



TO LLC OR NOT TO LLC:

FLORIDA UPDATE

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COMPARISON OF BUSINESS ENTITY FORMS: TAXATION OF LLCs AND MEMBERS

- ▶ No “double income taxation” of net income of LLC not electing corporate taxation and its members by Internal Revenue Service. No taxation of net income of LLC not electing corporate taxation or its Florida individual resident members by Florida Department of Revenue. Taxation of net income of LLC not electing corporate taxation only as net income of its corporate members subject to Florida income tax. S corporations net income taxed like LLCs.
- ▶ Unless LLC (i) elects to be taxed as a corporation (including a corporation electing S corporate status) and (ii) agrees with each member in writing for that member’s services at reasonable compensation to that member, all net income of LLC up to federally prescribed maximum subject to FICA federal employment tax (for 2018, 12.4% for Social Security and 2.9% for Medicare, totaling 15.3%-these rates may change).
- ▶ No LLC federal tax free reorganization (e.g., stock for stock exchanges).
- ▶ No limit on LLC net income taxable to members (including offshore investors) by restricting distributions from LLC.

COMPARISON OF BUSINESS ENTITY FORMS: TAXATION OF LLCs AND MEMBERS

- ▶ LLC distribution of appreciated property generally tax free with carryover basis in members receiving distribution. Corporation distribution of appreciated property realizes receiving shareholders' taxable income and stepped up basis.
- ▶ For LLC owning real estate subject to substantial debt, permitted adjustment (increase) in each member's tax basis in that real estate for LLC liabilities upon sale of that member's interest in the LLC. LLC members potentially can deduct more LLC net losses for income tax purposes than shareholders of a corporation holding that real estate subject to that debt could deduct.
- ▶ Eligible LLCs, like corporations, can elect S corporation status for federal and Florida income tax purposes and pass their entire income, losses, deductions, and credits to their owners for federal and Florida income tax purposes. Those owners report the flow through items on their respective tax returns.

COMPARISON OF BUSINESS ENTITY FORMS: TAXATION OF LLCs AND MEMBERS

▶ **Disadvantages of electing S corporation status:**

- ▶ Number of shareholders limited to 100.
- ▶ Shareholders must be individuals, certain trusts, and estates, not corporations unless the parent is an S corporation and the parent makes a qualified subchapter S subsidiary (QSub) election for the instant corporation.
- ▶ Shareholders may not be LLCs, partnerships, corporations, or non-resident aliens unless S corporation is “qualified S corporation subsidiary” or another S corporation.
- ▶ Restrictions on subsidiaries of S corporations.
- ▶ Certain financial institutions, insurance companies, and domestic international corporations may not elect S corporation status.
- ▶ No classes of owners distinguishable by rights to distributions from the corporation (only classes distinguishable only by voting rights or constituting debt instruments, options, or warrants are permitted).

COMPARISON OF BUSINESS ENTITY FORMS: TAXATION OF LLCs AND MEMBERS

Federal Tax Cuts and Jobs Act of 2017 (Information below based solely on blogs and webinars by independent and certified accounting firms):

(a) QBI Deduction:

“Qualified business income” or “QBI” is taxable income (excluding net capital gains, payments in lieu of dividends, interest and dividends, foreign currency gains, gains on commodity transactions other than through the business, and net income from notional principal contracts) from a pass-through entity operating solely within the USA (e.g., an LLC or S corporation), including taxable income reported on Schedule C, E, or F.

LLC members or S corporation shareholders who are married filing joint federal income tax returns and have 2018 taxable income not more than \$315,000, can deduct “below the line” 20% of those owners’ respective allocable shares of QBI for federal income tax purposes.

LLCs members or S corporation shareholders who are single and have 2018 taxable income not more than \$157,500, can deduct “below the line” 20% of those owners’ respective allocable shares of QBI for federal income tax purposes.

Applies even to service business pass-through entities the principal asset of which is reputation or skill of one or more employees (e.g., law, accounting, health, actuarial science, performing arts, consulting, athletics, financial or brokerage services).

COMPARISON OF BUSINESS ENTITY FORMS: TAXATION OF LLCs AND MEMBERS

Federal Tax Cuts and Jobs Act of 2017 (Information below based solely on blogs and webinars by independent and certified accounting firms):

(a) QBI Deduction continued:

QBI deduction phases out up from over \$315,000 to \$415,000 taxable income for married owners filing a joint federal income tax return and from over \$157,500 to \$207,500 taxable income for single owners.

Above the \$415,000/\$207,500 thresholds, respectively, total owners' 20% QBI deductions limited to greater of (i) 50% of total W-2 wages paid by entity and (ii) 25% of total W-2 wages paid by entity plus 2.5% of unadjusted basis of qualified property, and 20% QBI deduction unavailable if principal asset of entity is reputation or skill of one or more employees (e.g., law, accounting, health, actuarial science, performing arts, consulting, athletics, financial or brokerage services) excluding architects and engineers. **For these owners' taxable income thresholds, incorporation/ S corporation election for a non-excluded services entity is better than LLC.**

"Qualified property" is depreciable tangible property in service at end of taxable year, used at any point in during taxable year to produce QBI, and still having depreciable period not ended before close of taxable year (generally, all assets except land and intangible assets).

COMPARISON OF BUSINESS ENTITY FORMS: TAXATION OF LLCs AND MEMBERS

Federal Tax Cuts and Jobs Act of 2017 (Information below based solely on blogs and webinars by independent and certified accounting firms),

(b) Limitation on Excess Business Losses Recognized by Non-C corporation Taxpayers:

Allocable shares of excess of \$500,000 for married entity owners filing joint federal income tax returns and \$250,000 for single entity owners disallowed and treated as net operating loss carryover for entity owners.

CONSULT WITH CPAs, TAX ATTORNEYS, AND OTHER TAX ADVISORS REGARDING ALL INCOME AND OTHER TAX MATTERS. THESE MATERIALS DO NOT CONSTITUTE TAX ADVICE AND YOU AND YOUR CLIENTS SHOULD NOT RELY UPON THEM FOR CHOICE OF ENTITY DECISIONS OR OTHER TAX PLANNING.

COMPARISON OF BUSINESS ENTITY FORMS: COMMON FEATURES OF FLORIDA CORPORATIONS AND LLCs

- ▶ Limited exposure of owners' assets not invested in entity to its creditors except:
 - ▶ "piercing" of "veil" for fraud, improper or misleading conduct, inadequate capital or income, or owner's commingling assets or controlling entity as *alter ego*.
 - ▶ professional corporation or LLC formed under Chapter 621, F.S. (officer, agent, member, manager, employee, or the entity liable for negligent or wrongful acts or misconduct by professional or another person under professional's direct supervision and control while rendering professional services on behalf of the entity).
- ▶ Organized by filing articles of incorporation or organization with Florida Department of State ("DOS") and designating registered office and agent.
- ▶ One or more owners without restriction as to citizenship, place of organization, or type of entity.
- ▶ Power to differentiate voting, distribution, and liquidation rights and preferences among owners by classes or series of ownership interests.

COMPARISON OF BUSINESS ENTITY FORMS: COMMON FEATURES OF FLORIDA CORPORATIONS AND LLCs

- ▶ Management by owners or designated persons (directors, officers, managers) or others under designated authority.
- ▶ Similar criteria for exculpation of directors, managing members, and managers from personal liability for damages.
- ▶ Restriction of right to transfer ownership interests by documents filed with DOS or agreements among owners.

COMPARISON OF BUSINESS ENTITY FORMS: COMMON FEATURES OF FLORIDA CORPORATIONS AND LLCs

- ▶ Right of entity or its owners to purchase interest of owner commencing action for judicial dissolution.
- ▶ Permitted acquisition of entity by merger, consolidation, sale of substantially all assets, or share exchange.
- ▶ Requirement to maintain records of owners, directors, or managers, agreements among owners, filings with DOS, and three fiscal year financial statements.

COMPARISON OF BUSINESS ENTITY FORMS: ADVANTAGES OF FLORIDA LLCs VERSUS FLORIDA CORPORATIONS

- ▶ “Charging order” exclusive remedy of judgment creditor against a judgment debtor that is a member of a multi-member LLC and, under conditions, a single-member LLC, under Section 605.0503, F.S., reflecting “Olmstead Patch” amendment of predecessor statute in response to Olmstead v. Federal Trade Commission, 44 So. 3d 76 (Fla. 2010), discussed below.
- ▶ Issuance of additional membership interests without amendment filed with DOS to increase “authorized shares.”
- ▶ No required bylaws, officers to prepare minutes and authenticate records, meetings of members, managing members, or managers, or minutes of meetings. Failure of LLC to observe formalities alone does not justify “piercing” its “veil.”
- ▶ Clearer, easier to read, statutes regarding management conflicts of interest, required fairness, standards of care (which agreement can modify), and indemnification. No requirement of reports to owners regarding indemnification or advances other than by court order, or issuance of ownership interests for promises of future services, unlike Section 607.1621, F.S. in the Florida Business Corporation Act.

COMPARISON OF BUSINESS ENTITY FORMS: ADVANTAGES OF FLORIDA LLCs VERSUS FLORIDA CORPORATIONS

- ▶ Flexibility to give non-members (e.g., lenders) veto powers over operating agreement amendments.
- ▶ Flexibility to limit apparent authority of members or managers by filing statement of authority with Florida Department of State.
- ▶ Flexibility to base LLC distributions and allocations of profits, depreciation, and losses on values of members' capital contributions (without reduction for return of capital) instead of on percentage of LLC membership interests or proportion of corporation shares.
- ▶ Flexibility to alter or eliminate duty of loyalty and alter duty of care of managers and managing members prescribed by statute, to the extent permitted by statute, by agreement among owners.
- ▶ Lower filing fees to DOS for LLC annual report (\$138.75) and certificate of status (\$5.00) than for corporation annual report (\$150.00) and certificate of status (\$8.75).
- ▶ By using a holding company LLC (unavailable to S corporations), identities of ultimate owners can be shielded from public view.

COMPARISON OF BUSINESS ENTITY FORMS: DISADVANTAGES OF FLORIDA LLCs VERSUS FLORIDA CORPORATIONS

- ▶ Permitted dissociation of a member (e.g., withdrawal of member, death of individual member, and, in member-managed LLC, bankruptcy of a member) and ownership by that member of transferable interest in the LLC as a transferee.
- ▶ Procedure for and restrictions on transfer of membership interests must be set forth in operating agreement.
- ▶ No perpetual existence of LLC: LLC dissolution (even if fewer than a majority of its members consent and no other circumstance that its operating agreement states causes dissolution) upon 90th consecutive day with no member unless transferees owning rights to receive a majority of distributions consent to admit at least one specified person that becomes a member.
- ▶ LLC may advance reasonable expenses to, and indemnify, only its former or present member or manager unless the operating agreement or another agreement otherwise provides. Indemnification is not mandatory even if indemnitee successfully defends a proceeding.

COMPARISON OF BUSINESS ENTITY FORMS: DISADVANTAGES OF FLORIDA LLCs VERSUS FLORIDA CORPORATIONS

- ▶ **LLC is less acceptable to venture capitalists and hedge funds and less suitable for public offerings of securities or employee securities benefit plans except in certain industries (e.g., energy):**
 - ▶ No perpetual existence.
 - ▶ Flexibility to modify statutory requirements by articles of organization or operating agreement.
 - ▶ Ease of dilution of percentage ownership.
 - ▶ Novelty compared with corporations, albeit less true than in 1997.
 - ▶ Less judicial precedent re management standards of care, conflict of interest, and other management issues, in Florida and Delaware.

COMPARISON OF BUSINESS ENTITY FORMS: DISADVANTAGES OF FLORIDA LLCs VERSUS FLORIDA CORPORATIONS

- ▶ No incentive stock options (instead, grants to employees of LLC profits interest that may be deemed to constitute partnership interests for tax and employee benefit purposes).
- ▶ Requirement to maintain three fiscal year tax returns, reports, and financial statements, if any, and records stating the amount of cash and property or other benefits contributed and agreed to be contributed by each member. Contrast Sections 607.1601 and 607.1620, F.S.
- ▶ Higher filing fees to DOS to form an LLC (\$125.00) than to incorporate a corporation (\$70.00). Generally higher cost for certified copy of LLC record (\$30.00 fixed fee) than for certified copy of corporation record (\$8.75).
- ▶ See discussion of taxation differences above.

PROTECTION OF LLC ASSETS FROM MEMBERS' CREDITORS

Florida Supreme Court in Olmstead v. Federal Trade Commission, 44 So. 3d 76 (Fla. 2010), on remand at Federal Trade Commission v. Peoples Credit First, LLC, 621 F. 3d 1327 (11th Cir. Fla. 2010), held that exclusiveness of “charging order” remedy of members’ judgment creditors with respect to those members’ interests in an LLC under then Section 608.433, F.S. of the former Florida Limited Liability Company Act, the predecessor of Section 605.0503, F.S. in the Florida Revised Limited Liability Company Act effective January 1, 2014 (“Florida Revised LLC Act”), did not apply to single-member LLCs, so that the court could order the judgment debtor to surrender “all right, title, and interest” in the debtor’s/member’s single-member LLC to satisfy the judgment.

Prior to the Olmstead opinion, many Florida attorneys assumed that the “charging order” also was the exclusive remedy with respect to interests in a single-member LLC.

PROTECTION OF LLC ASSETS FROM MEMBERS' CREDITORS

Amendments effective May 31, 2011 (Hage v. Salkin, Trustee in Bankruptcy for Maxko Petroleum, LLC, 2012 U.S. Dist. LEXIS 29101 (U.S.D.C. for S.D. Fla. 2012)) to Section 608.433, F.S. ("Olmstead Patch"), reflected in the current Section 605.0503, F.S., continue the **"charging order" as the sole and exclusive remedy of a judgment creditor against the membership interests or rights to distributions of a judgment debtor in a multi-member LLC**, entitling the judgment creditor only to whatever distributions would otherwise be due to the member or transferee whose interest is subject to that order and **not to the right to execute under Section 56.061, F.S. on, vote or participate in management in respect of, or to sell, that interest.**

Section 605.0503(6), F.S. states that a judgment creditor cannot foreclose on the debtor's interest in or rights to distribution from a multi-member LLC.

PROTECTION OF LLC ASSETS FROM MEMBERS' CREDITORS

Under the Olmstead Patch amendments, as reflected in Section 605.0503(4), F.S., if a **judgment creditor of a member of a single-member LLC or that member's transferee, within a reasonable time at any time after entry of the judgment, establishes to the court's satisfaction that "distributions under a charging order will not satisfy the judgment within a reasonable time,"** the charging order is **not the sole and exclusive remedy of that creditor with respect to that debtor/sole member and the court may order the foreclosure sale of that interest.**

The purchaser at the court-ordered foreclosure sale of the debtor's interest in a single-member LLC, or of a charging order lien against that debtor/sole member, (i) obtains the debtor/sole member's entire LLC interest, not merely the rights of a transferee, and (ii) becomes a member of the LLC. The debtor thereupon ceases to be a member of the LLC.

See summary of post-2015 judicial opinions regarding charging orders in materials accompanying this presentation.

LLC MANAGEMENT FLEXIBILITY; PREEMINENT OPERATING AGREEMENT

- ▶ **Discussed earlier, contrast with Florida corporations:**
 - ▶ Flexibility to give non-members (e.g., lenders) veto powers over operating agreement amendments.
 - ▶ Flexibility to limit apparent authority of members or managers by filing statement of authority with Florida Department of State.
 - ▶ Flexibility to base LLC distributions and allocations of profits, depreciation, and losses on values of members' capital contributions (without reduction for return of capital) instead of on percentage of LLC membership interests or proportion of corporation shares.
 - ▶ Flexibility to alter or eliminate duty of loyalty and alter duty of care of managers and managing members prescribed by statute, to the extent permitted by statute, by agreement among owners.
 - ▶ *Ferk Family, LP v. Frank, see summary of post-2015 judicial opinions regarding preeminence of operating agreement over Florida Revised LLC Act in materials accompanying this presentation.*

INDEMNIFICATION

▶ Indemnification under Section 605.0408, F.S.:

- ▶ LLC may advance reasonable expenses to, and indemnify, only its former or present member or manager unless the operating agreement or another agreement otherwise provides. See *MVW Management, LLC v. Regalia Beach Developers LLC* in *summary of post-2015 judicial opinions regarding indemnification in materials accompanying this presentation*.
- ▶ LLC may not indemnify its former or present member or manager for claims arising from their breach of duty regarding distributions by the LLC, remuneration to members for their services in a member-managed LLC in the absence of contrary agreement, delegation of their rights or powers to manage, management of a manager-managed LLC, voting rights of members or managers, agency rights of members or managers, or loyalty or care. Section 605.0408(2), F.S.
- ▶ Indemnification is not mandatory even if indemnitee successfully defends a proceeding. Contrast Section 607.0850, F.S. in the Florida Business Corporation Act.
- ▶ No requirement of reports to LLC members regarding indemnification or advances other than by court order, unlike Section 607.1621(1), F.S. in the Florida Business Corporation Act.

INDEMNIFICATION

- ▶ **Indemnification under Section 605.0408, F.S.:**
 - ▶ Under Section 605.0105(3)(p), F.S. an LLC operating agreement may not require the LLC to indemnify its member or manager for:
 - ▶ Conduct involving bad faith, willful or intentional misconduct, or a knowing violation of law.
 - ▶ Transaction from which the member or manager derived an improper personal benefit.
 - ▶ Circumstance under which the liability provisions of Section 605.0406, F.S. regarding improper distributions are applicable.
 - ▶ Breach of fiduciary and other duties or obligations under Section 605.04091, F.S., taking into account modification of those duties and obligations provided by the operating agreement to the extent that such modification is allowed by Section 605.0105(4).

WHEN OPERATING AGREEMENT GOVERNS

Operating agreement, under Sections 605.0102(45) and 605.0106, F.S.:

- ▶ Need not bear that title.
- ▶ May be oral, implied, in a record, or any combination, and not subject to statute of frauds.
- ▶ Not unenforceable simply because only one person is a party or because it is not signed by a person becoming a member or transferee or because it is signed by a representative of that person if that person otherwise demonstrates intent to become a member or transferee or complies with conditions for becoming a member or transferee as provided in the operating agreement or other record.
- ▶ Manager of LLC or transferee bound by operating agreement event regardless whether agreed to it.
- ▶ LLC and each member is deemed to assent to, is bound by, and may enforce operating agreement regardless whether manifests assent to or executes it.

WHEN OPERATING AGREEMENT GOVERNS

As previously noted, generally, under Section 605.0105(1), F.S., operating agreement among LLC members governs:

- ▶ Relations among LLC members as LLC members.
- ▶ Relations between members and the LLC.
- ▶ Rights and duties of managers.
- ▶ Activities and affairs and conduct by LLC of those activities and affairs.
- ▶ Means and conditions for amending the operating agreement.

Generally, except for unpermitted provisions of the operating agreement, Florida Revised LLC Act governs only to extent that the operating agreement does not otherwise provide. Section 605.0105(2), F.S.

For disputes among members, dissociated members, transferees, and managers, if articles of organization and operating agreement conflict, operating agreement prevails. But third parties may rely on articles of organization unless advised that operating agreement conflicts or their reliance on articles otherwise is unreasonable. Section 605.0107(4), F.S.

WHEN OPERATING AGREEMENT GOVERNS

Operating agreement also governs obligations of LLC and its members to a transferee or person dissociated as a member. Amendment after a person becomes a transferee or is dissociated as a member is:

- ▶ Effective regarding a debt, obligation, or other liability of the LLC or its members to that person, and
- ▶ Not effective to extent that amendment imposes a new debt, obligation, or other liability on that person.

Section 605.0107(2), F.S.

WHEN OPERATING AGREEMENT GOVERNS

Among other permissible provisions of operating agreement, it may:

- ▶ Specify method to authorize or ratify violation of duty of loyalty by one or more disinterested and independent persons after full disclosure of all material facts. Section 605.0105(4)(a)1, F.S.
- ▶ Alter limitation on distributions under Section 605.0405(1)(b) to require solely that total assets not be less than sum of total liabilities. Section 605.0105(4)(a)2, F.S.
- ▶ Eliminate or limit a duty or obligation pertaining to the responsibility of a member that the operating agreement of a member-managed LLC expressly relieves of that member. Section 605.0105(4)(b), F.S.
- ▶ Impose reasonable restrictions on availability and use of information obtained under Section 605.0410, F.S. and define appropriate remedies, including liquidated damages, for a breach of a reasonable restriction on use. Section 605.0105(3)(h), F.S.
- ▶ Preclude appointment by the LLC of a special litigation committee without purporting to prevent a court from doing so. Section 605.0105(3)(l), F.S.
- ▶ Provide rights to a person, even if not a party to the operating agreement, to the extent provided by the operating agreement. Section 605.0106(7), F.S.

WHEN OPERATING AGREEMENT GOVERNS

- ▶ Specify that its amendment requires approval of a person not a party to the operating agreement or upon satisfaction of a condition. Section 605.0107(1), F.S.
- ▶ Modify from unanimous the vote of members required to admit new members or amend the articles of organization or operating agreement. Sections 605.0401, 605.04073, and 605.0105(4), F.S.

(Section 605.0105(4) is not exclusive as to permitted provisions of the operating agreement.)

- ▶ Authorize members having no right to distributions or obligation to contribute. Sections 605.0401(4) and 605.0105(4), F.S.
- ▶ Base distributions on members' respective capital contributions instead of a percentage interest for other purposes such as voting. Sections 605.0404(1) and 605.0105(4), F.S.

WHEN OPERATING AGREEMENT GOVERNS

- ▶ If not manifestly unreasonable:
 - ▶ Alter or eliminate aspects of duty of loyalty under Section 605.04091(2), F.S. or any other fiduciary duty except duty of care. Section 605.0105(4)(c)1 and 4, F.S.
 - ▶ Identify specific types or categories of activities not violating duty of loyalty. Section 605.0105(4)(c)2, F.S.
 - ▶ Alter duty of care but not authorize willful or intentional misconduct or a knowing violation of law. Section 605.0105(4)(c)3, F.S.
 - ▶ Prescribe standards to measure performance of obligation of good faith and fair dealing. Section 605.0105(3)(f), F.S.

WHEN OPERATING AGREEMENT DOES NOT GOVERN

Operating Agreement may not:

- ▶ Vary LLCs capacity under Section 605.0109, F.S. to sue and be sued in its own name. Section 605.0105(3)(a), F.S.
- ▶ Vary law governing internal affairs of LLC or liability of member as member and manager as manager for debts, obligations, or other liabilities of LLC, under Section 605.0104, F.S. Section 605.0105(3)(b), F.S.
- ▶ Vary any provision of Chapter 605, F.S. regarding registered agents or DOS, including provisions regarding records authorized or required to be delivered to DOS for filing. Section 605.0105(3)(c), F.S.
- ▶ Vary provisions of Section 605.0204, F.S. regarding signing or filing a record under judicial order. Section 605.0105(3)(d), F.S.
- ▶ Eliminate the duty of loyalty or duty of care under Section 605.04091, F.S. except to the extent previously noted for duty of loyalty (*i.e.*, may eliminate aspects and Identify specific types or categories of activities not violating duty of loyalty if not manifestly unreasonable). Section 605.0105(3)(e) and (4), F.S.

WHEN OPERATING AGREEMENT DOES NOT GOVERN

- ▶ Eliminate the obligation of good faith and fair dealing under Section 605.04091, F.S. (a principal of common law of contracts honored even in Delaware, Fisk Ventures, LLC v. Segal et al., 2008 WL 1961156 at *8 (Del. Ch. 2008) (LLCs are creatures not of the state but of contract) except to the extent previously noted regarding prescribing standards. Section 605.0105(3)(f), F.S.
- ▶ Authorize, or relieve or exonerate a person from liability for, conduct involving bad faith, willful or intentional misconduct, or a knowing violation of law. Section 605.0105(3)(g), F.S.
- ▶ Unreasonably restrict duties and rights regarding books and records and information under Section 605.0410, F.S. except to the extent previously noted regarding reasonable restrictions on availability and use of information and defining appropriate remedies, including liquidated damages, for breach of reasonable restriction on use. Section 605.0105(3)(h), F.S.
- ▶ Vary grounds for dissolution under Section 605.0702, F.S. Section 605.0105(3)(i), F.S.
- ▶ Vary requirement to wind up dissolved LLC's business, activities, and affairs under Section 605.0709(1),(2)(a) and (5), F.S. Section 605.0105(3)(j), F.S.

WHEN OPERATING AGREEMENT DOES NOT GOVERN

- ▶ Unreasonably restrict members' rights to maintain an action under Sections 605.0801-6, F.S. See *Ferk Family, LP v. Frank*. See *summary of post-2015 judicial opinions regarding actions by members against other members in materials accompanying this presentation*.
- ▶ Vary Section 605.0804, F.S. but operating agreement may provide that LLC may not appoint a special litigation committee and cannot preclude a court from appointing one. Section 605.0105(3)(l), F.S.
- ▶ Vary members' rights to approve reorganization: merger, interest exchange, or conversion under Sections 605.1023(1)(b), 605.1033(1)(b), or 605.1043(1)(b), F.S.. Section 605.0105(3)(m), F.S.
- ▶ Vary required contents of reorganization plans: plan of merger under Section 605.1022, F.S., plan of interest exchange under Section 605.1032, F.S., plan of conversion under Section 605.1042, F.S., or plan of domestication under Section 605.1052, F.S. Section 605.0105(3)(n), F.S.

WHEN OPERATING AGREEMENT DOES NOT GOVERN

- ▶ Restrict rights under Chapter 605, F.S. of a person other than a member or manager except as rights of such other persons otherwise may be restricted under Sections 605.0106 and 605.0107, F.S. Section 605.0105(3)(o), F.S.
- ▶ Provide for indemnification of a member or manager under Section 605.0408, F.S. in violation of the restrictions noted in the earlier discussion of indemnification. Section 605.0105(3)(p), F.S.

Contrast Delaware Limited Liability Company Act (even more flexible and pro-management than Florida RLLC Act):

- ▶ Del. Code § 18-1101 Construction and application of chapter and limited liability company agreement.
- ▶ (a) The rule that **statutes in derogation of the common law are to be strictly construed shall have no application to this chapter.**
- ▶ (b) It is the policy of this chapter to give the **maximum effect to the principle of freedom of contract and to the enforceability of limited liability company agreements.**

WHEN OPERATING AGREEMENT DOES NOT GOVERN

- ▶ Del. Code § 18-1101 continued:
- ▶ (c) To the extent that, at law or in equity, a member or manager or other person has duties (including fiduciary duties) to a limited liability company or to another member or manager or to another person that is a party to or is otherwise bound by a limited liability company agreement, the **member's or manager's or other person's duties may be expanded or restricted or eliminated by provisions in the limited liability company agreement; provided, that the limited liability company agreement may not eliminate the implied contractual covenant of good faith and fair dealing.**
- ▶ (d) **Unless otherwise provided in a limited liability company agreement,** a member or manager or other person shall **not be liable** to a limited liability company or to another member or manager or to another person that is a party to or is otherwise bound by a limited liability company agreement for breach of fiduciary duty **for the member's or manager's or other person's good faith reliance on the provisions of the limited liability company agreement**
- ▶ (e) **A limited liability company agreement may provide for the limitation or elimination of any and all liabilities for breach of contract and breach of duties (including fiduciary duties) of a member, manager or other person to a limited liability company or to another member or manager or to another person that is a party to or is otherwise bound by a limited liability company agreement; provided, that a limited liability company agreement may not limit or eliminate liability for any act or omission that constitutes a bad faith violation of the implied contractual covenant of good faith and fair dealing.** [Emphasis supplied.]

SOME OF THE CHANGES EFFECTED BY FLORIDA REVISED LLC ACT JANUARY 1, 2014

- ▶ **Management authority, voting rights, and non-fiduciary duties of members, managers, and others:**
 - ▶ Status of “managing members” as members of a member-managed LLC and not as managers. Section 605.0407(1)(b), F.S.
 - ▶ Modification, relief, and shift of duties of members by provision of operating agreement, including modification of duties of loyalty and care if not manifestly unreasonable. Section 605.0105(4)(a) and (c), F.S.
 - ▶ Veto of amendments to operating agreement by persons other than LLC members (e.g., lenders or landlords). Section 605.0107(1), F.S.
 - ▶ Statements of authority (including authority and limitations on authority) of, and denial of authority by, members, managers, or others. Sections 605.0302 and 605.0303, F.S.
 - ▶ Unanimous instead of majority vote of members required to admit new members or amend the articles of organization or operating agreement unless operating agreement otherwise provides. Sections 605.0401, 605.04073, and 605.0105(4), F.S.

SOME OF THE CHANGES EFFECTED BY FLORIDA REVISED LLC ACT JANUARY 1, 2014

- ▶ **Indemnification, fiduciary duties, and conflicts of interest of members and managers:**
 - ▶ LLC may not indemnify its former or present member or manager for claims arising from their breach of duty regarding distributions by the LLC, remuneration to members for their services in a member-managed LLC in the absence of contrary agreement, delegation of their rights or powers to manage, management of a manager-managed LLC, voting rights of members or managers, agency rights of members or managers, or loyalty or care. Section 605.0408(2), F.S.
 - ▶ Permissibility of certain conflicts of interest transactions and burden of proof if challenged. Section 605.04092, F.S.

SOME OF THE CHANGES EFFECTED BY FLORIDA REVISED LLC ACT JANUARY 1, 2014

- ▶ **Business entity organizational and governance documents:**
 - ▶ “Implied” existence of operating agreement from any “record” (information inscribed on tangible medium or stored in electronic or other medium and retrievable in perceivable form). Section 605.0102(45) and (59), F.S.
 - ▶ For internal disputes, if articles of organization and operating agreement conflict, operating agreement prevails. Third parties may rely on articles of organization unless advised that operating agreement conflicts. Section 605.0107(4), F.S.

SOME OF THE CHANGES EFFECTED BY FLORIDA REVISED LLC ACT JANUARY 1, 2014

▶ **Distributions to members:**

- ▶ Some members may lack rights to distributions or obligations to contribute.
Section 605.0401 (4), F.S.
- ▶ Calculation of distributions based on values of members' contributions without reduction by amount of any capital contributions previously returned to respective members.
Section 605.0404(1), F.S.

SOME OF THE CHANGES EFFECTED BY FLORIDA REVISED LLC ACT JANUARY 1, 2014

▶ **Dissociation of members:**

- ▶ Permitted dissociation (withdraw) of a member from LLC, subject to that member's liability for resulting damage to LLC. Section 605.0601, F.S.
- ▶ After dissociation, a member continues to own transferable interest (*i.e.*, right to distributions) owned by dissociated member as a transferee with no voting or other management rights. Section 605.0603, F.S.

▶ **Business entity transactions:**

- ▶ Action for judicial dissolution of LLC triggers rights of LLC or its other members to elect to purchase interest of member commencing that action. Section 605.0706, F.S.
- ▶ Interest exchange, analogous to corporate share exchange. Sections 605.1031-6, F.S.
- ▶ Appraisal rights of members for interest exchanges and sales of substantially all of the assets of LLC. Section 605-1006, F.S.
- ▶ Domestication as Florida LLC of entity not formed under law of jurisdiction in U.S.A. Section 605.1051, F.S.

SOME OF THE CHANGES EFFECTED BY FLORIDA REVISED LLC ACT JANUARY 1, 2014

- ▶ **Service of process, notice, or demand on LLC:**

- ▶ Clarification of order of priority of persons to be served. Section 605.0117, F.S.

See summary of post-2015 judicial opinions regarding service of process on Florida LLCs in materials accompanying this presentation.

REINSTATEMENT OF ADMINISTRATIVELY DISSOLVED FLORIDA LLC

Section 605.0715, F.S., added to the Florida Revised LLC Act effective July 1, 2015, permits Florida LLC administratively dissolved under that or the predecessor LLC Act to submit to DOS application for reinstatement or a current annual report:

- ▶ at any time after effective date of dissolution,
- ▶ together with all fees and penalties then owed by the LLC at the rates in effect when the LLC applies for reinstatement,
- ▶ signed by LLC's registered agent and authorized representative, and
- ▶ Including all information prescribed by Section 605.0715(1), F.S.

Reinstatement effective retroactively as of the date of administrative dissolution.

LLC may resume activities and affairs as if administrative dissolution had not occurred.

REINSTATEMENT OF ADMINISTRATIVELY DISSOLVED FLORIDA LLC

Rights of a person arising out of act or omission in reliance on dissolution before that person knew or had notice of reinstatement are not affected.

Name of dissolved LLC not available until one year after effective date of dissolution unless that LLC provides DOS with record executed under Section 605.0203, F.S. permitting immediate assumption or use by another LLC.

THE TIMES THEY ARE ACHANGIN'

- ▶ *See summary of post-2015 judicial opinions in materials accompanying this presentation.*
- ▶ I am a member of a subcommittee of the Corporations, Securities, and Financial Services Committee of the Business Law Section of The Florida Bar.
- ▶ That subcommittee intends to propose to the full Committee that the Committee propose to the Executive Committee of the Business Law Section that the Business Law Section propose to the Board of Governors of The Florida that the Board of Governors **propose to the Florida legislature, during the legislature's 2018-19 session, substantial changes to the Florida Revised LLC Act:**
 - ▶ to harmonize the Florida Revised LLC Act with that subcommittee's proposed substantial rewrite of the Florida Business Corporation Act, Chapter 607, F.S.
 - ▶ including oppression of minority owners, as that term is defined judicially, as a separate basis for judicial dissolution of the business entity.

Stay tuned.

LEGAL ETHICS ISSUES IN REPRESENTING A FLORIDA LLC OR ITS MEMBER

Florida Rules of Professional Conduct ("FRPC"), Chapter 4 of Rules Regulating The Florida Bar, became effective on May 22, 2006. Ethics Opinions and judicial opinions regarding facts occurring before that date may be considered cautiously.

Consequences of violating FRPC:

- ▶ Disciplinary proceedings, including suspension or disbarment, The Florida Bar v. Ticktin, 14 So. 3d 928 (2009) and The Florida Bar v. Reed, 644 So. 2d 1355 (1994).
- ▶ Disqualification of attorney from representing particular client or clients, Lincoln Associates & Construction, Inc. v. Wentworth Construction Company, Inc., 26 So. 638, 639 (Fla. 1st DCA 2010).
- ▶ Civil liability.

"Violation of a rule should not itself give rise to a cause of action against a lawyer **nor** should it **create any presumption that a legal duty has been breached**. In addition, violation of a rule does not necessarily warrant any other nondisciplinary remedy, such as disqualification of a lawyer in pending litigation.... Accordingly, nothing in the rules should be deemed to augment any substantive legal duty of lawyers or the extra-disciplinary consequences of violating a substantive legal duty. **Nevertheless, since the rules do establish standards of conduct by lawyers, a lawyer's violation of a rule may be evidence of a breach of the applicable standard of conduct.**" Preamble to FRPC.

LEGAL ETHICS ISSUES IN REPRESENTING A FLORIDA LLC OR ITS MEMBER

- ▶ Attorney not entitled to fees for services rendered after attorney realizes or should have realized that attorney could not ethically represent that purported client, e.g., as a result of a conflict of interest between the attorney and that client or between that client and another client of that attorney, or as a result of the attorney being required to testify as a witness in a proceeding involving that purported client. James T. Butler, P.A. v. Walker et al., 932 So. 2d 1218 (Fla. 5th DCA 2006) citing Hill v. Douglass, 271 So. 2d 1 (1972).

LEGAL ETHICS ISSUES IN REPRESENTING A FLORIDA LLC OR ITS MEMBER

Rule 4-1.7 of FRPC states:

“(a) Representing Adverse Interests. Except as provided in subdivision (b), a lawyer must not represent a client if:

***“(2) there is a substantial risk that the representation of 1 or more clients will be materially limited by the lawyer’s responsibilities to another client, a former client or a third person or by a personal interest of the lawyer.

“(b) Informed Consent. Notwithstanding the existence of a conflict of interest under subdivision (a), a lawyer may represent a client if:

“(1) the lawyer reasonably believes that the lawyer will be able to provide competent and diligent representation to each affected client;

***and “(4) each affected client gives informed consent, confirmed in writing. . . .”

LEGAL ETHICS ISSUES IN REPRESENTING A FLORIDA LLC OR ITS MEMBER

Nonwaivable conflict:

Commentary to Rule 4-1.7 of FRPC:

“The critical questions are the likelihood that a conflict will eventuate and, if it does, whether it will materially interfere with the lawyer's independent professional judgment in considering alternatives or foreclose courses of action that reasonably should be pursued on behalf of the client....

However,**when a disinterested lawyer would conclude that the client should not agree to the representation under the circumstances, the lawyer involved cannot properly ask for such an agreement or provide representation on the basis of the client's consent....** When more than 1 client is involved, the question of conflict must be resolved as to each client. Moreover, there may be circumstances where it is impossible to make the disclosure necessary to obtain consent. For example, when the lawyer represents different clients in related matters and 1 of the clients refuses to consent to the disclosure necessary to permit the other client to make an informed decision, the lawyer cannot properly ask the latter to consent.” [Emphasis supplied.]

LEGAL ETHICS ISSUES IN REPRESENTING A FLORIDA LLC OR ITS MEMBER

Caveat: Identify your client. Is it the LLC? Is it a member?

Do not purport to represent the LLC and one or more members except for a single-member LLC, even if all members are related by marriage or otherwise.

LEGAL ETHICS ISSUES IN REPRESENTING A FLORIDA LLC OR ITS MEMBER

Personal interest of attorney:

Florida Bar Professional Ethics Committee Ethics Opinion 16-2 (October 21, 2016):

Citing Rules 4-1.5(h), 4-1.6, and 4-1.7(2)(a) of the FRPC, assuming that the terms of the loans comply with applicable law, opinion concludes that attorney may include in her fee agreement with her clients information about financing company's providing loans to her clients to pay her fees, the financing fee, and the loan process, a portion of the principal amount of which loan would be retained by the finance company (effectively, paid by the attorney) as a financing fee similar to a credit card charge fee, if attorney:

- ▶ does not consult with finance company about principal amount, interest rate, financing fee, maturity and installment repayment date or dates, or other terms or conditions of the loans.
- ▶ does not have any ownership interest in, relationship with, or receiving any benefit from the finance company other than payment of attorney's fees charged to her clients.
- ▶ does not increase those attorneys fees or impose additional charge in view of the financing arrangement.

LEGAL ETHICS ISSUES IN REPRESENTING A FLORIDA LLC OR ITS MEMBER

- ▶ continues representing clients regardless whether they defaulted on loans.
- ▶ discloses to her clients alternative options for financing her attorney's fees.
- ▶ does not disclose confidential client information to the finance company.
- ▶ determines that referral of clients to finance company is in each instance in best interests of respective clients.

QUESTIONS AND EVALUATION

Please pose questions to:

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Please do not text message.

THANK YOU FOR ATTENDING MY WEBINAR.

