

IN THE COURT OF APPEALS OF MARYLAND

PETITIONER R. POTTER, Petitioner,	*	Petition No. _____
	*	
v.		CSA-REG-0671-2018
	*	
RESPONDENT D. POTTER, Respondent.	*	Circuit Court No. C-02-CV-17-003225
	*	
* * * * *		* * * * *

PETITION FOR WRIT OF CERTIORARI

Ruby Potter, by and through her undersigned counsel, files this Petition for Writ of Certiorari ("Petition") pursuant to Md. Rules 8-301, *et seq.*, to request review by this Court.

I. Executive Summary

The central question is whether members of a Limited Liability Company ("LLC") can agree by contract how their membership interests will be distributed upon their deaths.

II. Procedural History

The Anne Arundel County Circuit Court granted summary judgment in favor of Petitioner, Ruby Potter ("Ruby"),¹ holding that James Potter's ("Mr. Potter") membership interest in TR Steak Pasadena, LLC ("the LLC") passed to her under the terms of the LLC's members' agreement following Mr. Potter's death. Denise Potter ("Denise"), Mr. Potter's heir, appealed arguing that, in order to effectuate a post-mortem distribution, a contract must comply with the formalities of a will. The Court of Special Appeals agreed with Denise and issued an opinion on May 26, 2021 remanding the case to the Circuit Court

¹ Because there are multiple parties with the surname Potter, Petitioner uses first names.

("Opinion"). The Mandate was entered on June 29, 2021.

III. Questions for Review.

Can members of an LLC contract to control the distribution of a member's interest at death?

IV. Review is Desirable and in the Public Interest.

Practitioners in Maryland routinely include provisions in partnership and LLC agreements controlling the disposition of the business interests at the death of a partner or member. Until the Opinion, it was widely believed that such provisions were dispositive. The Opinion has caused panic as it disturbed a long-settled principle that business organizational documents can (and routinely do) contain valid post-mortem distribution provisions.

- Within hours of the issuance of the Opinion, the facts and holding were sent out by individuals not involved with this case to the Maryland State Bar Association Estates & Trusts Section email listserv.
- The day after the Opinion was published, the LLC Committee of the Maryland State Bar Association's Business Law Section held a meeting during which it was supposed to review the Uniform LLC Act. Instead, as a result of the Opinion, the meeting was dedicated to reviewing the Opinion in this matter and "the problems that the ruling poses."
- Leimberg Information Services, Inc., a national organization that provides analysis of legislations, regulations, cases and rulings that are relevant to estate planning, business entities, financial planning and charitable planning, dedicated one of its 60

Second Planner podcasts to summarizing the Opinion.

Essentially, the estate planning and business law sections of the Maryland Bar have been scrambling because the Opinion eviscerates a routine provision of partnership and LLC agreements. The Opinion casts a cloud over any post-mortem provision in a partnership or LLC agreement, including general post-mortem transfer provisions (such as those at issue in this case) as well as common "buy-sell" provisions (e.g., a provision that says that upon a member's death, the partnership or LLC has the right to purchase the deceased partner's/member's interest at a pre-established price, such as book value). These provisions are virtually universal in partnership and LLC agreements, and are instrumental in the formation and management of closely held businesses.

Review of this case is in the public interest so that the Court can resolve the turmoil that resulted from the Opinion.

V. Statement of Fact.

Mr. Potter owned a membership interest in the LLC at the time of his death on May 15, 2017 ("LLC Interest"). The members of the LLC had negotiated and signed contracts that controlled various aspects of the LLC's management and governance, including who would acquire each member's interest at his death. According to those agreements, Mr. Potter's LLC Interest passed to Ruby.

Two documents control the LLC and its membership interests. The first document is the Third Amended Operating Agreement of TR Steak Pasadena, LLC (the "Operating Agreement"). The Operating Agreement includes Article 6.1.3.1: Death of Class A Member which states that upon the death of a member, the person or entity succeeding to

the interest shall only become a member of the LLC if the person or entity succeeding to the membership interest "is a member of the Permitted Group as defined in the Members' Agreement." The Operating Agreement does not define the term "Permitted Group" even though the term is styled like the other defined terms of the Operating Agreement.

In conjunction with the Operating Agreement, the members of the LLC have executed the Third Amended Members' Agreement ("Members' Agreement"). The purpose of the Members' Agreement, as outlined in the "explanation" section of the document, is "to provide for the terms, conditions and limitations upon the future distribution, retention and disposition of the Members' Membership Interests of the Company." Like the Operating Agreement, the Members' Agreement does not define the term "Permitted Group." It is clear, and uncontested by Denise, that the Members' Agreement and the Operating Agreement (collectively, the "Agreements") are designed and intended by the LLC to be used in conjunction with each other. The Agreements, when taken together, control the disposition of membership interests upon the death of a member of the LLC.

In pertinent part, Section 3.1 of the Members' Agreement states as follows:

Purchase upon Death. Upon the death of a Member, all of the Membership Interests of the Company owned by him shall be transferred as shown below for each member with the voting rights attached to their Membership Interests being assigned to the Member shown.

MEMBER	SUCCESSOR	VOTING RIGHTS
...
6. James R. Potter	Ruby Potter	Anthony G. Toskov, Jr. and Matthew B. Gunther
...

Mr. Potter obtained the LLC Interest when he was married to Ruby. Their marriage

ended in divorce after 32 years. Mr. Potter then married Denise approximately one year before his death. Subject to the terms of the Agreements, Mr. Potter was the sole owner of the LLC Interest at the time of his death.

Denise was appointed personal representative of Mr. Potter's Estate ("Estate") on or around August 22, 2017. Denise, as personal representative, inventoried the LLC Interest as part of the Estate. Believing the LLC Interest passed to her outside of the Estate, Ruby filed a complaint for declaratory judgment with the Circuit Court Case No. C-02-CV-17-003225 on November 7, 2017 against Denise individually and as personal representative of the Estate.

Denise filed a motion for summary judgment on December 11, 2017. In her motion, Denise claimed that the LLC Interest belonged to the Estate because the Agreements did not comply with Md. Code Ann. Estates & Trusts (hereinafter "ET") § 4-102, the Wills Act, and therefore could not validly pass property on Mr. Potter's death.

Ruby opposed Denise's motion for summary judgment and filed a cross-motion for summary judgment. Ruby argued that the Agreements passed the LLC Interest outside of probate. Denise filed an opposition to Ruby's cross-motion for summary judgment.

The Circuit Court ruled in favor of Ruby. In an oral opinion from the bench, the Circuit Court granted Ruby's motion for summary judgment. Additionally, the Court issued a written order on May 30, 2018 finding no dispute of material facts and that Ruby was the recipient of the LLC Interest under the Agreements.

Denise appealed the Circuit Court's order. The only question Denise raised on appeal was whether an LLC membership agreement could pass members' interests at death

without complying with the formalities of a will. The Court of Special Appeals held that members of an LLC could not control the distribution of the membership interest by contract and remanded the case to the Circuit Court.

VI. Legal Argument in Support of Petition

Will formalities only apply to property that falls within the ET Code's definition of "property." Property outside of the ET Code's definition may be controlled by contracts that do not comply with the will formalities. The principle of freedom of contract that is fundamental to LLCs permits members to negotiate agreements that control who may become members.

a. Wills formalities only apply to instruments that transfer "property" as defined by ET § 1-101(r)

ET § 1-301(a) states that the law of estates of decedents applies to the transfer of property upon an individual's death. The section reads in part as follows: "[a]ll property of a decedent shall be subject to the estates of decedents law, and upon the person's death shall pass directly to the personal representative . . ."

ET § 1-101(a) states that "[i]n the estates of decedents law the following words have the meanings indicated." Subsection (r) of ET § 1-101 explains that when used in the ET Code the term "property" has the following meaning:

"Property" includes both real and personal property, and any right or interest therein. "Property" refers to (1) all real and personal property of a decedent and (2) any right or interest therein which does not pass, at the time of the decedent's death, to another person by the terms of the instrument under which it is held, or by operation of law.

For clarity, Petitioner will refer to all ET § 1-101(r) property as "Probate Property." Only Probate Property is subject to the § 1-301(a) and the other provisions of the ET Code.

b. The Agreements control the disposition of the LLC Interest at the members' deaths

Members of an LLC are given broad leeway to agree amongst themselves on the management of the company and the relations of its members. *See* Md. Code Ann. Corp.& Ass'n ("CA") § 4A-102 ("Unless otherwise provided in this title, the policy of this title is to give the maximum effect to the principles of freedom of contract and to the enforceability of operating agreements.") Members "may enter into an operating agreement to regulate or establish any aspect of the affairs of the limited liability company or the relationship of its members." CA § 4A-402(a). This includes the "rights of the members to assign all or a portion of their membership interest," CA § 4A-402(a)(3), and to control "the circumstances in which a person may be admitted as a member of the limited liability company," CA § 4A-402(a)(4).

The LLC Act's focus on freedom of contract reflects the fact that, fundamentally, LLCs are governed by contracts. The members' ability to negotiate with each other to reach an agreement that controls the management of the LLC and the relations of the members, including who may become a member, is an essential element of LLC law.

In this case, all the members of the LLC entered into a bargained-for exchanged—the Agreements—in which, among other things, they agreed who would be admitted to the LLC upon a member's death. Denise wants to re-write the LLC members' contract. Her proposed limitation on LLC members' freedom to control their relationship with each other

violates the principle of the LLC Act that the general assembly articulated in CA § 4A-102.

Denise's proposed outcome does not only impact Mr. Potter's membership interest. It violates the Agreements the LLC members entered into. The members agreed who would become members following each member's deaths. Although Denise does not argue that the Agreements are invalid, she wants to override them and insert herself as the owner of Mr. Potter's LLC Interest without the agreement of the LLC members.²

Far from being rare and unenforceable, this Court noted that provisions controlling what happens at the death of an owner (a partner in that case), are common in sophisticated partnerships. "Sophisticated partnerships virtually always use carefully drafted partnership agreements to protect the various partners' interests by providing for the continuation of the business, the distribution of partnership assets, etc., in the face of various contingencies such as death." *Creel v. Lilly*, 354 Md. 77, 88 (1999) (citing JUDSON A. CRANE & ALAN R. BROMBERG, LAW OF PARTNERSHIP § 73, at 417-19 (1968)).

c. An LLC membership interest disposed of in the membership agreement is not "Probate Property" for the purposes of the ET Article

Because the Agreements transfer the LLC Interest to Ruby at Mr. Potter's death, the LLC Interest is not Probate Property. As explained by the definition of Probate Property, an asset that transfers to another person at the owner's death "by the terms of the instrument

² The members may not want Denise to become a member of the LLC. Denise was previously married to a different member of the LLC, Anthony Decker, but divorced him after having an affair with Mr. Potter. It is entirely possible that Mr. Decker would not have agreed to admitting his ex-wife as a member of the LLC.

under which it is held" is not Probate Property. Examples of non-Probate Property include life insurance policies with beneficiary designations, retirement accounts with beneficiary designations, life estates with reserved powers, pay on death and transfer on death accounts, and joint property with the right of survivorship.

In its Opinion, the Court of Special Appeals relied heavily on the Henderson Report when analyzing whether an LLC membership interest was Probate Property. The Court correctly noted that the revisions to the definition of Probate Property that the Henderson Report recommended were meant to change only one aspect of the definition of Probate Property: the treatment of real property held by the decedent. *See* Opinion at 18; Second Report of the Governor's Commission to Study and Revise the Testamentary Laws of Maryland 3 (1968) ("Henderson Report"). In light of this fact, the Court asked "whether a membership interest in a Maryland limited liability company [with a valid agreement that transferred the membership interest at each member's death] would have been treated as [Probate Property] prior to the enactment of Article 93 in 1969." Opinion at 19.

The Court could not analyze pre-Henderson Report cases that address LLC membership interests because the LLC did not exist until after the Henderson Report.³ Instead of looking to cases involving other business structures (such as partnerships and corporations), the Court of Special Appeals reviewed two cases involving bank accounts (*Whalen v. Milholland*, 89 Md. 199 (1899) and *Whalen v. Milholland*, 89 Md. 212 (1899)),

³ Wyoming was the first state to enact an LLC statute in 1977. *See* Amy P. Jetel, 2 ASSET PROTECTION: DOM. & INT'L L. & TACTICS § 18.1 (2021). Maryland adopted its first limited liability company act in 1992. *See* Limited Liability Act of 1992.

two cases involving contracts that failed for lack of consideration (*American Univ. v. Collings*, 190 Md. 688 (1948) and *Carey v. Dennis*, 13 Md. 1 (1859)), and a case involving a failed bill obligatory (*Cover v. Stem*, 67 Md. 449 (1887)).

Although LLCs did not exist prior to 1992 in Maryland, partnerships did. Partnership cases are especially instructive because the legal principles before the Court—members or partner's freedom to control their relationships by contract—are the same in LLC and partnership agreements. The question presented about LLC agreements applies equally to partners' ability to dispose of their partnership interests in a partnership agreement.

The close relationship between the principles of partnership and LLC law also tend to make the partnership precedence relevant. In the First Report of the Special Joint Committee on a Proposed Maryland Limited Liability Company Act the Maryland State Bar Association Sections of Taxation and Business Law notes that the concepts in the Limited Liability Act will be familiar because they were "substantially drawn from the Maryland Revised Uniform Limited Partnership Act." MARYLAND STATE BAR ASSOCIATION SECTIONS OF TAXATION AND BUSINESS LAW, FIRST REPORT OF THE SPECIAL JOINT COMMITTEE ON A PROPOSED MARYLAND LIMITED LIABILITY COMPANY ACT 3 (1990).

Prior to 1969,⁴ partnership interest subject to agreements controlling their post-mortem distribution were not probate property, and the agreements themselves were

⁴ The change in the definition of Probate Property recommended by the Henderson Report became effective in 1969.

upheld.

In *Ottaviano v. Lorenzo*, 169 Md. 51, 54-55 (1935) this Court held that the partnership agreement, if valid, would override a will and control the distribution of the partnership interest at the partner's death. In that case, a mother, son and stepfather formed a partnership. The son alleged that the partners agreed that following the deaths of the mother and stepfather, the partnership interests would go to the son. *Ottaviano*, 169 Md. at 56. At the mother's death, her will did not direct her interest in the partnership to her son following the stepfather's death. *Id.* at 57-58. Similarly, the stepfather's will left assets in the partnership to various other family members rather than the stepson. *Id.* at 59. (This case was brought during the stepfather's lifetime so his will was not yet effective.) Noting that the partnership statute "expressly recognizes that the rights of the partners with respect to their association are determined by their agreement," *Id.* at 61, the Court remanded the case to give the son the opportunity to establish the validity of the partnership agreement. *Id.* at 64. If the agreement were valid, *it* would control the disposition of the partnership interest. *Id.* at 63-64.

The freedom to dispose of partnership interests by the partners' agreement was upheld in *Collier v. Benjes*, 195 Md. 168 (1950).

There is nothing in the provisions of the Partnership Act Article 73A, 1939 Code, which prevents partners from agreeing as to the title of any specific asset. In the case of *Ottaviano v. Lorenzo*, 169 Md. 51, 179 A. 530, the partners agreed that the partnership property on the death of the survivor of two of the three partners should become the property of the third partner.

Collier, 195 Md. at 176.

This Court summarized partners' freedom to enter into an agreement that (1)

overrides the statutory default that a partnership terminates at death and (2) directs how the partnership interests will be distributed at the death of a partner in *Gerding v. Baier*, 143 Md. 520, 524-26 (1923).

These cases confirm that partners may control the disposition of their partnership interests by contract. Each of these cases answers the lower Court's question: prior to 1969, an interest in an entity that was subject to a contract directing its distribution at the owner's death was not probate property. In *Collier* the partnership interest was distributed to John H. Benjes under the partners' agreement rather than to the Estate. In *Ottaviano*, if the lower court found on remand that the partnership agreement was valid, the son would receive the partnership interest as directed by the agreement rather than the stepfather's various family members as directed by the mother and stepfather's estates.⁵

d. The Agreements are valid Contracts to which Rudy is a Third-Party Beneficiary

Ruby has the authority to enforce the Agreements because she is a third-party beneficiary. "An individual is a third-party beneficiary to a contract if 'the contract was intended for his [or her] benefit' and 'it ... clearly appear[s] that the parties intended to recognize him [or her] as the primary party in interest and as privy to the promise.'" *Dickerson v. Longoria*, 414 Md. 419, 452 (2010) (quoting *Shillman v. Hobstetter*, 249 Md. 678, 687 (1968)). The parties to the contract—the members—clearly

⁵ These cases took place prior to the Uniform Revised Partnership Act in 1997, but the provisions for the assignment of partnership interests remained largely the same from the Uniform Partnership Act to the Uniform Revised Partnership Act. See Ronald M. Shapiro, *The Need for Limited Partnership Reform: A Revised Uniform Act*, 37 MD. L. REV. 544, 566 (1978) ("Except for clarifying language, or the elimination of surplusage, the Commissioners have kept the statute affecting assignment of partnership interest substantially intact.")

identified Ruby as a beneficiary of the contract by naming her as such.

e. Inconsistent with Other States

The impact of the Opinion is not limited to Maryland LLCs. Members of an LLC from another state may form an agreement—valid in their state⁶—that controls the distribution of the LLC interest at a members' death only to find that it is invalid if a member is a resident of Maryland at his or her death. This outcome where the validity of a contract depends on where an individual happens to reside at his or her death would be problematic.

f. Statutory Exception to the Testamentary Rules Applies

The definition of Probate Property identifies what property falls under the requirements of Estates and Trusts Section of the Maryland Code. Any property that is not within that definition is not controlled by the provisions of the ET Code regardless of whether there is a specific statutory exception to ET § 4-102. That being said, the provision within the Agreements that directs the disposition of the LLC Interest at the member's

⁶ Such states include *Matter of Hillowitz*, 22 N.Y.2d 107, 109 (1968) ("A partnership agreement which provides that, upon the death of one partner, his interest shall pass to the surviving partner or partners, resting as it does in contract, is unquestionably valid and may not be defeated by labeling it a testamentary disposition."); *Matter of Estate of Cook*, 2020 Ark. App. 292 (2020) (holding that, because there was a valid LLC agreement distributing the membership interest at the member's death, "interest transferred upon his death to Brooks rather than to [the member's] estate."); *Brick Professional, L.L.C. v. Napoleon*, 2009 WL 2176699 (N.J. Super. Ct. App. Div. 2009) (holding that "the court was not free to disregard the [LLC's operating] agreement because it required a different mechanism for the assignability of a deceased member's interest."); *Blechman v. Estate of Blechman*, 160 So. 3d 152 (Fla. Dist. Cot. App. 2015) (holding that "the Deceased's membership interest immediately passed outside of probate to his children upon his death, thus nullifying his testamentary devise as an attempted disposition of property not subject to his ownership."); *Young v. Young*, 240 W.Va 169 (2017) (holding that the ½ interest in a company that was subject to an option contract at the owner's death was *non-probate* property the value of which was part of the elective share).

deaths falls within the Maryland Uniform Transfer-on-Death Security Registration Act which is codified at ET §§ 16-101-112.

ET § 16-107(a) states that "[o]n death of a sole owner or the last to die of all multiple owners, ownership of securities registered in beneficiary form passes to the beneficiary or beneficiaries who survive all owners."

ET § 16-101(i)(1) defines a "Security" to include "a share, participation, or other interest in property, in a business, or in an obligation of an enterprise or other issuer." The LLC Interest is a share in a business and so, for the purpose of ET Title 16, it is a "security." A security is registered in beneficiary form "when the registration includes a designation of a beneficiary to take the ownership at the death of the owner or the deaths of all multiple owners." ET § 16-104. The "registration" in this case is the Agreements which designate that Ruby takes ownership of the LLC Interest at James's death.

VII. Documents Attached to Petition.

- a. Circuit Court Docket Entries
- b. Circuit Court Order
- c. Court of Special Appeals Opinion
- d. Emails from the MSBA Estates and Trusts Section discussing the Court of Special Appeals Opinion
- e. Third Amended Operating Agreement of TR Steak Pasadena, LLC, dated August 7, 2012
- f. Third Amended Members' Agreement, dated August 7, 2012

VIII. Conclusion.

To resolve the uncertainty the Opinion created related to the validity of post-mortem transfer and "buy-sell" provisions in LLCs and partnerships, this Court should grant certiorari.

Times New Roman, 13 pt.

Respectfully submitted,

Deb Howe

Frederick R. Franke, Jr. (CPF: 7412010106)
Jack K. Beckett (CPF: 1112130070)
Deborah F. Howe (CPF: 1712130249)
Franke Beckett LLC
151 West Street, Suite 301
Annapolis, Maryland 21401
(410) 263-4876
(410) 269-5882 (fax)
dhowe@frankebeckett.com

Attorneys for Petitioner R. Potter

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that on this 14th day of July, 2021, a copy of the foregoing Petition for Certiorari was served via MDEC and first-class mail, postage pre-paid on:

D. Gregory Howard, Esq.
Carl Alban Howard, Esq.
Howard & Howard, Attorneys-at-Law
298 Butler Road
Reisterstown, Maryland 21136
Chip@hhlawonline.com

Counsel for Denise Potter

Deb Howe

Deborah F. Howe (CPF: 1712130249)

**CERTIFICATION OF WORD COUNT AND COMPLIANCE WITH MD. RULE
8-112**

1. This petition for certiorari contains 3,897 words.
2. This Brief complies with the font, spacing, and type size requirements stated in Rule 8-112.

Deb Howe

Deborah F. Howe (CPF: 1712130249)