



Ten Tremont Street, Suite 600 | Boston, MA 02108
www.bovelanga.com | p 617.720.6040 | f 617.720.1919

Where There's A Will, There is a Way (Around It)

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Alexander A. Bove, Jr. & Melissa Langa

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It is interesting how, in the long term course of a law practice, certain procedures have a way of becoming a part of a firm's "standard practice", without first ascertaining whether the particular practice is supportable under applicable law.

Consider this common practice, for example. Client is forming a limited liability company (or a family partnership or other entity, but here we will use the LLC for discussion purposes). The law firm suggests that the operating agreement for the LLC contain a provision that allows a member to designate a named beneficiary to receive the member's business interest directly on client's death, thereby maintaining the ease of individual ownership during the client's lifetime (which can help when obtaining business financing), while avoiding the time, expense, and publicity of passing the business interest through probate. Such a provision would not normally provide that the designated beneficiary would be a member with full rights, just that the designated beneficiary would receive the deceased economic interest – as an assignee of the membership interest (unless later admitted as a full member).

On its face, since all LLC members agree in advance to the designation, this would seem to be a simple, legally enforceable (and good practical) solution to the otherwise involved and time-consuming procedure of probate, which could possibly interfere with the smooth continuation of the business. But is it "legal?" Doesn't the LLC membership interest qualify as "property?" And as such shouldn't the

transfer be subject to the usual requirements for transfers of property on death? That is, for example, transfers through a trust, joint ownership, retirement plans, or – yes – a will, executed with all the formalities required under the statute of wills? Depending on the language of the writing, it could go either way. If the writing was intended to become a part of the partnership agreement and agreed to by the parties, it should be regarded as part of the contract between /among the parties. But if it was a simple expression solely by one of the parties, it would likely be regarded as a violation of the statute of wills.

The beneficiary designation issue arose in a recent Maryland case, *Potter v. Potter*, 250 MD App. 569, 252 A.3d 17 (2021). In *Potter*, the facts involved the transfer of a member’s LLC interest on his death. Prior to his death, the member, James Potter, designated his spouse Ruby, as the “successor” of his interest in the LLC as provided in the LLC operating agreement. Later, James and Ruby divorced, and about a year later, James married Denise. Shortly after that, James died, without ever changing the beneficiary designation of Ruby as his “successor” in the LLC interest. Of course, both ex-spouse Ruby and current spouse Denise claimed a right to the LLC interest. The lower court held in favor of ex-spouse Ruby, but the Maryland Court of Special Appeals saw it quite differently. They reviewed Maryland law dealing with will substitutes, identifying the several situations where “property” could be legally transferred at death, such as life insurance, inter vivos trust property, “and the like”, as specifically set forth in Maryland law. In fact, it was the “and the like” part the ex-spouse Ruby relied on to argue that Maryland law allowed the non-probate transfer of the LLC interest. Unfortunately for Ruby, the Appeals Court did not wish to add this interpretation to Maryland law and held that the interest should pass to James’s probate estate and thus ultimately to current spouse Denise.

One question that is hard to ignore is whether the court went out of its way to sidestep James’s oversight in not changing the beneficiary to Denise after he divorced Ruby. Such slip-ups happen fairly often, such as where a spouse forgets to remove an ex-spouse as beneficiary of a life insurance policy or retirement plan. Without a separation agreement releasing such benefits, there may not be much recourse, unless state law automatically voids the pre-divorce designation. Massachusetts Uniform Probate Code

does just that in some instances. See M.G.L. chapter 190B, Section 2-804. But counsel must still tread carefully, as a separation agreement releasing rights in an ERISA benefit is insufficient alone to change the designated beneficiary of the covered retirement plan. *Kennedy v. Plan Administrator for DuPont Savings and Investment Plan*, 555 U.S. 285 (2009).

So, what is the law in Massachusetts? If counsel recommends that clients with an interest in an LLC (or other entity) sign a beneficiary declaration as part of the terms of an operating agreement, so that the clients interest in the LLC will pass smoothly on their death, is that a violation of the Massachusetts statute of wills? Fortunately, there is considerable Massachusetts law on the very issue, clearly holding that a beneficiary designation of the recipient of a partner's share of a partnership will be valid, as repeated in the numerous cites on the question, provided that the designation was not made "with the intent to evade the statute of wills." None of the cases discuss what the circumstances might be that would be such a violation, but apparently the attention to and validity of the partnership agreement would seem to be sufficient to overcome a challenge. Here is one cite from the several Massachusetts court decisions directly relating to the issue, reflecting the court's position in numerous such cases:

It is not disputed that an attempted gift of property, to take effect on the death of the donor without delivery of the property, control and dominion being retained by the donor during his lifetime, is invalid. [Citations omitted] The statute of wills, however, does not prevent an owner of property from stipulating by contract for the disposition of his property at the time of his death.

Hale v. Wilmarth, 274 Mass. 186,189 (1930).

Thus, when faced with a situation where it makes sense for the client to keep the membership interest in their own name yet wants to avoid probate at death, counsel can recommend an amendment to the LLC operating agreement to permit a beneficiary designation. The LLC operating agreement provision should at a minimum (i) require the consent of all members on the designation, (ii) indicate whether remaining members have the ability to trigger a buy-out of the transferee's interest and how that

would work, (iii) state whether the transferee is a full member with all rights or a mere assignee, and (iv) where the transferee is a member require the transferee to sign on to the LLC operating agreement as a condition of the transfer.