

New Florida Limited Liability Act – Effective January 1, 2015

The Florida Revised Limited Liability Act (the “New Florida LLC Act”) is now effective for all limited liability companies in Florida. There had been a one-year interim period wherein any LLC that had been incorporated prior to January 1, 2014 continued to be governed by the old LLC Act until January 1, 2015, however that period expired on January 1, 2015. Now, all Florida limited liability companies are governed by the New Florida LLC Act, regardless of when they were formed.

The New Florida LLC Act appreciably changes the method in which Florida limited liability companies operate and are governed. Nevertheless the New LLC ACT retains many of the provisions and characteristics of the old LLC Act. Like the old LLC Act, the New LLC ACT gives the members who organize a new limited liability company broad leeway in determining how the LLC will operate. That flexibility is one of the reasons many people choose to incorporate under a limited liability company. Keep in mind, however, both the old LLC Act and the New LLC Act are “default statutes.” This means that with regards to key provisions in a LLC operating agreement, where specific provisions governing the way it manages its affairs in its articles of organization or operating agreement are missing or not clear, the governing rules will be provided by the “default” provisions of the statute. Those default rules are considered to be essential “gap fillers” in the operating agreement to remove ambiguity.

First, let’s examine what an “operating agreement” is under the New Florida LLC Act, and how it differs from the old LLC Act.

Broader Definition Under the New LLC Act Regarding What Constitutes an Operating Agreement

The old LLC Act provided that an operating agreement was comprised of “written or oral” provisions adopted for the management of the limited liability company and setting forth the relationship among the members, but required those provisions to be identified as an operating agreement or portion thereof. The New Florida LLC Act significantly and deliberately broadens the definition of an operating agreement by:

- Making it clear that agreements among the members *do not have to be designated as an operating agreement to be considered an operating agreement*, and
- Adding language that provisions intended to be considered part of the operating Agreement may be “oral, implied, in a record, or in any combination thereof.”

This language is very broad and suggests that the operators of multi-member limited liability companies organized prior to January 1, 2004 should, at the least, review their corporate documents and reconsider their course of conduct regarding corporate activities to determine whether they have inadvertently created an “implied” operating agreement that is inconsistent with their original intent. Due to this broadening of the definition of an operating agreement provision, members forming new Florida LLCs should be careful when drafting operating agreements to describe what does, and what does not, constitute its operating agreement. Limited liability companies that were established before the new LLC Act should consider adopting an amendment to their operating agreements if there is any ambiguity as to what constitutes their operating agreement.

Having determined what may constitute an operating agreement, now we’ll look at some of the default provisions that apply under the New Florida LLC Act.

A Member’s Right to Dissociate

Under the New Florida LLC Act any member of the limited liability company may dissociate from it at any time simply by withdrawing, regardless of the consequences to the LLC. Under the old LLC Act, a member could not dissociate prior to dissolution of an LLC unless the operating agreement provided otherwise. This is a non-waivable default provision, and members of limited liability companies formed before January 1, 2014 will automatically have a right to dissociate after January 1, 2015. This has significant implications and ramifications!

When a member dissociates:

- the member's right to participate as a member in the management and conduct of the limited liability company terminates;
- the member's fiduciary duties of loyalty and care to the limited liability company and the other members terminates with respect to matters arising after the dissociation provided the limited liability company is member managed; and
- the member continues to have a right to receive distributions from the limited liability company.

The ability to unilaterally dissociate is problematical, to say the least, especially for limited liability companies organized prior to January 1, 2004 which relied on the presumption that dissociation was not available to a member unless it was provided for in the operating agreement. For example, a member's duty of loyalty and care may restrict that member from operating a competing business or require the member to bring business opportunities to the limited liability company for consideration. As another example, the limited liability company may provide for calls for capital infusions from the members. A dissociated member is absolved of any such fiduciary duties or financial obligations after he or she dissociates.

To deal with the issue of dissociation, the New Florida LLC Act provides that a member who *wrongfully* dissociates is liable for damages to the limited liability company and, subject to statutory exceptions, the other members for such wrongful dissociation. This allows for the inclusion in any new or amended operating agreement of specific provisions dealing with the unintended consequences of a wrongful dissociation through the inclusion of specific damage provisions, or the inclusion of contractual clauses obligating members to abide by non-competition or non-solicitation provisions.

Default Provisions

While the old LLC Act contained several "default" provisions that could be modified or changed by the operating agreement, the New LLC Act adds a new "default" provision eliminating the concept of "Managing Member" and modifies the "default" provisions dealing with Admission of New Members, Amendments and Distributions.

- Elimination of the concept of Managing Member

The New LLC Act provides that all new limited liability companies are either member-managed or manager-managed. Starting January 1, 2015, the rule will apply retroactively to all limited liability companies, including those organized prior to January 1, 2014. Unless the operating agreement specifically indicates that the limited liability company is manager-managed, it will be treated as member-managed under the New LLC Act.

The New LLC Act specifically states that the inclusion of the term "managing member" or "managing members" in the operating agreement is not, by itself, sufficient to make the limited liability company manager-managed. If the pre-January 1, 2014 limited liability company is not considered manager-managed, it is member-managed. Under the New Florida LLC Act, a member-managed limited liability company can only take actions that are approved by holders of majority of its members based on their right to participate in profits. With respect to limited

liability companies organized prior to January 1, 2014 which purport to be managed by a “Managing Member,” the statutory requirement for member approval calls into question the managing member’s ability to enter into enforceable agreements and shifts control of the limited liability company from the managing member to the members as a whole.

In order to resolve the “managing member” issue, we strongly recommend that pre-January 1, 2014 limited liability companies managed by one or more “managing members” consider amending their operating agreements prior to January 1, 2015 to make it clear that they are manager-managed. Although it has been suggested that the newly broadened definition of “operating agreement” would allow the intention of the members to be “manager managed” to be implied from the general language of the pre-January 2014 operating agreement and the conduct of its members, there is no assurance that such an implication will be sufficient to give effect to the intention of the members.

- Admission of New Members

The old LLC Act provided that new members could be admitted to the limited liability company by a majority in interest of the existing members. The New Florida LLC Act provides that they may be admitted only by unanimous consent.

- Amendments

The old LLC Act was ambiguous with respect to the vote required to amend the operating agreement or the articles of organization of the limited liability company. The New Florida LLC Act provides that amendments may only be made with the unanimous consent of the members.

- Distributions

The old LLC Act provided that if distributions were made on the basis of capital contributions, the relevant capital contribution would be reduced by the amount of capital returned. The New Florida LLC Act does not reduce the amount of the original capital contribution for purposes of calculating the amount of distribution to which each member is entitled.

Non-Waivable Default Provisions

The New Florida LLC Act lists over a dozen of its “default” provisions which cannot be changed by the operating agreement, or which can only be modified to a limited degree. We are only going to discuss the most crucial of these provisions. Note that these new and updated, non-waivable provisions apply to *all* limited liability companies, including those organized prior to enactment of the new LLC Act.

- Duty of Loyalty and Care

An operating agreement may not abolish a manager’s or a member’s duty of loyalty or care as specifically described in the New Florida LLC Act – **except** in cases in which it is not “manifestly unreasonable” the operating agreement may (1) alter or eliminate the aspects of the duty of loyalty specifically described another section of the New Florida LLC Act, (2) specify certain activities, such as participation in a competing business, that will not violate the duty of loyalty, and (3) alter the duty of care, but not authorize willful or intentional misconduct or a knowing violation of the law. Whether a provision in an operating agreement is “manifestly unreasonable” is specifically to be determined by a court as a matter of law.

- Good Faith and Fair Dealing

An operating agreement may not eliminate a manager’s or a member’s obligation of good faith and fair dealing – neither of which is specifically described in the New Florida LLC Act – **except** the operating agreement may prescribe the standards by which the performance of the obligation is to be measured if the standards are not “manifestly

unreasonable". Again whether a standard is "manifestly unreasonable" is to be determined by a court as a matter of law.

- Bad Faith, Willful Misconduct
An operating agreement may not relieve or exonerate a person for conduct involving bad faith, willful or intentional misconduct, of a knowing violation of the law.
- Limitation on indemnification
An operating agreement may not provide for indemnification for a member or manager for, among other things, conduct involving bad faith, willfully or intentional misconduct or a knowing violation of the law or a breach of a member's or manager's duty or obligations of loyalty or care or good faith and fair dealing.
- Approval Rights of Members
An operating agreement may not vary a member's right to approve a merger, interest exchange or conversion.
- Restrict Right to Bring Actions Against the Limited Liability Company
An operating agreement may not unreasonably restrict a member's right to maintain a direct or derivative action against or on behalf of the limited liability company.
- Special Litigation Committee
An operating agreement may not vary the provisions relating to the appointment of a special litigation committee of members or managers who are not made party to a derivative action – **except** the operating agreement may prohibit the limited liability company from appointing a special litigation committee.
- Right to disassociate
An operating agreement may not vary the power of a person to disassociate, **except** the operating agreement may require notice of disassociation be of record.

Additional Appraisal Rights for Members

The old LLC Act provided members entitled to vote on a merger or conversion of a limited liability company with appraisal rights if they were entitled to vote upon the transaction.

The New Florida LLC Act provides members with appraisal rights upon the occurrence of the following events:

- Consummation of a membership interest exchange, provided the member had a right to vote upon the transaction and their interest is subject to the exchange.
- Consummation of the sale of substantially all of the assets of the limited liability company, provided the member had a right to vote upon the transaction, unless the sale is pursuant to a court order or is for cash under a plan by which the net proceeds are distributed to the members within one year of the date of the sale.
- An amendment to the governing documents of the limited liability company pursuant to which reduces the member's interest to a fraction which may then be bought out by the limited liability company.
- An amendment to the governing documents of the limited liability company which adversely alters the rights of such member, except in connection with the issuance of or authorization of a new class of membership interests.
- An amendment to the governing documents of the limited liability company which adversely affects the members existing appraisal rights.

The operating agreement may indicate other events which would trigger appraisal rights. The operating agreement may also eliminate or modify appraisal rights. If new operating agreements do not contain appropriate language eliminating appraisal rights, or if operating agreements entered into prior to January 1, 2014 are not amended to eliminate them, each of the events described above will trigger appraisal rights.

Other Notable Provisions of the New Florida LLC Act

The New Florida LLC Act significantly changed the way Florida limited liability companies operate and are governed. For example, it includes new provisions regarding the inclusion of members with no economic interest in the limited liability company, the liability of members and managers for inaccurately filed information, the ability to file statements of authority putting third parties on constructive notice as to the ability of members or others to bind the limited liability company, new provisions relating to disputes over transaction involving conflicts of interest. The New Florida LLC Act did not change the rules regarding changing orders.

Conclusion

For a Florida LLC organized prior to January 1, 2014 you should contact your attorney to determine whether you should amend or restate its operating agreement in light of the New Florida LLC Act.

If you are considering organizing a new limited liability company in Florida, or if you have organized a LLC in Florida on or after January 1, 2014 without consulting a attorney, you should consult with an attorney to determine which of the default provisions of the New Florida LLC Act that are subject to waiver or modification you want to apply to your limited liability company either in whole or as modified.

You should also be aware of your option to organize a limited liability in another jurisdiction and qualify the LLC to conduct business in Florida. The drafters of the New Florida LLC Act indicated that it was their intention for the Act was to provide a middle ground between accommodating the needs of sophisticated business relationships among sophisticated investors, and the day to day operations of small businesses by one or more member/operators. If you are considering conducting business through a limited liability company, you need to consider whether this middle of the road approach is consistent with your objectives. For example, due to its flexibility, larger and more mature body of case law, specialized judiciary (Court of Chancery) and ability to completely waive fiduciary duties for members, Delaware may be a preferable jurisdiction for your LLC. In addition, the uncertainties created by the New Florida LLC Act's expanding what constitutes an operating agreement and the prohibition against preventing a member from disassociating from the LLC may lead you to desire to utilize a Delaware limited liability company which provides more certainty.