Explanation of 2015 Amendments to the Florida Revised LLC Act

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The Florida Revised LLC Act ("Act") was enacted in 2013 and took effect January 1, 2014 for new Florida LLCs and January 1, 2015 for all Florida LLCs. The Act has been further amended with "clean-up" changes and "glitch" fixes, as well as some important substantive adjustments.

The following is an outline of the telephonic CLE presentation to be made on the above date.

Also provided as resource materials are copies of the following:

First Engrossed Senate Bill 554 (House Bill 531)

Bill Analysis and Fiscal Impact Statement – Senate Bill 554 – April 2, 2015

Excerpts of certain Chapter 605 sections that were modified

➢ Glitch and Clean-Up Changes

(References to "Sections" are to the Act unless otherwise noted)

- Section 605.0102(37) – makes it clear that the determination of a "majority-in-interest" as a default voting rule is based upon <u>all</u> members and not just those members having the right to vote
  - but the determination for purposes of those sections dealing with the approval of a merger, interest exchange or conversion is based upon those members having the right to approve the transaction
    - note that this would mean all members unless the Operating Agreement provides differently

- Section 605.0103(4)(b)5. – requires a county clerk recording as an additional constructive notice condition when a grant or restriction on a person's authority is contained in the articles of organization and the grant or restriction in question pertains to real estate transactions
  - this is not a change to former law under the Act, as this was the requirement under 608 as well

- Section 605.04073(4) – clarification that a member consent resolution in lieu of a meeting requires the approval of same number of votes that would be required at a meeting

- this is also not a change to former law by the Act, as this provision was the same under 608

- Section 605.0410(2)(c) – adds the procedure for responding to a member's request for certain information in a "member-managed" LLC, including a requirement to describe why the request is unreasonable or improper
  - this change was required because of the structure used in some sections of the uniform act as well as the Act to differentiate requirements applicable to "member-managed" and "manager-managed" LLCs
    - this is the same language that already appears in Section 605.0410(3)(c) for "manager-managed" LLCs

- Section 605.1072(2)(c) – the non-compliance with the special approval requirements for *interested transactions* has been eliminated as one of the "exceptions" to the rule that a person's exercise of the statutory appraisal rights is an exclusive remedy
  - the language in question was based on language contained in the Revised Model Business Corporation Act, which was a source of various other provisions in the appraisal remedy parts of the statute (Sections 605.1006, and 605.1061 – 605.1072)
  - because of the uncertainty as to how "conflict of interest" provisions in Section 605.04092 should be applied in this context and because the verdict is still out as to whether these revisions in the Revised Model Business Corporation Act will be brought over to Chapter 607, there was a consensus by those helping the sponsors with the language for the new law that the language should be eliminated for the time being

- Section 605.1108(3) – eliminates a rule that a reference to the company being a "manager-managed" LLC in the articles of organization is the same as including that kind of reference in the Operating Agreement
  - the eliminated language was redundant and confusing because changes by the drafting committee to Section 605.0407(1) later in its drafting process made it clear that the manifestation of the management structure can be made in either or both or the articles or organization or the Operating Agreement
    - consider the constructive knowledge effect of having the articles specify this "election"

- Miscellaneous technical or minor fixes
  - Chapter "605" substituted for chapter "608" in other statutes
  - Deletion of remaining references to "managing member" in other statutes
  - Fixed punctuation and cross-references in a few places in new 605

➢ Fiduciary duties - Manager (and Member of Member-Managed LLC)

- General Background
  - A Florida legislator was concerned because judges were confused about whether common law fiduciary duties existed alongside the express statutory fiduciary duties
  - Wanted an express statement that common law fiduciary duties continue to exist alongside the express statutory fiduciary duties
    - Similar language was added to the Delaware LLC statute

- Statute prior to glitch bill
  - Default rules
    - Follows the "Cabined approach" – same as under Chapter 608
      - Duty of loyalty – Section 605.04091 (2) – "is limited to"
        - Accounting for profit, benefits, etc.
        - Not having adverse interests
        - Not competing (before dissolution)
      - Duty of care – Section 605.04091 (3) – "is limited to"
        - refraining from engaging in grossly negligent or reckless conduct and willful or intentional misconduct, or a knowing violation of law
      - Must discharge duties under act and Operating Agreement consistent with "obligation of good faith and fair dealing"
    - Nonwaivables - Section 605.0105
      - Fiduciary Duties
        - Restrictions apply to changes to fiduciary duties of loyalty and care and obligations of good faith and fair dealing
        - "Manifestly unreasonable" standard applies to changes of those fiduciary duties and obligations
      - Manifestly Unreasonable Standard
        - Requires a court to decide "as a matter of law" (without a jury) whether a term in the Operating Agreement is "manifestly unreasonable"
        - The court must make this determination by considering only those circumstances that existed when the term became part of the agreement
        - The court may invalidate the term only if the objective of the term is unreasonable or it is an unreasonable means to achieve an objective
        - Cannot exonerate a person from liability for conduct involving bad faith, willful or intentional misconduct or a knowing violation of law

- Statute after the glitch bill becomes effective
  - Default rules

- Follows an "Uncabined approach" – same as in RULLCA - follows RULLCA language
    - Duty of loyalty – Section 605.04091 (2) – changes "is limited to" to "includes"
        - No other changes
    - Duty of care – Section 605.04091 (3) – changes "is limited to refraining from" to "is to refrain from"
        - engaging in grossly negligent or reckless conduct and willful or intentional misconduct, or a knowing violation of law
        - no other changes
    - Obligation of good faith and fair dealing
        - no changes
- Nonwaivables
    - no changes relative to fiduciary duties
    - Same restrictions apply to any reductions of such duties
        - Same "manifestly unreasonable" standard still applies to changes of those fiduciary duties and obligations

- Common Law Principles Supplement – Ability to Waive
    - Glitch bill adds express statement in Section 605.0111 (3) that the "common law principles relating to the fiduciary duties of loyalty and care" supplement Chapter 605
    - BUT, Glitch bill also adds express statement in Section 605.0111(2) allowing for all fiduciary duties to be restricted, expanded or eliminated except for those that are nonwaivable under Section 605.0105
        - Which effectively allows the common law principles relating to the fiduciary duties of loyalty and care to be waived by express language in an Operating Agreement

- Consequences
    - Before the Glitch bill, every LLC automatically got the benefit of the limited fiduciary duties unless those duties were expressly expanded by way of provisions in the Operating Agreement
    - After the Glitch bill, unless there is a broad waiver of fiduciary duties to the extent permitted by law, common law fiduciary duties will supplement the express statutory duties
        - As a result of the uncabining, other fiduciary duties may be implied as well

- Practice Points
  - In new Operating Agreements, consider adding a broad based waiver, restriction and elimination of all fiduciary duties other than those that are nonwaivable
  - In all existing Operating Agreements, check to see if they contain such a broad based waiver, restriction and elimination; and, if not, consider whether the parties want to amend to add such a waiver, restriction and elimination
    - Note: ability to do so may depend on what approval of members is required to amend the Operating Agreement
      - certain members may effectively have veto rights to making such changes

➢ Pending Business Judgment Rule Issue

- Background
  - The Florida legislator also expressed concern about the effect of Section 605.04093 relating to the exculpation of managers and members from personal liability for monetary damages
  - We understand that the concern relates to the fact that certain members and managers have sought to use this exculpation section as a shield to defend claims of breach of express provisions of an Operating Agreement
    - For example:
      - Express provision of an Operating Agreement states that no borrowings can be made by the limited liability company without the consent of all of the members
      - One of the members, without securing the consent of all of the other members, arranges for a loan to be made to the limited liability company because that member believed that, without the loan, the limited liability company would not be able to continue in business
      - Obviously, there is an express violation of the terms of the Operating Agreement
      - But the member who arranged for the loan claims that he is not liable for a breach of the Operating Agreement because he acted under the protection of the "business judgment rule" and is thus exculpated from liability

- Next Steps
  - In a deal worked out with the Florida legislator, the Business Law Section of the Florida Bar agreed to study this issue over the next few months
  - Efforts would be made to prepare a proposed legislative solution to the concerns expressed by the Florida legislator
  - Some preliminary proposals have been floated but no definitive action has been taken

- Concerns have been expressed that if the legislative change paints with too broad of a brush, it could have unintended consequences and therefore more careful study is required

➢ Dissociation

- Background and prior law
  - Section 608.427(1) prohibited withdrawal unless Articles or Operating Agreement provided otherwise
  - Accommodation to estate planning professionals and their clients
  - Section 605.0601 is departure from prior law -- the default rule now states that a member has the power to dissociate (withdraw), even when the dissociation is wrongful
  - Section 605.0105(3)(i) of the Act provided that the power of dissociation could not be overridden (or "varied") by the Operating Agreement
    - Based on the approach of the uniform act, which distinguished between the right to dissociate versus the power to dissociate

- Subsection "(i)" has now been deleted from the nonwaivable item list under Section 605.0105(3)

- In order to achieve the same outcome that automatically applied under former 608.427, the Operating Agreement must prohibit the voluntary dissociation (withdrawal)

- If the Operating Agreement is silent or deficient on the matter, Sections 605.0601 and 605.0603 nonetheless contain default rules addressing the determination of whether the dissociation is wrongful and the primary consequences of the dissociation (including the dissociated member's continuing liability for debts and other obligations, as well as damages resulting from the dissociation)

➢ Reinstatement via Filing of Annual Report

- Entities that are administratively dissolved in Florida have always had the ability to be reinstated by making appropriate filings and paying appropriate past due fees and penalties

- Under Sections 608.4482 and 608.5135, a limited liability company that was administratively dissolved or whose certificate of authority to transact business was revoked could apply for reinstatement by filing an application setting forth certain information.
  - Sections 608.4482(1)(b) and 608.5135(1)(b) specifically set forth that, as an alternative to submitting the application, a limited liability company that was administratively dissolved or whose certificate of authority to transact business was revoked could submit a current annual report,

signed by the registered agent, which substantially complies with the requirements of the application
    - This is similar to the provisions in Chapters 607 and 620 which also allow for the alternative procedure of filing an annual report to effectuate a reinstatement

- When Chapter 605 was adopted, Section 605.0715 (relating to reinstatement of a domestic limited liability company) and Section 605.0909 (relating in reinstatement of a foreign limited liability company) failed to expressly include the alternative procedure for reinstatement through filing a current annual report
    - Nevertheless, the Florida Department of State has been allowing reinstatement of limited liability companies and foreign limited liability companies through the alternative procedure
    - The Department of State wanted the statute to be amended so as to clearly authorize such alternative
    - In addition, the Department of State was anxious to clearly set forth in the statute the information that needs to be included in either the application for reinstatement or in the annual report that is submitted as an alternative

- Sections 605.0715 and 605.0909 are largely identical with respect to reinstatement
    - Section 605.0715 relates to reinstatement of a domestic limited liability company
    - Section 605.0909 relates to the reinstatement of a foreign limited liability company

- The changes incorporated in the Glitch Bill make it clear that all fees and penalties then owed by the limited liability company must be paid in order to effectuate any such reinstatement

- With respect to a domestic limited liability company, the application must be signed by both the registered agent and an authorized representative of the company and must state the following information:
    - The name of the limited liability company
    - The street address of the company's principle office and mailing address
    - The date of the company's organization
    - The company's federal employer identification number or, if none, whether one has been applied for
    - The name, title or capacity and address of at least one person who has authority to manage the company
    - Any additional information that the Department deems necessary or appropriate from time to time to enable the Department to carry out Chapter 605

- For the most part, the same items are required for a foreign limited liability company to be reinstated

- The one exception - with respect to the name, the name that must be set forth must be the name under which the foreign limited liability company is registered to transact business in the State of Florida

- Both of the Sections include a provision which allows for the alternative procedure of filing an annual report as long as:
  - All fees and penalties owed by the company at the rates provided by law at the time the company applies for reinstatement are submitted
  - The current annual report is signed by both the registered agent and an authorized representative of the company
  - The current annual report contains all of the information that would have been contained in an application

- During the course of the preparation of the glitch bill, several members of the Florida Bar were of the view that the alternative procedure of filing a current annual report might need to be reconsidered and that, instead, an application should be the sole method by which limited liability companies could be reinstated from an administrative dissolution
  - However, there was the view that, from a practical perspective, many limited liability companies seek to reinstate themselves by way of filing a current annual report, not because they have relied on what they saw in the statute, but rather simply by virtue of an expectation that such a filing should be sufficient
  - In order to avoid the additional work of the Department of State having to reject the submission of a current annual report filing and require a preparation of a formal application for reinstatement, the alternative procedure is being expressly provided for in the changes reflected in the glitch bill

- Subsection (1) of Section 605.0715, as currently written (i.e., prior to the effect of the glitch bill), technically only allows reinstatement of limited liability companies that are administratively dissolved under Section 605.0714
  - It was realized there are limited liability companies that have been administratively dissolved under the former Chapter 608 that, if desirous of being reinstated, must reinstate under Chapter 605 (because Chapter 608 has now been repealed)
  - Therefore, Subsection (1) of Section 605.0715 is also being amended in the glitch bill to make it clear that a limited liability company that is administratively dissolved under the former Chapter 608 can be reinstated under the provisions of Section 605.0715
    - This is not an issue under the language of Section 605.0909

➢ Effective Dates

- Generally, July 1, 2015 for substantive amendments
- January 1, 2015 for certain technical amendments

➢ Other Operating Agreement Drafting Considerations

- Example of Operating Agreement provisions dealing with judicial expansion of duty of loyalty in various situations:

  - "The Manager will not be deemed in breach of any fiduciary duty or other obligation that he or she may have under the Act, irrespective of whether such duty or obligation is expressly described therein or may be implied or otherwise deemed to apply, including in connection with any judicial, arbitral or other legal proceeding, if the Manager (or any of his or her affiliates) directly or indirectly engages in any other business activities that may be considered the same as or similar to those conducted by the Company (even if such activities may be considered competitive with those of the Company)."

  - "The Members acknowledge and agree that the objectives of this Section ___ are fair and reasonable under the circumstances, and, for the avoidance of any doubt, they will not be deemed manifestly unreasonable or otherwise invalid or improper under the Act. The Members have agreed that the Managers shall have no fiduciary duty of loyalty other than as expressly set forth in this Agreement, and further for the avoidance of any doubt, no other sources of law or principles related to the duty of loyalty, or the obligations of good faith or fair dealing, whether arising under common law or equitable principles, shall be deemed to apply to the performance of the duties and responsibilities of the Manager, notwithstanding any provision of the Act to the contrary."

  - "For the avoidance of any doubt, the Members have stipulated and agreed that: (i) the provisions of this Section ___ are fair and reasonable, have been negotiated and agreed upon in good faith, and shall apply to the performance of the Manager's duties and responsibilities hereunder, notwithstanding any provision in the Act to the contrary, and (ii) that it is their express intention that this Section be construed as a permitted modification of any provision of the Act pertaining to the Manager's duties of care and loyalty, or obligations of good faith and fair dealing, including any common law or equitable principles that may be deemed to apply with respect thereto, including in connection with any judicial, arbitral or other legal proceeding."

- You need to be aware of various cross-references in the Act to Section 605.04091 that are intended to establish whether wrongful conduct has occurred for other purposes
  - Sections 605.0105(3)*(p)* [formerly subsection "*(q)*"] and 605.0408 - for purposes of determining whether reimbursements, indemnification or

advances for expenses and fees may not be permitted to managers or members (of member-managed LLC)
    - Duties are subject to variation in the Operating Agreement to the extent allowed by subsection (4) of Section 605.0105
    - The provisions of Section 605.0408 are otherwise waivable and omnibus declaration of availability of indemnification probably works subject to "baseline" nonwaivable rules in Section 605.0105
- Section 605.0406(1) – as to whether a manager or a member (in member-managed LLC) could be personally liable for permitting an improper distribution
    - Consider exculpatory election under Section 605.0406(2) in member-managed LLC
- Section 605.0602(6)(b) - whether a member may be subject to expulsion by court order

➢ Other topics (time permitting)

- "Managing Member" Terminology
    - Not a glitch bill issue
    - One of the major changes contained in Chapter 605 is the removal of references to the term "managing member"
    - Background
        - There was often much confusion as to whether the existence of a "managing member" or multiple "managing members" for a Florida limited liability company meant that the limited liability company should be treated as a "member managed limited liability company" or as a "manager managed limited liability company"
        - The decision that was made (both under RULLCA and under the Florida Revised Limited Liability Company Act) was to remove the references to "managing member" with the hope that limited liability companies would not elect to use such terminology going forward
            - Eliminate the potential ambiguity such term often creates relative to the type of limited liability company management structure being utilized
        - Section 605.0407 specifically indicates that a limited liability company will be deemed to be member managed unless the articles of organization or the operating agreement expressly provide:
            - the company is or will be manager managed; or
            - the company is or will be managed by managers; or
            - management of the company is or will be vested in managers; or
            - includes words of similar import

        - The provision goes on to state that the terms "managing member" and "managing members" do not, in and of themselves, constitute works of similar import for this purpose
        - In other words, an LLC that has "managing members" will not automatically be treated as a manager managed limited liability company
    - Many believe that, without more, the use of the term "managing member" will result in a limited liability company being considered managed under the default rule of being member managed
    - Many limited liability companies in Florida continue to have operating agreements which utilize the term "managing member"
        - This is either unintentional by virtue of the fact that no amendment to the operating agreement has been implemented following the effectiveness of Chapter 605 or because, in some cases, the limited liability company wishes to continue to utilize the term "managing member" even though the apparent intent of the statute was to discourage continued use of such term
    - Some practitioners do not believe that the intent of the change in the statute was to encourage the elimination of the term "managing member" and indeed certain articles have been written in support of the ability to continue to utilize the term "managing member" in connection with limited liability companies in Florida
        - These articles seem to profess that there are circumstances where the use of the term "managing member" continues to be an appropriate and even preferable term for identifying how the limited liability company is managed
    - The debate over the utilization of the term "managing member" is likely to continue for some time, particularly in light of the fact that:
        - Chapter 605 does not expressly prohibit the use of such term; and
        - The Department of State will continue to allow filings to be made identifying individuals as managing members

- Series LLC Update
    - NCCUSL has released draft of "Series of Unincorporated Business Entities Act"
        - November 2014 -- proposed as a stand-alone act
        - Consistent with Proposed Treasury Regulations released in 2010
            - IRB 2010-45 (REG-119921-09)
            - Find here: http://www.irs.gov/irb/2010-45_IRB/ar11.html

        - Intended to apply to general and limited partnerships as well (and possibly other entities?)
- The draft (along with helpful self-contained summaries and discussion of open issues) can be found here: http://www.uniformlaws.org/shared/docs/series%20of%20unincorporated%20business%20entities/2014nov_SUBEA_Mtg%20Draft.pdf