

STORAGE NAME: h0787a.jo.doc
DATE: February 7, 2002

**HOUSE OF REPRESENTATIVES
COMMITTEE ON
JUDICIAL OVERSIGHT
ANALYSIS**

BILL #: HB 787
RELATING TO: Limited Liability Companies
SPONSOR(S): Representative Rubio
TIED BILL(S): none

ORIGINATING COMMITTEE(S)/COUNCIL(S)/COMMITTEE(S) OF REFERENCE:

- (1) JUDICIAL OVERSIGHT YEAS 8 NAYS 0
 - (2) COUNCIL FOR SMARTER GOVERNMENT
 - (3)
 - (4)
 - (5)
-

I. SUMMARY:

THIS DOCUMENT IS NOT INTENDED TO BE USED FOR THE PURPOSE OF CONSTRUING STATUTES, OR TO BE CONSTRUED AS AFFECTING, DEFINING, LIMITING, CONTROLLING, SPECIFYING, CLARIFYING, OR MODIFYING ANY LEGISLATION OR STATUTE.

HB 787 continues Florida's adoption, begun in 1999, of the Uniform Limited Liability Company Act. This bill provides for a third form of limited liability company ("LLC") management; namely, by a member or committee of members elected by the membership as a whole to be "managing members." This bill also eliminates the requirement that a member's interest in an LLC be represented by a capital account.

This bill reduces restrictions on what may be included in an LLC operating agreement, specifies the time-frame within LLC operating agreements may be entered into, and specifies a default effective date for an operating agreement. In addition, this bill provides that the statutory default voting rules apply unless they conflict with any rules the LLC has adopted.

This bill clarifies that current execution requirements apply to LLC articles of organization and dissolution, makes the requirements for registered agents of domestic and foreign LLC's identical, and requires that, in addition to current requirements, the LLC also keep copies at its principal office of "any other documents filed with the Department of State concerning the [LLC]."

This bill provides that a future LLC may not transact business prior to its effective date of existence, clarifies that a vote of a majority-in-interest of an LLC's disinterested members is only required to "authorize, approve or ratify" conflict-of-interest transactions in certain cases, and broadens the definition of wrongful distributions to include any distributions that would render an LLC insolvent. This bill also clarifies how an LLC can take on new members so as not to be dissolved upon losing its last member.

This bill expressly maintains the Legislature's authority to amend or repeal the entire Florida LLC Act. Finally, this bill provides that any changes to the Florida LLC Act do not affect rights that predate those changes.

This bill does not appear to have a fiscal impact on either state or local government.

II. SUBSTANTIVE ANALYSIS:

A. DOES THE BILL SUPPORT THE FOLLOWING PRINCIPLES:

- | | | | |
|-----------------------------------|---|-----------------------------|---|
| 1. <u>Less Government</u> | Yes <input type="checkbox"/> | No <input type="checkbox"/> | N/A <input checked="" type="checkbox"/> |
| 2. <u>Lower Taxes</u> | Yes <input type="checkbox"/> | No <input type="checkbox"/> | N/A <input checked="" type="checkbox"/> |
| 3. <u>Individual Freedom</u> | Yes <input checked="" type="checkbox"/> | No <input type="checkbox"/> | N/A <input type="checkbox"/> |
| 4. <u>Personal Responsibility</u> | Yes <input type="checkbox"/> | No <input type="checkbox"/> | N/A <input checked="" type="checkbox"/> |
| 5. <u>Family Empowerment</u> | Yes <input type="checkbox"/> | No <input type="checkbox"/> | N/A <input checked="" type="checkbox"/> |

For any principle that received a “no” above, please explain:

B. PRESENT SITUATION:

Limited Liability Companies – In General

A limited liability company (“LLC”) is a business entity with characteristics of both a corporation and a partnership. For most legal purposes, an LLC is treated like a corporation and therefore affords its owners (referred to as “members” to distinguish them from a corporation’s shareholders) certain protections from liability. For federal and state income tax purposes, however, an LLC is classified as a partnership, thus allowing the earnings or losses of an LLC to be passed through to the LLC’s members, rather than treating the LLC as a separate taxable entity like a corporation and thereby exposing the LLC’s members to double taxation.

In its Prefatory Note to the Uniform LLC Act (“the Uniform Act”), the National Conference of Commissioners on Uniform State Laws (“NCCUSL”) described the history and purpose of, and some of the recent developments in, the law relating to LLC’s:

Borrowing from abroad, Wyoming initiated a national movement in 1977 by enacting this country’s first limited liability company act. The movement started slowly as the Internal Revenue Service took more than ten years to announce finally that a Wyoming limited liability company would be taxed like a partnership. Since that time, every State has adopted or is considering its own distinct limited liability company act, many of which have already been amended one or more times.

The allure of the limited liability company is its unique ability to bring together in a single business organization the best features of all other business forms - properly structured, its owners obtain both a corporate-styled liability shield and the pass-through tax benefits of a partnership. General and limited partnerships do not offer their partners a corporate-styled liability shield. Corporations, including those having made a Subchapter Selection, do not offer their shareholders all the pass-through tax benefits of a partnership. All state limited liability company acts contain provisions for a liability shield and partnership tax status.

Despite these two common themes, state limited liability company acts display a dazzling array of diversity. Multistate activities of businesses are widespread. Recognition of out-of-state limited liability companies varies. Unfortunately, this lack of uniformity manifests itself in basic but fundamentally important questions, such as: may a company be formed and operated by only one owner; may it be formed for purposes other than to make a profit; whether owners

have the power and right to withdraw from a company and receive a distribution of the fair value of their interests; who has the apparent authority to bind the company and the limits of that authority; what are the fiduciary duties of owners and managers to a company and each other; how are the rights to manage a company allocated among its owners and managers; do the owners have the right to sue a company and its other owners in their own right as well as derivatively on behalf of the company; may general and limited partnerships be converted to limited liability companies and may limited liability companies merge with other limited liability companies and other business organizations; what is the law governing foreign limited liability companies; and are any or all of these and other rules simply default rules that may be modified by agreement or are they nonwaivable.

Practitioners and entrepreneurs struggle to understand the law governing limited liability companies organized in their own State and to understand the burgeoning law of other States. Simple questions concerning where to organize are increasingly complex. Since most state limited liability company acts are in their infancy, little if any interpretative case law exists. Even when case law develops, it will have limited precedential value because of the diversity of the state acts.

Accordingly, uniform legislation in this area of the law appeared to have become urgent.

After a Study Committee appointed by [NCCUSL] in late 1991 recommended that a comprehensive project be undertaken, [NCCUSL] appointed a Drafting Committee which worked on a Uniform Limited Liability Company Act (ULLCA) from early 1992 until its adoption by [NCCUSL] at its Annual Meeting in August 1994.

...

The Committee met nine times and engaged in numerous national telephonic conferences to discuss policies, review over fifteen drafts, evaluate legal developments and consider comments by our many knowledgeable advisers and observers, as well as an ABA subcommittee's earlier work on a prototype. In examining virtually every aspect of each state limited liability company act, the Committee maintained a single policy vision - to draft a flexible act with a comprehensive set of default rules designed to substitute as the essence of the bargain for small entrepreneurs and others.

[The Uniform] Act is flexible in the sense that the vast majority of its provisions may be modified by the owners in a private agreement. To simplify, those nonwaivable provisions are set forth in a single subsection. Helped thereby, sophisticated parties will negotiate their own deal with the benefit of counsel.

The Committee also recognized that small entrepreneurs without the benefit of counsel should also have access to the [Uniform] Act. To that end, the great bulk of the [Uniform] Act sets forth default rules designed to operate a limited liability company without sophisticated agreements and to recognize that members may also modify the default rules by oral agreements defined in part by their own conduct. Uniquely, the Act combines two simple default structures which depend upon the presence of designations in the articles of organization. All default rules under the [Uniform] Act flow from these two designations.

First, unless the articles reflect that a limited liability company is a term company and the duration of that term, the company will be an at-will company. Generally, an at-will company dissolves more easily than a term company and its owners may demand a payment of the fair value of their interests at any time. Owners of a term company must generally wait until the expiration of the term to obtain the value of their interests. Secondly [*sic*], unless the articles

reflect that a company will be managed by managers, the company will be managed by its members. This designation controls whether the members or managers have apparent agency authority, management authority, the nature of fiduciary duties in the company, and important dissolution characteristics.

NCCUSL believes that widespread adoption of the Uniform Act will provide much needed consistency among the states, with flexible default rules, and multistate recognition of limited liability on the part of LLC members. It also believes it will promote the development of precedential case law.

Florida's LLC Act was enacted in 1982,¹ the second in the nation after Wyoming. The Legislature adopted most of the Uniform Act as part of a comprehensive revision of Florida's LLC Act in 1999.²

Membership

Current law requires that a member's ownership interest in an LLC be represented by a capital account.³

Management

The Florida LLC Act currently provides for two forms of LLC management: by a manager or managers elected by the members of the LLC, or by the members directly. In addition to determining who manages the LLC, the two different forms of management determine who has actual and apparent authority to act as an agent for the LLC: the members in a member-managed LLC;⁴ the manager or managers in a manager-managed LLC.⁵

Voting

The Florida LLC Act currently provides a "default" voting system at s. 608.4231, F.S. The provisions of this section apply only in the absence of any voting provisions in an LLC's articles of organization or operating agreement.⁶ Under this system:

The members of a limited liability company shall vote in proportion to their then-current percentage or other interest in the profits of the limited liability company or, in the case of a member who has assigned the member's entire economic interest in the limited liability company to a person who has not been admitted as a member, in proportion to the then-current percentage or other interest in the profits of the limited liability company that the assigning member would have, had the assignment not been made.⁷

Section 608.422(6), F.S., expressly authorizes proxy voting by both members and managers.

¹ See s. 2, ch. 82-177, L.O.F.

² See s. 1, ch. 99-315, L.O.F.

³ See s. 608.402(21), F.S.

⁴ See s. 608.4235(1), F.S.

⁵ See s. 608.4235(2), F.S.

⁶ See s. 608.4231(3), F.S.

⁷ Section 608.4231(3)(a), F.S.

Articles of Organization and Dissolution

Section 608.407(d), F.S., currently requires that if an LLC is to be manager-managed, a statement to this effect must be included in the LLC's articles of organization filed with the Department of State.

Section 608.408, F.S. presently reads:

Execution of certificate or statement.--

(1) A certificate or statement required by this chapter to be filed with the Department of State must be executed in the following manner:

(a) If it is the articles of organization, a certificate of conversion, or a statement of change of registered agent or registered office, it must be signed by a member or by the authorized representative of a member, and by the new registered agent, if applicable; and

(b) If it is a certificate of dissolution or revocation of dissolution, it must be signed by members having the same percentage of membership interests necessary to approve the dissolution or revocation of dissolution.

Operating Agreements

Section 608.423(1), F.S., currently provides that

all members of a limited liability company may enter into an operating agreement, which need not be in writing, to regulate the affairs of the company and the conduct of its business, establish duties in addition to those set forth in this chapter, and to govern relations among the members, managers, and company. Any inconsistency between written and oral operating agreements shall be resolved in favor of the written agreement.

In addition, s. 608.423(2)(e) specifies that an operating agreement may not "vary the right to expel a member" of an LLC.

Registered Agents

Both Florida LLC's and foreign LLC's doing business in Florida must have a registered office and a registered agent in this state.⁸ A Florida LLC's registered agent

may be either:

1. An individual who resides in this state whose business office is identical with such registered office.
2. A foreign or domestic entity authorized to transact business in this state, having a business office identical with such registered office.⁹

A foreign LLC's registered agent

may be:

⁸ See s. 608.415, F.S. (Florida LLC's); s. 608.507, F.S. (foreign LLC's).

⁹ Section 608.415(1)(b), F.S.

(a) An individual who resides in this state and whose business office is identical with the registered office; or

(b) A domestic corporation or domestic limited liability company the business office of which is identical with the registered office; or

(c) A foreign or domestic corporation or foreign limited liability company authorized to transact business in this state the business office of which is identical with the registered office.¹⁰

Record-Keeping

Section 608.4101(1), F.S., currently requires that every LLC maintain the following records at its principal office:

(a) A current list of the full names and last known business, residence, or mailing addresses of all members and managers.

(b) A copy of the articles of organization and all certificates of conversion, together with executed copies of any powers of attorney pursuant to which any articles of organization or certificates were executed.

(c) Copies of the limited liability company's federal, state, and local income tax returns and reports, if any, for the 3 most recent years.

(d) Copies of any then-effective operating agreement and any financial statements of the limited liability company for the 3 most recent years.

(e) Unless contained in the articles of organization or the operating agreement, a writing setting out:

1. The amount of cash and a description and statement of the agreed value of any other property or services contributed by each member and which each member has agreed to contribute.

2. The times at which or events on the happening of which any additional contributions agreed to be made by each member are to be made.

3. Any events upon the happening of which the limited liability company is to be dissolved and its affairs wound up.

Transactions Prior to Effective Date of Existence

Under s. 608.409(4), F.S., a future LLC is prohibited from transacting business or incurring debt "except that which is incidental to its organization or to obtaining subscriptions for or payment of contributions," until articles of organization are filed with the Department of State.

Interested Member or Manager Transactions

Section 608.4226, F.S., specifies actions that do, and do not, constitute a wrongful conflict of interest on the part of an LLC's members or managers. Among other provisions, s. 608.4226(1)(b),

¹⁰ Section 608.507(2), F.S.

F.S., provides that a transaction on the part of a member or manager with an interest in, or relationship to, another business entity seeking to business with the LLC is neither void nor voidable as such a conflict if “[t]he fact of such relationship or interest is disclosed or known to the members entitled to vote and they authorize, approve, or ratify such contract or transaction by vote or written consent[.]” Further, s. 608.4226(3), F.S., specifies that

[f]or purposes of paragraph (1)(b), a conflict of interest transaction is authorized, approved, or ratified if it receives the vote of a majority-in-interest of the members entitled to be counted under this subsection. Membership interests owned by or voted under the control of a manager or managing member who has a relationship or interest in the transaction described in subsection (1) may not be counted in a vote of members to determine whether to authorize, approve, or ratify a conflict of interest transaction under paragraph (1)(b). The vote of those membership interests, however, is counted in determining whether the transaction is approved under other sections of this act. A majority-in-interest of the members, whether or not present, that are entitled to be counted in a vote on the transaction under this subsection constitutes a quorum for the purpose of taking action under this section.

Wrongful Distributions

Section 608.428(2), F.S., prohibits distributions to a member of an LLC “to the extent that, after giving effect to the distribution, all liabilities of the limited liability company, other than liabilities to members on account of their membership interests in the limited liability company, exceed the value of the limited liability company's assets.”

Survival or Termination of LLC

Unless otherwise provided for in its articles of organization or operating agreement, an LLC is dissolved upon losing its last member.¹¹

Reservation of Power to Amend or Repeal and Effect of Prior Repeal

The Florida LLC Act does not currently have any express provisions addressing these matters, as the Florida Business Corporations Act, ch. 607, F.S., does.¹²

C. EFFECT OF PROPOSED CHANGES:

Limited Liability Companies – In General

For the sake of clarity, this bill adds the phrase “limited liability” before “company” throughout the Florida Limited Liability Company (“LLC”) Act, ch. 608, F.S.

In addition, this bill makes a number of substantive changes to the Florida LLC Act in accord with the Uniform Act’s stated purpose of greater flexibility.

Membership

This bill amends s. 608.402(21), F.S., to provide that a member’s interest in an LLC may be, but does not have to be, represented by a capital account.

¹¹ See s. 608.441(2), F.S.

¹² See, e.g., s. 607.0102, F.S. (reservation of power to amend or repeal); s. 607.1907 (effect of repeal of prior acts).

Management

This bill amends the Florida LLC Act throughout to allow for a third form of LLC management: by an elected member or committee of members, designated “managing members.”

This bill also amends s. 608.422, F.S., to allow for restrictions on members, managers or managing members serving as officers of an LLC. Under this bill, such restrictions may be included in either the LLC’s articles of organization or an operating agreement.

Additionally, this bill amends s. 608.4228, F.S., to make explicit that, in addition to not being personally liable to the LLC itself, managers or managing members are not personally liable to the (other) members of the LLC for their management or policy acts or inaction, unless one of the conditions listed in s. 608.4228(1), F.S., applies.

Voting

This bill amends s. 608.4231(3), F.S., to provide that the general voting provisions found in that section apply even if other voting rules are provided by the articles of organization or operating agreement, so long as they do not conflict. Thus, the LLC’s members are not forced to choose between their own voting rules or the Act’s, but may take elements of both.

In addition, this bill amends s. 608.4231(3)(a), F.S., to provide that an LLC’s members “vote in proportion to their allocable then-current percentage or other allocable interest in the profits,” rather than any other interest, which could conceivably be intangible or for other reasons difficult or impossible to quantify.

Further, this bill amends s. 608.4231(6), F.S., to specify a ten-day deadline within which to notify an LLC’s managers or managing members of managerial decisions made by unanimous written consent of the other managers or managing members, which they have not consented to or which they would not have been entitled to vote on.

Finally, this bill amends s. 608.422, F.S., to specifically allow restrictions on, or the elimination of, proxy voting by members, managing members or managers of an LLC. Such restrictions or elimination may be in either the LLC’s articles of organization or an operating agreement.

Articles of Organization and Dissolution

This bill amends s. 608.407, F.S., to eliminate the requirement that an LLC’s articles of organization state if the LLC is to be manager-managed.

This bill further amends s. 608.407, F.S., to specify that filing an LLC’s articles of organization with the Department of State constitutes legal notice “that the entity formed ... is a limited liability company formed under the laws of [Florida] and ... of all other facts set forth in the articles of organization.”

This bill also amends s. 608.408, F.S., to clarify that the section’s execution requirements apply to articles of both organization and dissolution.

Operating Agreements

This bill amends s. 608.423(1), F.S., to provide that the members of an LLC (or of a future LLC) may enter into an operating agreement at any time, including before the LLC’s articles of

organization are filed with the Department of State. In the absence of any other date expressly provided-for, the operating agreement becomes effective on the date of formation of the LLC.

This bill also eliminates s. 608.423(2)(e), F.S., so that an operating agreement is allowed to “vary the right to expel a member” of an LLC.

In addition, this bill amends s. 608.432(1)(b), F.S., to allow procedures for assigning member’s interests in an LLC to be included in an operating agreement as well as in the LLC’s articles of organization.

Registered Agents

This bill amends s. 608.507, F.S., to make the requirements for registered agents of foreign LLC’s identical to those of domestic LLC’s.

Record-Keeping

This bill amends s. 608.4101(1)(b), F.S., to require that, in addition to current requirements, the LLC also keep copies at its principal office of “any other documents filed with the Department of State concerning the [LLC]”.

Transactions Prior to Effective Date of Existence

This bill amends s. 608.409(4), F.S., to change the date before which a future LLC is prohibited from transacting business or incurring debt. This bill changes that date from the date of filing articles of organization to the effective date of the LLC’s commencement of existence.

Interested Member or Manager Transactions

This bill amends s. 608.4226(3), F.S., to clarify that a vote of a majority-in-interest of an LLC’s disinterested members is only required to “authorize, approve or ratify” conflict-of-interest transactions in the sub-category defined by s. 608.4226(1)(b): namely, where the relationship or interest that is the basis of the conflict “is disclosed or known to the members entitled to vote.”

Wrongful Distributions

This bill amends s. 608.428(2), F.S., to prohibit distributions to an LLC’s members that would render the LLC “insolvent.” By doing so, this bill broadens the scope of prohibited distributions because, in addition to what is currently prohibited, this bill also prohibits distributions that render an LLC incapable of paying its own debts as they become due in the ordinary course of business.

Survival or Termination of LLC

This bill amends s. 608.441(2), F.S., to clarify that an LLC does not necessarily immediately dissolve upon losing its last member. This bill does this by explicitly cross-referencing s. 608.441(1)(d), F.S., which provides:

unless otherwise provided in the articles of organization or operating agreement, the limited liability company is not dissolved and is not required to be wound up if, within 90 days, or such other period as provided in the articles of organization or operating agreement, after the occurrence of the event that terminated the continued membership of the last remaining member, the personal or other legal representative of the last remaining member agrees in writing to continue the limited liability company and agrees to the admission of the personal

representative of such member or its nominee or designee to the limited liability company as a member, effective as of the occurrence of the event that terminated the continued membership of the last remaining member[.]

Reservation of Power to Amend or Repeal and Effect of Prior Repeal

This bill creates a new s. 608.704, F.S. This new section expressly maintains the Legislature's authority to amend or repeal the entire Florida LLC Act.

This bill also creates a new s. 608.705, F.S. This new section expressly gives the repeal of a statute within the Florida LLC Act prospective application only. Hence, such a repeal does not affect the validity of preexisting articles of organization or operating agreements, or of acts by or to an LLC prior to the repeal.

D. SECTION-BY-SECTION ANALYSIS:

None.

III. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT:

A. FISCAL IMPACT ON STATE GOVERNMENT:

1. Revenues:

It is possible that this bill might encourage more organization of Florida limited liability companies, as opposed to organization in Delaware or other states. This could possibly generate an unknown increase in revenue from taxes and filing fees. The Department of Revenue estimates that any increase in tax revenue from this bill would be minimal.¹³ The Department of State estimates that any increase in revenue from filing fees would also be minimal.¹⁴

2. Expenditures:

None.

B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

1. Revenues:

None.

2. Expenditures:

None.

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

None.

¹³ Telephone conversation with Deborah Thomas, Legislation Specialist, Department of Revenue, January 28, 2002.

¹⁴ Telephone conversation with Buford Rivers, Legislative Director, Department of State, January 29, 2002.

D. FISCAL COMMENTS:

None.

IV. CONSEQUENCES OF ARTICLE VII, SECTION 18 OF THE FLORIDA CONSTITUTION:

A. APPLICABILITY OF THE MANDATES PROVISION:

This bill does not require counties or municipalities to spend funds or to take an action requiring expenditure of funds.

B. REDUCTION OF REVENUE RAISING AUTHORITY:

This bill does not reduce the authority of counties or municipalities to raise revenues in the aggregate.

C. REDUCTION OF STATE TAX SHARED WITH COUNTIES AND MUNICIPALITIES:

This bill does not reduce the percentage of state tax shared with counties or municipalities.

V. COMMENTS:

A. CONSTITUTIONAL ISSUES:

None.

B. RULE-MAKING AUTHORITY:

None.

C. OTHER COMMENTS:

This bill's new ss. 608.704 and 608.705, F.S., are taken verbatim from the Florida Business Corporation Act, ch. 607, F.S.¹⁵ As such, they refer to corporations when they should refer to limited liability companies, incorporation rather than organization, and bylaws instead of operating agreements.

VI. AMENDMENTS OR COMMITTEE SUBSTITUTE CHANGES:

On January 30, 2002, the Committee on Judicial Oversight adopted two amendments to this bill. These amendments change the language creating new ss. 608.704 and 608.705, F.S., so that these new sections now refer to limited liability companies instead of to corporations.

This bill was then reported favorably, as amended.

¹⁵ See s. 607.0102, F.S. (reservation of power to amend or repeal); s. 607.1907 (effect of repeal of prior acts).

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VII. SIGNATURES:

COMMITTEE ON JUDICIAL OVERSIGHT:

Prepared by:

Staff Director:

David L. Jaroslav, J.D.

Nathan L. Bond, J.D.