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Practice Update

Florida's New LLC Act from the Lender's Perspective

February 6, 2014

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Last year, Florida Governor Rick Scott signed the Florida Revised Limited Liability Company Act (the New Act) into law. The New Act, which is codified in new Chapter 605 of the Florida Statutes, is a complete rewrite of the preexisting LLC Act (the Preexisting Act), which is currently contained in Chapter 608 of the Florida Statutes. The New Act went into effect on January 1, 2014 for all Florida limited liability companies (LLCs) organized on or after that date and for all foreign limited liability companies qualified to transact business in Florida (whether such entities became qualified before or after that date). With one exception, Florida LLCs formed prior to January 1, 2014 will continue to be subject to the Preexisting Act until January 1, 2015 (unless they affirmatively elect to become subject to the New Act prior to that date), at which time the Preexisting Act will be repealed. The exception is that even though existing Florida LLCs are not subject to the New Act until January 1, 2015, any filing that an existing Florida LLC makes with the Florida Department of State after January 1, 2014 must follow the filing requirements contained in the New Act.

This practice update is aimed to help lenders understand key changes in the New Act and how

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they may impact their borrower relationships. Areas of particular importance include how an LLC is managed and conducts its internal affairs, how an LLC deals with lenders and other third parties, and how creditors may collect debts owed by a defaulting and/or dissolving LLC. A discussion of each area follows.

Management and Internal Affairs

Consistent with the Preexisting Act, the New Act requires that all LLCs must either be "member-managed" or "manager-managed" and that if the LLC does not make clear in its operating agreement or articles of organization that it elects to be "manager-managed," the LLC will, by default, be deemed to be "member-managed." In that regard, the New Act eliminates the concept of a "managing member" that was used throughout the Preexisting Act. This change was made by the drafters of the New Act to eliminate the "confusion and disparate interpretation" under the Preexisting Act of whether a limited liability company with a managing member was "member-managed" or "manager-managed."

Should existing LLCs with managing members fail to revise their operating agreement or articles of organization to make clear whether they are "member-managed" or "manager-managed," they will be deemed to be "member-managed" when the New Act becomes applicable to such LLCs. However, even in a "member-managed" LLC management structure, members continue to retain the right to delegate enumerated management rights to particular members or to a board of members, so long as such provisions are expressly set forth in the LLC's operating agreement.

Some voting rights have also been altered by the New Act. Resolving an ambiguity contained in the Preexisting Act, the New Act requires a unanimous vote of all members to amend the articles of organization or operating agreement, unless otherwise provided in the articles of organization or

the operating agreement. The Preexisting Act did not expressly address the voting procedure by which such amendments were to be approved, and courts had applied a general rule by which amendments required only the affirmative vote of members holding a majority of the then-current profit interests. Moreover, the New Act provides that in a "manager-managed" LLC, unless otherwise provided in the articles of organization or operating agreement, all actions of the LLC outside the ordinary course of business require not only the requisite approval of the managers, but also the affirmative vote of a majority-in-interest of the members. The Preexisting Act had not clearly addressed such required approvals. Further, the New Act carries over the provisions in the Preexisting Act that in a "manager-managed" LLC, actions in the ordinary course of the LLC's activities and affairs are to be decided by the affirmative vote of a majority of the managers.

The New Act also expands the class of potential members of an LLC by introducing the concept of a non-economic member. The New Act allows any person or entity to become a non-economic member of an LLC without any transferable interest (i.e., no right to any distribution) or any capital contribution obligations. This change from the Preexisting Act opens the door to a variety of creative membership arrangements such as "springing members," who acquire the economic interest in an LLC upon the occurrence of a specific event—for example, after a sole member's bankruptcy or insolvency. This could also be helpful to lenders that desire to become non-economic members in order to have expanded veto and informational rights.

Dealings with Lenders and Other Third Parties

The New Act limits the means by which a person may obtain the power to bind an LLC to third-party obligations. The New Act enumerates four ways in which someone has the power to bind the LLC: if the person (1) is an agent of the LLC; (2) has the

authority to do so under the LLC's articles of organization or operating agreement; (3) has the authority to do so pursuant to a statement of authority; or (4) has the status as an agent under a law other than the New Act.

Consistent with the Preexisting Act, under the New Act, unless expressly set forth in the LLC's articles of organization or operating agreement, all members of a "member-managed" LLC retain statutory apparent authority to bind the LLC. Further, the New Act provides that in a "manager-managed" LLC, all managers are agents of the LLC and members are not automatically agents of the LLC. Finally, acts of an agent bind the LLC only insofar as such acts were undertaken in the name of the LLC and for the purpose of carrying on the LLC's activities in the ordinary course.

Adopting a concept already contained in Florida's partnership law, the New Act allows an LLC to file a "statement of authority" to limit the apparent authority of its members, managers, or other specified officers. Statements of authority may be filed by the LLC with the Florida Department of State to provide public notice of either a person's power to bind the LLC or, conversely, to provide public notice of limitations on a person's power to bind the LLC. The applicable provisions of the New Act that govern statements of authority outline the contents of such statements, depending on whether they pertain to authority over real property. Moreover, statements of authority governing real property transfers must also be filed with the same recording office in which the transferring instruments will be recorded. A "statement of authority" may similarly be filed under the New Act in order to counteract a prior grant of authority to a member, manager, or officer. Finally, the New Act allows persons who have been granted authority to act for an LLC to deny the grant of authority by filing a statement of denial. While a "statement of authority" may be helpful in determining who is authorized to act on behalf of an LLC, it should not be a substitute for

examining an LLC's articles of organization and operating agreement.

It is important to observe that statements of authority and denial are effective only with regard to dealings between the LLC and third parties; for members or managers dealing with each other, the operating agreement (and not any filed statements of authority or denial) control the scope of their authority.

Lenders and other parties that are not members, managers, or other parties related to an LLC, may nonetheless be given rights under an operating agreement, so long as such rights are included in the operating agreement. Similarly, the New Act provides that an operating agreement may specify that its amendment shall require the approval of a person who is not party to the agreement, and any amendments to the operating agreement made without any such required approval are ineffective (and not merely a breach of the agreement).While this provision was not in the Preexisting Law, this provision recognizes and affirms that this current business practice is effective. Since vetoes and other contractual rights are commonly sought by lenders, managers, and other third parties dealing with an LLC or its members, the New Act seeks to accommodate such provisions, and make clear that these arrangements are effective.

Third parties are entitled to rely on the articles of organization despite the New Act's general rule that the operating agreement trumps the articles of organization. Because each LLC is a "creature of contract," its articles of organization may be inconsistent with and even conflict with its operating agreement. Under such circumstances, the New Act provides that the operating agreement is paramount, but only between the members, dissociated members, transferees and managers. Third parties are entitled to rely on the articles of organization and other public filings despite any inconsistency or conflict with the

operating agreement and other documents. This is an especially important provision because under the New Act, an operating agreement may be either written or oral and may be implied by any record or combination of oral, written and record agreement. Public records are prioritized as they give unequivocal written notice to third parties.

Lenders should obtain and review a copy of their borrowers' operating agreements. Although the articles of organization are public record, the New Act (like the Preexisting Act) does not require an LLC to disclose whether it is "member-managed" or "manager-managed" in its articles of organization. That information must be in the operating agreement, which is not a public record.

Creditors' Rights

Several important changes to creditors' rights against LLCs are effected by the New Act. New procedural provisions have been included to bolster the ability of creditors to collect debts from LLCs that have defaulted and/or are seeking dissolution. Other provisions eliminate creditors' rights present in the Preexisting Act. Three of the most significant changes to creditors' rights effected by the New Act are: (1) the elimination of a creditor's right to petition a court for judicial dissolution of an LLC; (2) the added ability of a creditor to seek judicial appointment of a trustee or receiver to wind up an LLC; and (3) the addition of notice procedures to resolve unknown claims against a dissolving LLC. As discussed below, the New Act also retains the "Olmstead Patch" that was added to the Preexisting Act in 2011.

Creditors will no longer be able to request that a court dissolve an insolvent LLC under the New Act. The Preexisting Act permitted a creditor to bring an action for judicial dissolution of an LLC if the LLC was insolvent and either the creditor had an unsatisfied judgment against the LLC or the LLC admitted that the creditor's claim was due and

owing. The New Act does not allow creditors to petition a court for judicial dissolution of a debtor LLC under these circumstances. According to the drafters of the New Act, this provision was not included in the New Act because it is not included in the Revised Uniform Limited Liability Company Act on which the New Act is modeled nor is it included in the LLC acts of significant business states, including the Delaware LLC act.

However, once an LLC begins the process of dissolving itself, a creditor may petition a court of competent jurisdiction, upon a showing of "good cause," to oversee the process by which the LLC terminates its business affairs and pays its creditors. The New Act, unlike the Preexisting Act, provides for a comprehensive "winding up" process that lays out a framework under which an LLC in dissolution must pay its debts and obligations, sell its assets, bring or defend actions and proceedings, and distribute any remaining assets to its members. Trustees or receivers so appointed are authorized to take any steps necessary to settle the unfinished activities and affairs of the LLC. Further, under the New Act, if a member or other transferee becomes entitled to a distribution, it obtains the equal status and remedies of a creditor with respect to the outstanding unpaid distribution.

The final significant change in the New Act which may be of interest to lenders is a new provision governing the resolution of unknown claims against a dissolving LLC. While the Preexisting Act set up rules for the disposition of known claims against an LLC, it did not include provisions for dealing with unknown claims. The New Act, in a manner similar to Florida's corporate statute, now bifurcates claims against an LLC in dissolution into "known" and "unknown" claims, and provides rules for dealing with each type of claim. A dissolving LLC that complies with these procedures may in turn file an application with a court to determine the amount and form of security required to pay known contingent claims and unknown claims.

Under the New Act, unknown claims may be resolved by giving notice through either of two ways. The dissolving LLC may file notice of its dissolution with the Florida Department of State. Alternatively, the LLC may publish its notice of dissolution "at least once" in a newspaper of general circulation in the county in which the LLC's principal office in Florida is located. Under either method, the notice must state that the LLC is dissolving, provide potential claimants with information about how to present claims, and state that all claims are subject to a four-year statute of limitations. The one-time newspaper publication requirement is less stringent than that imposed under the Florida corporate statute, which requires publication to run once a week for two consecutive weeks if that option is chosen, because states are increasingly enacting a single publication requirement. The New Act also provides for the time frame following notice during which any such unknown claim must be brought.

The New Act retains without substantive change the "Olmstead Patch," that was adopted by the Florida Legislature in 2011, which clarifies that charging orders are the sole and exclusive remedy for judgment creditors in both multi- and single-member LLCs under almost all circumstances. In *Olmstead v. Federal Trade Commission*, 44 So.3d 76 (Fla. 2010), the Florida Supreme Court held that charging orders were not the exclusive remedy for judgment creditors of judgment debtors who owned the sole membership interests in an LLC. In response, the Florida Legislature adopted amendments to the Preexisting Act to specify that charging orders are the sole and exclusive remedy afforded to judgment creditors of a member in a multi-member LLC. The amendments also provided that judgment creditors of the member of a single-member LLC are similarly limited to charging orders unless a showing is made that the judgment will not be satisfied out of LLC distributions within a "reasonable time." Upon such a showing, a court will

supervise foreclosure against the single-member's individual membership interest

Implementation of the new statute may necessitate changes in the coming months to an LLC's articles of organization and operating agreement, particularly if the LLC is currently operating under a managing-member management structure. These changes may, in turn, require changes to other contractual documents (such as loan agreements) between LLCs and third parties.

If you have any questions about the New Act or its application to particular situations involving LLCs, please contact the authors or another member of the Akerman team.
