms of membership. The new act, however, more clearly describes the origin of such rights and the way they may be taken from a member. It speaks in terms of admission and dissociation.[62] Using these terms as it does, the new act more clearly establishes that membership rights originate and reside with the LLC, not the members. The members only have the right to exercise membership rights by agreement (the LLC agreement, hopefully). These rights cannot be assigned by a member, unless the members agree to the assignment.[63] This feature distinguishes LLC interests from shares of corporate stock,[64] and it is why the commercial law on LLC membership interest pledges is so much more complicated than the commercial law on pledges of corporate stock. More on this later.

Transferees should follow certain procedures in light of the characteristics of transferable interests and membership rights. If a transferee intends to become a member upon acquiring a transferable interest, the transferee should condition the acquisition on being admitted to membership. As part of its due diligence, the transferee should determine the manner in which it is admitted to membership. Presumably, this will be clear from the LLC agreement. If not, the transferee needs to consult Section 1551 of the new act.

In addition, a transferee should determine the manner in which a transferee may dissociate – or be dissociated. In other words, the transferee should determine the terms of its membership. Again, these terms should be contained in the LLC agreement. If the LLC agreement fails to address these rights, then the transferee should consult Subchapter 7 of the new act, and Section 1582, in particular.

Security Interests – Granting and Enforcing

Commercial law is generally complicated. Commercial law as it relates to LLC membership interests makes theoretical physics seem like child's play. While we will not go into detail about commercial law, it is the context within which certain new act provisions operate. These are the provisions that concern the validity of certain assignment restrictions and charging orders.

Restrictions on Assignments

LLC agreements typically contain restrictions on assignment of transferable interests. These restrictions allow the members to define the universe of persons with whom they have economic and (in some cases) fiduciary relations. When a member or transferee wishes to pledge a transferable interest as collateral for a debt, these restrictions can cause problems. The creditor receiving and perfecting the pledge may find that the pledge is void on account of LLC agreement restrictions. Or maybe not.

Under current law, 11 M.R.S.A. §§ 9-1406 and 9-1408 (collectively, the "UCC provisions") contain provisions that call into question whether a restriction in an LLC agreement would be enforced to invalidate a pledge of a transferable interest. Before going into the terms and meaning of these provisions, we have to provide a little context. These provisions apply to general intangibles. A transferable interest is a general intangible, unless the LLC opts into Article 8 of the UCC. In that case, the LLC interests would be securities. The rules regarding a pledge of a security, and perfection and enforcement of that pledge, seem much simpler and straightforward than their general intangible counterparts. The fact that the rules for securities are easier to understand and apply does not mean LLCs should opt into Article 8. That issue is a topic for another article.

Now, back to the UCC provisions. The quoted text is from Section 9-1406. The provisions of Section 9-1408 are substantially the same and read as follows:

> *Except as otherwise provided in subsection (5) and sections 2-1303 and 9-1407, and subject to subsection (8), a term in an agreement between an account debtor and an assignor or in a promissory note is ineffective to the extent that it:*
>
> *(a). Prohibits, restricts or requires the consent of the account debtor or person obligated on the promissory note to the assignment or transfer of, or the creation, attachment, perfection or enforcement of a security interest in, the account, chattel paper, payment intangible or promissory note; or*
>
> *(b). Provides that the assignment or transfer or the creation, attachment, perfection or enforcement of the security interest may give rise to a default, breach, right of recoupment, claim, defense, termination, right of termination or remedy under the account, chattel paper, payment intangible or promissory note.*[65]

If this provision applies to limited liability company interests, then it seems to potentially modify arrangements of LLC members in two ways, the second being more troubling than the first. However, before we discuss the potentially troubling elements of this provision, we note that this provision arguably by its terms does not apply. It is clear that a limited liability company interest (transferable interest under the new act) is a general intangible for UCC Article 9 purposes. However, these provisions only apply to make ineffective a term in an agreement between an account debtor and an assignor. The assignor is the member making a pledge. An account debtor includes one who is obligated on a general intangible.[66] Some argue that the LLC agreement is an agreement among members and that none of the members is an account debtor as to the LLC agreement. Under the Delaware new act and the new act, the LLC itself is a party to the LLC agreement, whether or not it signs the agreement.[67] The counter-argument, therefore, is that the LLC is an account debtor, obligated to make distributions to the assignor under the LLC agreement. The members, being ultimately responsible for the management of the LLC also may be account debtors. In any case, we note the argument, for what it is worth. For the rest of the discussion of this issue, we will assume that the UCC provisions apply to a term in an Operating Agreement of a Maine LLC formed under and governed by the current act.

As noted above, the UCC provisions contain two troubling provisions, the second more troubling than the first. The first seems to suggest that a restriction on transfer will not be enforced to invalidate a pledge of LLC interests. To the LLC, this is not that troubling. The creditor has, at best, a right to force the LLC to pay over to the creditor distributions to which the debtor is entitled under the LLC agreement. The second provision seems to provide that an assignment in violation of a transfer restriction cannot be treated as a breach of the LLC agreement. If this were true, the members of the LLC would not have recourse against the pledging member for breach of the LLC agreement.

We understand these provisions were intended to protect the creditor. The first secures the economic rights for which the creditor bargained. The second protects the creditor against tort claims for interfering with an advantageous contract.

As noted above, the first provision does not really harm the compliant LLC members. It merely diverts distributions that belong to the breaching member. However, they are harmed by the second provision. They lose a cause of action for damages suffered from the presence of a charging order. On account of the charging order, the LLC may incur additional legal and accounting fees. The LLC should be able to recover these fees, and any other damages, from the breaching member.

Several states have determined that, as to this issue, the interests of LLC members outweigh those of the creditors. Accordingly, they have adopted provisions similar to those in Section 1506(5) of the new act. Under that subsection:

> *Title 11, sections 9-1406 and 9-1408 do not apply to any interest in a limited liability company, including all rights, powers and interests arising under a limited liability company agreement or this chapter. This subsection prevails over Title 11, sections 9-1406 and 9-1408 and is intended to permit the enforcement of the provisions of a limited liability company agreement that would otherwise be ineffective under Title 11, sections 9-1406 and 9-1408.*[68]

So, under the new act, the UCC provisions will not apply to invalidate a provision in a LLC agreement that restricts transfers of transferable interests, including pledges of transferable interests as collateral, provided that the transfer is effective on or after July 1, 2011. The UCC provisions will apply as to pledges of limited liability company interests creating a security interest with an effective date that is before July 1, 2011.[69]

Beginning on July 1, 2011, lenders and other creditors will need to check the applicable LLC agreement for restrictions on transfers. Presumably, these creditors are checking the applicable LLC agreement anyway, to ascertain that the pledging member actually has an interest, and that the pledge of such interest is worth the trouble of documenting the pledge. Therefore, we do not believe that requiring creditors to check the LLC agreement for transfer restrictions adds a significant burden on creditors. Creditors may also require the LLC to opt into UCC Article 8, but, as previously noted, that strategy has implications that are best addressed in another article.

Charging Orders

Assuming that a creditor secures and perfects a security interest in a transferable interest, the creditor will have rights to enforce the security interest if the debtor defaults on the underlying obligation. Under the current act, the creditor may seek a charge against the membership interest pledged.[70] As to such interest, the creditor would have the rights of an assignee, and no more.[71]

This provision in the current act seemed incomplete and unclear in several respects when compared to counterparts in other jurisdictions, and in similar provisions of both the ABA Prototype[72] and Uniform Act.[73] First, it is unclear what is meant by "a charge against" the membership interest. Second, it leaves open other remedies that the creditor may have, including foreclosure on the interest. We believed that the presence or absence of a foreclosure remedy should be clear under the new act.

The new act, therefore, clearly provides that a creditor with a security interest in a transferable interest may enforce that interest with a charging order.[74] A charging order is a charge issued by a court that requires the LLC to pay the creditor distributions that otherwise would have been paid to the debtor until the creditor's debt has been satisfied.[75] The provision clarifies the rights of the creditor, the process by which the charging order may be obtained, and the order that the court should issue. Further, the charging order provision clearly states that the charging order is the exclusive remedy under the new act.[76] In other words, the new act does not authorize a creditor to foreclose on the transferable interest.

The absence of a foreclosure remedy under the new act does not mean that such a remedy is not available to a creditor. Courts have granted equitable relief to parties in spite of provisions of a limited liability company act that would seem to preclude it. For example, in *Olmstead v. Federal Trade Commission*,[77] the Florida Supreme Court ruled that, under Florida law, it was authorized to require a judgment debtor to surrender all right, title, and interest in and to its limited liability company interest, in spite of a provision in the Florida Limited Liability Company Act (Florida LLC Act)[78] that provided that the judgment creditor was only allowed the rights of an assignee. There were two legs of the court's ruling. First,[79] the court noted that the Florida LLC Act did not limit remedies available to a judgment creditor. It seems the appellant/debtor argued that the legislature intended that such a limit was a matter of general Florida public policy since, under the Florida Revised Uniform Limited Partnership Act and the Florida Revised Uniform Partnership Act, each provided that a charging order is the exclusive remedy available to a judgment creditor under such act.[80] The Court rejected this argument.

Second, the Court ruled that the "assignee" limitation did not apply in this case. It supported its ruling with an analysis of the intended purpose of the rule. According to the Court, the rule was intended to only benefit "other members" from a forced business association.[81] The limited liability company in question was a single member limited liability company. Because there are no "other members" in a single-member LLC, the rationale for the rule did not apply.[82]

On these two legs, the Florida Supreme Court ruled that it was appropriate to permit the judgment creditor to acquire all of the debtor's right, title, and interest in the membership interest under a provision allowing levy and sale of rights that the debtor may assign.

A similar case arose out of Colorado. *In re Ashley Albright*[83] questioned whether a bankruptcy trustee acquired all right, title, and interest in a bankrupt's single-member limited liability company interest under the Colorado Limited Liability Company Act as then in effect (Colorado Act). The Colorado Act included the unadmitted assignee rule: an unadmitted assignee of an interest has the rights (interests) of an assignee only.[84] In other words, it has no membership rights. In this case, that meant it had no right to reach the assets of the company to satisfy creditors' claims. The Bankruptcy Court expressly ruled that the bankruptcy trustee acquired all rights–including membership rights–in spite of the Colorado Act's unadmitted assignee provisions. Like the Florida Supreme Court in *Olmstead*, the Bankruptcy Court in *Albright* based its ruling on the fact that the assignee provisions were meant to protect other members from forced associations.[85] As to a single-member limited liability company, there is no reason to apply this rule. Therefore, it allowed the bankruptcy trustee to acquire all rights.

Both *Olmstead* and *Albright* involved single member LLCs. As a result, it is not that surprising for a court to disregard the charging order remedy in such a case, as charging orders are designed specifically to accommodate the rights of both creditors and non-debtor members, and therefore are arguably unnecessary if there are no non-debtor members. Additionally, charging orders are more subject to debtor opportunism in single-member LLCs because they invite a distribution policy designed solely to frustrate the debtor's creditors.[86] Both the *Olmstead* court and the *Albright* court seemed to adopt this view in reaching their respective decisions to allow the creditor to foreclose on the interests. It is notable that, *in dicta*, the *Albright* court said that it may also disregard the unadmitted assignee rule as to a multi-member limited liability company where the "other members" are created with "peppercorn interests."[87] It seems the statement is meant to keep a debtor from issuing a nominal, small interest to a related person, such as the debtor's spouse, wholly-owned entity, or trust of which the debtor's children are beneficiaries, and the debtor is trustee, in response to these decisions in an effort to frustrate creditors.

The lesson of *Olmstead* and *Albright* seems to be that a court may exercise its equitable remedies to override the result that the statutory remedies provide. It is unclear, however, whether a court would order an equitable remedy in the *Albright* case or the *Olmstead* case where the statute provides that the charging order is the exclusive remedy. It seems that a court should feel free to override the "exclusive remedy" provision of the new act where equity demands, but only where equity demands. In the ordinary cases – and even in single-member LLC cases, where charging orders are arguably unnecessary since there are no non-debtor members, the "exclusive remedy" provisions should generally be respected.

Conclusion

With few exceptions, the Limited Liability Company agreement governs the relations among members as members, and between the members and the LLC. Accordingly, the terms and conditions of decisional authority, interest transfers, membership admission, and member dissociation ideally will be clearly and comprehensively defined and articulated in the LLC agreement. The LLC agreement's counterpart in apparent authority matters is the Statement of Authority. A carefully-drafted Statement of Authority precisely identifies the LLC's agents and the scope of their apparent authority. In any case, a Statement of Authority on file averts a situation where various persons have sweeping authority to bind the LLC. Security interests in transferable interests raise commercial law issues as well as issues under the new act. Ascertaining the rights of the parties to such a transaction requires each party–and the LLC–to carefully evaluate commercial law, the LLC agreement, and applicable provisions of the new act. Finally, courts may apply equitable remedies where justice demands. As we have seen, courts have taken such steps where a single-member LLC's sole member assigns an interest to a creditor or bankruptcy trustee.

Our series of articles on the new act will conclude in the next edition of the *Maine Bar Journal*. The final article will address several topics, including the ability of parties to tailor fiduciary duties by contract.

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1. We use "LLC" and "limited liability company" interchangeably. We also use "LLC Agreement" and "Operating Agreement" interchangeably, though, for consistency's sake, we use "Operating Agreement" when referring to the members' governing document to the extent its validity and interpretation is governed by the Current Act (Chapter 13); otherwise, we use "LLC Agreement." When we refer to the New Act, we mean Chapter 15 of Title 31, the law that will take effect on July 1, 2011. We refer to Chapter 13 as the "Current Act."

2. It is worth mentioning here that the definition of the limited liability company agreement includes oral agreements, as well as agreements made by course of conduct. *See* 31 M.R.S.A. § 1502(15).

3. 31 M.R.S.A. § 622(1)(C).

4. *Id.* § 641(1).

5. *Id.* § 641(2).

6. Restatement (Third) of Agency § 2.03 (2008).

7. 31 M.R.S.A. § 641.

8. A person has "knowledge" of a fact within the meaning of this Act not only when the person has actual knowledge of that fact, but also when the person has knowledge of such other facts as in the circumstances shows bad faith. *Id.* § 752.

9. *Id.* §§ 641(1) (for members) and 641(2) (for managers).

10. *Id.* § 641(3).

11. *Id.* § 641(4).

12. *Id.* § 651.

13. Restatement (Third) of Agency § 2.01 (2008).

14. Rutledge and Frost, RULLCA Section 301 – The Fortunate Consequences (and Continuing Questions) of Distinguishing Apparent Agency and Decisional Authority, 64 Bus. Law. 37, 38 n.6 (2008).

15. *Id* at 39.

16. 31 M.R.S.A. § 1542(1): "A limited liability company may deliver to the office of the Secretary of State for filing a statement of authority" (emphasis supplied).

17. Rutledge and Frost, supra note 14 at 47.

18. The Statement accomplishes this result by defining authority and (perhaps most significantly) eliminating the blanket authority given to each member, manager, president, and treasurer under Section 1541(4).

19. The LLC may also amend or eliminate the authority in the Statement of Authority by communicating to a third party that the Statement of Authority is not a true reflection of actual authority. Delivering an LLC Agreement with provisions that counter the Statement of Authority should suffice. For obvious reasons, the LLC should amend its Statement of Authority if the Statement if Authority inaccurately identifies those with apparent authority or inaccurately defines the LLC agents' apparent authority.

20. Knowledge under the New Act differs from knowledge under the Current Act. The New Act includes imputed knowledge, but does not expressly treat a person as having knowledge based on facts and circumstances known to the person.

21. 31 M.R.S.A. § 1542(3).

22. *Id.* § 1541(4).

23. *Id.* § 1541(1).

24. *Id.* § 1541(2).

25. *Id.* § 1541(5).

26. *Id.* § 1542(2).

27. *Id.*

28. *Id.* § 1542(4).

29. *Id.* § 641. *See* supra note 4.

30. *See id.* § 1541.

31. *Id.* § 1693(2)(B).

32. *Id.* The current provision states that the designation is treated as part of the LLC Agreement. We have prepared a proposed amendment that will change the provision to read as described above. We proposed this amendment because we believed that members and their counsel would not want Section 1541(4) to apply to all existing LLCs as of July 1, 2011. As noted earlier, Section 1541(4) applies only if there is not a Statement of Authority on file. Providing that a Statement of Authority is deemed filed with the Articles designation eliminates the wholesale application of Section 1541(4).

33. *Id.* § 1556(1).

34. *Id.* § 1521(1).

35. *Id.* § 1556(2).

36. *Id.* § 1556(3).

37. *Id.* § 1531(1)(C).

38. *Id.* § 1531(1)(B).

39. *Id.* § 1531(2) (as amended by proposed amendments to the New Act submitted by our committee). Under Section 1531(2) as of the date this article goes to press, the timing of formation is a little less clear. The confusion as to timing caused us to submit the amendment that we believe will fix the problem. Under the amendment, the LLC is formed as of the date there is substantial compliance with the formation requirements of Section 1531(1). If the Certificate of Formation is filed before the LLC Agreement is effective, then the LLC is formed on the effective date of the LLC Agreement, not the date the Certificate is filed. Persons doing business with LLCs that have only recently filed a Certificate should insist on evidence of an LLC Agreement.

40. *Id.* § 1551(1)(B).

41. *Id.* § 1551(2)(C).

42. *Id.* § 1551(2)(B).

43. *Id.* § 1551(2)(D).

44. *Id.*

45. *Id.* § 1551(3).

46. *Id.* § 1553(1).

47. *Id.* § 1522(1)(G).

48. *Id.* § 663.

49. Treas. Reg. § 1.704-1(b)(1)(i).

50. *See id.* § 1.704-1(b)(3).

51. *See id.* § 1.704-1(b)(3)(ii). Specifically, the following conditions, at a minimum, must exist: (i) all contributions, interim distributions, and liquidating distributions are made pro rata; (ii) none of the property contributed has a value that differs from its adjusted tax basis; (iii) all members' shares of partnership liabilities (recourse and nonrecourse) are equal (*see* Treas. Reg. §§ 1.752-2 and 1.752-3); and (iv) there is no change in membership, interests in distributions, or shares of partnership liabilities in the LLC from the time it is formed to the time it is liquidated. We assume, for purposes of this discussion, that the LLC is treated as a partnership for Federal income tax purposes. If the LLC elects under the "check-the-box" regulations to be treated as an association (corporation) for tax purposes, then these allocation provisions are less problematic, unless the LLC also elects to be treated as an S corporation. In such a case, these default allocation provisions could be quite harmful.

52. 31 M.R.S.A. § 671.

53. *See* Treas. Reg. § 1.704-1(b)(1)(i). If the LLC Agreement provisions lack substantial economic effect, then the PIP rules apply. For purposes of determining whether allocations have substantial economic effect, *see* Treas. Reg. § 1.704-1(b)(2).

54. 31 M.R.S.A. § 1521(1).

55. *Id.* § 1554(1).

56. *Id.* § 1601(2).

57. If the distribution and allocation provisions conflict, the allocations will likely fail the substantial economic effect test. *See* Treas. Reg. § 1.704-1(b)(2)(ii).

58. 31 M.R.S.A. § 675(1).

59. *Id.* § 1555(1).

60. *Id.* § 602(9).

61. *Id.* § 1502(29).

62. *See id.* §§ 1551 and 1581.

63. *Id.* § 1551(2).

64. *See* 13-C M.R.S.A. § 722.

65. 11 M.R.S.A. § 9-1406.

66. *Id.* § 9-1102(3).

67. 31 M.R.S.A. § 1523(1).

68. *Id.* § 1506(5).

69. *Id.*

70. *Id.* § 686.

71. *Id.*

72. *See* generally Revised Prototype LLC Act 2010 (April 2010, Draft v. 2.3), available to members of the ABA Business Law Section at http://apps.americanbar.org/dch/committee.cfm?com=CL590005.

73. *See* generally Revised Unif. Limited Liability Company Act, available at http://www.law.upenn.edu/bll/archives/ulc/ullca/2006act_final.htm.

74. 31 M.R.S.A. § 1573(1).

75. *Id.*

76. *Id.* § 1573(7).

77. *Olmstead v. FTC*, 44 So. 3d 76 (Fla. 2010).

78. In contrast to the Florida Limited Partnership Act and the Florida Uniform Partnership Act. *See* Fla. Stat. ch. 620.1703(3) and 620.8504(5) (2008).

79. The Florida Supreme Court discussed these legs in reverse order. It first discussed the rules limiting the rights of an unadmitted assignee, and then discussed the absence of a provision limiting a judgment creditor to a charging order. For purposes of this discussion, we think it is wise to deal with the absence of the second leg first.

80. *Olmstead*, 44 So. 3d at 82-83.

81. *Id.* at 81.

82. *Id.*

83. 291 B.R. 538 (Bankr. D. Co. 2003).

84. Colo. Rev. Stat. Ann. § 7-80-702.

85. 291 B.R. at 541.

86. Larry Ribstein, "The Olmstead Decision and the Problem of Single Member LLCs," June 27, 2010, available at http://truthonthemarket.com/2010/06/27/the-olmstead-decision-and-the-problem-of-single-member-llcs/.

87. 291 B.R. at 541 n.9. The court would employ bankruptcy ant-avoidance rules. We see no reason why a court may not also employ equitable remedies.

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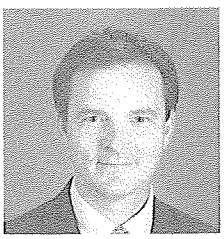

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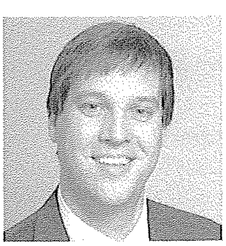

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