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CORPORATIONS, PARTNERSHIPS AND ASSOCIATIONS

Limited Liability Companies: Provide for Default Rule Maintaining Continuous Existence of Limited Liability Companies; Provide that Except as Established Otherwise in the Articles of Organization or Written Operating Agreement of a Limited Liability Company, a Member of a Limited Liability Company with Respect to Which the Event of Dissociation Occurs is not Entitled to Receive any Payment by Reason of Such Event and Will Become an Assignee as to Such Limited Liability Company Interest

CODE SECTIONS:	O.C.G.A. §§ 14-11-405, -601 (amended), -601.1 (new), -602, -604 (amended)
BILL NUMBER:	SB 41
ACT NUMBER:	396
GEORGIA LAWS:	1999 Ga. Laws 822
SUMMARY:	The Act amends the existing "Georgia Limited Liability Company Act" to provide that in the event of dissociation, a member of a limited liability company becomes an assignee to the interest of such limited liability company (LLC). A person can cease to be a member of an LLC in the following circumstances: by operation of law; by reason of his or her death or incapacity; if he or she is removed in accordance with the articles of organization or a written operating agreement of the LLC; by the majority vote assignment; when he or she assigns his or her interest in the company for the benefit of the company or of the creditors; or when he or she is adjudicated bankrupt or in the process of being adjudicated as bankrupt or insolvent. An LLC can be dissolved under the provisions of the articles of organization by a written operating agreement, by the decision of its members,

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or by operation of law. The Act provides for default winding up of the dissolved LLC by persons entitled to receive a majority of the subsequent distributions or their assignees or legatees in absence of the company's managing members.

EFFECTIVE DATE: July 1, 1999[1]

History

The legal status of a limited liability company (LLC) allows its owners to enjoy the benefits of partnership-like tax treatment and corporate-like stability at the same time.[2] Registration of one's business as an LLC is a comparatively new development in Georgia: most LLCs are now being formed because the check-the-box federal tax regulation made it easy for small businesses owners to register their enterprises as LLCs.[3] Before, owners had to go through a complicated process of structuring their businesses in a specific way in order to qualify for LLC treatment.[4] The Georgia General Assembly passed the Limited Liability Company Act in 1993 to set legal guidelines for and encourage registration of local businesses as LLCs.[5] The Act had wide support from both the legal and business communities.[6] The Georgia Limited Liability Company Act regulates formation and operation of limited liability companies.[7] However, the Act failed to address with certainty some aspects of the life of an LLC; in particular, what would happen if the last member of the company died or became disabled and the operating agreement provided no clear directions for this contingency.[8] Prior to passage of the Act,

1. SB 41 is a strictly proactive piece of legislation and applies only to LLCs formed after July 1, 1999. *See* the discussion *infra*.

2. *See* Interview with Prof. William A. Gregory, Georgia State University College of Law (July 22, 1999) [hereinafter Gregory Interview].

3. *See* Telephone Interview with Charles R. Beaudrot, Jr., Chairman, Partnership Subcommittee of the Corporate and Banking Section, Georgia Bar Association (May 3, 1999) [hereinafter Beaudrot Interview].

4. *See* Gregory Interview, *supra* note 2.

5. *See generally Review of Selected 1993 Georgia Legislation*, 10 GA. STATE U. L. REV. 79 (1993) [hereinafter *Selected 1993 Legislation*] (stating that before the passage of the Act a Georgia business wishing to register as an LLC would have to do so elsewhere and then get certified in Georgia as a foreign LLC).

6. *See id.*

7. *See id.*

8. *See id.*

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under the default rule, an LLC dissolved when its last member became dissociated from the company.[9] In this respect, an LLC resembled a partnership more than a corporation.[10] The 1999 Act gives LLCs a continuous existence, making them more like corporations.[11] The new Act preserves one of the main advantages of the LLC status by giving LLC members the ability to create, by contract, an entity that is not a corporation in the full sense of the word but that has a quasi-continuous existence like a corporation.[12]

Partnerships are traditionally loosely-organized business structures.[13] The law of partnerships was formed to address the needs of business entities based on personal relationships of their members and to provide easy dissociation procedures.[14] Presently, most small businesses are purely commercial with few personal ties and interests.[15] Owners typically do not want easy dissolution rules because such rules result in uncertainty, risk of the sale of assets on unfavorable conditions, and loss of goodwill.[16] The purpose of the Act is to ensure that those who registered LLCs without legal advice and who failed to specifically provide for the continuous existence of their companies are not surprised by the default common-law rule that previously existed.[17]

Introduction

Senator Michael J. Egan of the 40th District introduced the Act at the request of the Georgia Bar Association.[18] The Act is a technical correction of the existing Georgia Limited Liability Company Act. The language of the Act remained unchanged throughout Committee consideration and floor debates.[19]

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9. *See id.*
10. *See id.*
11. *See* Beaudrot Interview, *supra* note 3.
12. *See id.*
13. *See* Gregory Interview, *supra* note 2.
14. *See id.*
15. *See id.*
16. *See id.*
17. *See* Beaudrot Interview, *supra* note 3.
18. *See* Telephone Interview with Sen. Michael J. Egan, Senate District No. 40 (Apr. 15, 1999) [hereinafter Egan Interview].
19. *See* Beaudrot Interview, *supra* note 3; Egan Interview, *supra* note 18.

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The Act

The Act amends Chapter 11 of Title 14 by changing the language of Code sections 14-11-405,[20] -601,[21] -602,[22] and -604,[23] and adding Code section 14-11-601.1.[24]

Preserving the Unique Features of an LLC

What the Act leaves unchanged may be as important as its new developments.[25] The Act leaves unchanged the two features that distinguish an LLC from a regular corporation: (1) it preserves the default rule that interests in an LLC are not transferable;[26] and (2) it does not provide for unconditional continuity of existence for an LLC, because the drafters believed that those who check-the-box to register their LLC would not expect such an extreme result.[27] Rather, it gives the owners an opportunity to provide for dissolution on specific conditions that can be enumerated in a written operating agreement or articles of organization.[28]

Prospective Effect of the Act

The shift from the partnership-like default dissolution rule towards a quasi-corporate continual life for an LLC is rather radical.[29] Therefore, the drafters decided to make the Act prospective to avoid creating difficulties for those who formed an LLC expecting that it would automatically dissolve upon the dissociation of the last member and thus made no specific written provisions for that contingency.[30] The Act preserves the old default dissociation rule with respect to

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20. *Compare* 1993 Ga. Laws 123, § 1, at 174 (formerly found at O.C.G.A. § 14-11-405 (Supp. 1998)), *with* O.C.G.A. § 14-11-405 (Supp. 1999).
21. *Compare* 1995 Ga. Laws 470, § 19, at 479 (formerly found at O.C.G.A. § 14-11-601 (1994)), *with* O.C.G.A. § 14-11-601 (Supp. 1999).
22. *Compare* 1995 Ga. Laws 470, § 19, at 479 (formerly found at O.C.G.A. § 14-11-602 (Supp. 1998)), *with* O.C.G.A. § 14-11-602 (Supp. 1999).
23. *Compare* 1993 Ga. Laws 123, § 1, at 186 (formerly found at O.C.G.A. § 14-11-604 (1994)), *with* O.C.G.A § 14-11-604 (Supp. 1999).
24. *See* O.C.G.A. § 14-11-601.1 (Supp. 1999).
25. *See* Beaudrot Interview, *supra* note 3.
26. *See* O.C.G.A. 14-11-405 (Supp. 1999)
27. *See id.*; Beaudrot Interview, *supra* note 3.
28. *See* Beaudrot Interview, *supra* note 3.
29. *See id.*
30. *See id.*

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LLCs formed before July 1, 1999[31] and introduces the new default continuity rule with respect to those formed after July 1, 1999.[32] Moreover, the Act preserves the definition of dissociation contained in the prior version of the Code with respect to LLCs formed before July 1, 1999[33] and introduces a new definition for those formed thereafter.[34] The same pertains to the definition of dissolution of an LLC.[35]

Interest Transfer in Case of Dissolution

The major change introduced by the bill is the new default rule that states, unless provided for otherwise in the articles of organization or a written organization agreement of the LLC, the member with respect to whom dissociation has occurred will not be entitled to receive any payment; rather, he or she becomes an assignee to the LLC interest unless the LLC's articles of organization or a written organization agreement provide otherwise.[36] The member would then be entitled solely to his or her share of LLC income.[37]

Continuity of Existence

The Act ensures the continuity of the LLC by providing that, after July 1999, an LLC would not automatically cease to exist in the case of dissociation due to withdrawal of its last member or in the course of an uncontested reorganization, arrangement, composition, readjustment, liquidation, dissolution, or a similar legal proceeding as in the previous law.[38] The Act nevertheless allows LLC members the flexibility of the prior rule by allowing them to define other conditions of dissociation by reference in the articles of organization or in a written operating agreement.[39]

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31. *See* O.C.G.A. § 14-11-405(a) (Supp. 1999).
32. *See id.* § 14-11-405(b).
33. *Compare* 1995 Ga. Laws 470, § 19, at 479 (formerly found at O.C.G.A. § 14-11-601(a) (1994)), *with* O.C.G.A. § 14-11-601(a) (Supp. 1999).
34. *See* O.C.G.A. § 14-11-601.1 (Supp. 1999).
35. *Compare* 1995 Ga. Laws 470, § 19, at 479 (formerly found at O.C.G.A. § 14-11-602 (Supp. 1998)), *with* O.C.G.A. § 14-11-602 (Supp. 1999).
36. *Compare* 1993 Ga. Laws 123, § 1, at 174 (formerly found at O.C.G.A. § 14-11-405 (Supp. 1998)), *with* O.C.G.A. § 14-11-405 (Supp. 1999).
37. *See* Gregory Interview, *supra* note 2.
38. *Compare* 1995 Ga. Laws 470, § 19, at 479 (formerly found at O.C.G.A. § 14-11-601 (1994)), *with* O.C.G.A. § 14-11-601.1 (Supp. 1999).
39. *See* O.C.G.A. § 14-11-601.1(b) (Supp. 1999)

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Dissolution Provisions

In their effort to provide for a quasi-corporate continuity of life for LLCs, the drafters of the Act did not want to deprive the members of an LLC of the possibility of dissolving their company by operation of law or by mutual agreement.[40] Therefore, the new rule preserved the prior provisions for dissolution when specified in the articles of organization or a written operating agreement, by consent of all the members,[41] or by a decree of judicial dissolution.[42] The Act did, however, dispose of the rule calling for the automatic dissolution upon the dissociation of the last member.[43]

Winding up the LLC Assets

The Act provides further assurance of continuity of existence for LLCs.[44] The Act provides for division of LLC assets upon its dissolution by a legal representative or an assignee of the last dissociating member.[45] Drafters expect this provision to reassure creditors of an LLC and to afford them more favorable financial treatment.[46]

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40. *See* Beaudrot Interview, *supra* note 3.
41. *Compare* 1993 Ga. Laws 123, § 1, at 183 (formerly found at O.C.G.A. § 14-11-602(3) (1994)), *with* O.C.G.A. § 14-11-602(b)(3) (Supp. 1999).
42. *Compare* 1995 Ga. Laws 470, § 19, at 479 (formerly found at O.C.G.A. § 14-11-602(5) (1994)), *with* O.C.G.A. § 14-11-602(b)(5) (Supp. 1999).
43. *Compare* 1993 Ga. Laws 123, § 19, at 479 (formerly found at O.C.G.A. § 14-11-602(4) (1994)), *with* O.C.G.A. § 14-11-602(b)(4) (Supp. 1999).
44. *See* Beaudrot Interview, *supra* note 3.
45. *Compare* 1995 Ga. Laws 470, § 19, at 479 (formerly found at O.C.G.A. § 14-11-604 (1994)), *with* O.C.G.A. § 14-11-604 (Supp. 1999).
46. *See* Beaudrot Interview, *supra* note 3.