

The Florida Senate
BILL ANALYSIS AND FISCAL IMPACT STATEMENT

(This document is based on the provisions contained in the legislation as of the latest date listed below.)

Prepared By: The Professional Staff of the Committee on Rules

BILL: CS/SB 336

INTRODUCER: Judiciary Committee and Senator Berman

SUBJECT: Uniform Commercial Code

DATE: January 19, 2022

REVISED: _____

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	<u>Harmsen</u>	<u>McKay</u>	<u>CM</u>	Favorable
2.	<u>Davis</u>	<u>Cibula</u>	<u>JU</u>	Fav/CS
3.	<u>Harmsen</u>	<u>Phelps</u>	<u>RC</u>	Favorable

Please see Section IX. for Additional Information:

COMMITTEE SUBSTITUTE - Substantial Changes

I. Summary:

CS/SB 336 amends Florida’s Uniform Commercial Code. The bill addresses a potential conflict between Florida’s Uniform Commercial Code and statutes that govern the transferability of ownership interests in three business entities: general partnerships, limited partnerships, and limited liability companies.

Florida’s UCC currently supports the free transferability of intangible rights, such as ownership rights, by providing “override” provisions that would override or prohibit any restrictions on the transferability of those rights. However, when the override provisions are applied to these three business entities, the statutes seem to interfere with what is referred to as the “pick-your-partner” principle.

The “pick-your-partner” principle recognizes that owners of small businesses have the right to “pick” who their co-owners will be. In general terms, the principle protects members and partners in these businesses ventures from being forced, by law, into business relationships with a stranger or someone they never wanted to do business with. This situation occurs when someone pledges his or her ownership interest as collateral for a loan and defaults on the loan. The creditor then seeks to enforce his or her secured interest in the business and exercise ownership rights. The bill clarifies that the override provisions do not apply to limits on the transferability of ownership interests found in general partnerships, limited partnerships, or limited liability companies.

The bill amends ss. 679.4061 and 679.4081, F.S., of the Florida Uniform Commercial Code to reflect updates made to Article 9 of the UCC in 2018. These amendments are designed to simplify the interaction of a general partnership's, a limited partnership's, or a limited liability company's ownership interest with that of a creditor who seeks to enforce its secured interest in the entity.

The Florida Business Law Section recommends these changes to clarify applicable law and reduce the potential for litigation over these issues.¹

II. Present Situation:

The Uniform Commercial Code and Article 9

The model Uniform Commercial Code (UCC) is a comprehensive group of laws that govern commercial transactions throughout the country. The UCC is not a federal law, but rather a “uniformly adopted state law.”² This uniformity among state laws is necessary for businesses to conduct interstate transactions and gives them the confidence that commercial terms will be interpreted and enforced consistently by courts in different states.³ The UCC was created to simplify the law that governs commercial transactions—especially contracts.⁴ Florida's UCC substantially reflects the model UCC. The Legislature has periodically amended Florida's UCC in accordance with updates made to the model UCC.

Florida's UCC, codified in chs. 670-680, F.S., is based on the model UCC that was drafted, and is periodically updated, by a joint committee of the American Law Institute and the Uniform Law Commission.⁵ The UCC governs specific contracts and commercial transactions that are based on the effect of a contract.

Article 9 of the UCC creates a framework of laws that govern items known as secured transactions. A secured transaction is an agreement in which one party gives property to the other party as security, or collateral, for a loan.⁶ This transaction creates a security interest.⁷ Article 9 of the UCC, Secured Transactions, was created to protect a secured creditor's interest from being destroyed by a third person. The article specifically governs transfers of personal property (security interests) to secure loans, but also applies to outright sales of certain personal property.

¹ Florida Business Law Section, *Proposed Amendments to Fla. Stat. §§679.4061 and 679.4081 Executive Summary*, p. 2, available at <http://www.flabizlaw.org/files/Summary%20and%20Materials%20-%20UCC%209-406%20and%209-408%20Amendments%20%28v2%29.pdf> (last visited Jan. 3, 2022).

² Uniform Law Commission, *Uniform Commercial Code, Summary*, <https://www.uniformlaws.org/acts/ucc>.

³ *Id.*

⁴ 47 FLA. JUR 2D SECURED TRANSACTIONS s. 1 (Sept. 2021), Uniform Commercial Code, generally; Article 9. *See also*, s. 671.102, F.S.

⁵ The American Law Institute, *Uniform Commercial Code UCC*, <https://www.ali.org/publications/show/uniform-commercial-code/> (last visited Jan. 3, 2022). Forty-nine states have adopted language based on the model UCC; Louisiana has adopted most of the model UCC, but deviates to maintain certain provisions of its civil code.

⁶ U.S. Department of the Interior, *Indian Affairs, Why Secured Transactions are Important*, <https://www.indianaffairs.gov/service/running-business/why-are-secured-transactions-important>.

⁷ 47 FLA. JUR 2D SECURED TRANSACTIONS s. 21 *Transactions or Interests Subject to Article 9, Generally* (2021).

For example, a transaction that creates a debt in exchange for an interest in a debtor's personal property is subject to Article 9. If the debtor in such a transaction defaults, the creditor may repossess and sell the property (collateral) to satisfy the debt. The creditor's interest, if recorded (perfected) in accordance with the protocols required by Article 9, is called a "security interest." Article 9 is codified in Florida law mainly in ch. 679, F.S., "Uniform Commercial Code—Secured Transactions."

Article 9: Anti-Assignment Override Provisions

Sections 679.4061 and 679.4081, F.S., mirror the *former* anti-assignment override provisions of Article 9 of the model UCC.⁸ Those provisions voided legal or contractual provisions that restricted the transfer of ownership interests, including the grant or enforcement of security interests. The anti-assignment override provisions were drafted to ensure the transferability of property interests and other security interests subject to Article 9. However, the model UCC has since been updated to clarify that the override provisions do not apply to general partnerships, limited partnerships, or limited liability companies.

Section 679.4061, F.S., applies to restrictions created by agreement that require an account debtor's⁹ consent to transfer a security interest in a payment intangible (but not the outright sale of a payment intangible), an account, a chattel paper, and a promissory note. Section 679.1021(1)(iii), F.S., defines a payment intangible as "a general intangible under which the account debtor's principal obligation is a monetary obligation." For purposes of this legislation—a payment intangible is the economic interest portion, and not the governance interest portion, of a member or partner's ownership interest in a general partnership, limited partnership, or a limited liability company (LLC). Stated simply—it is the monetary interest in the business entity.¹⁰ An important distinction in this section is that the restriction must be found in an agreement with an entity, such as the limited liability company or general partnership (the account debtor)—not an individual person, such as the co-owner.

Section 679.4081, F.S., prohibits restrictions on the transfer of general intangibles. It further invalidates laws or rules that restrict such transfers. Section 679.1021(1)(pp), F.S., defines a general intangible as "any personal property, including . . . payment intangibles." Therefore, s. 679.4081, F.S., prohibits specific restrictions on the following transactions:

- The outright sale of a payment intangible;
- The outright sale of ordinary security interests in general intangibles that are not payment intangibles (i.e., most complete ownership interests, as well as an interest in the member's governance interest alone); and
- The outright sale of economic rights.

⁸ Sections 9-406 and 9-408 of the U.C.C.

⁹ Section 679.1021(1)(c), F.S., defines an "account debtor" as a person who is obligated on an account, chattel paper, or general intangible. For purposes of this analysis, an account debtor is usually the business entity itself, rather than a member of the LLC, or a partner in a general partnership.

¹⁰ Carl Bjerre, Daniel Kleinberger, Edwin Smith, and Steven Weise, *LLC and Partnership Transfer Restrictions Excluded From UCC Article 9 Overrides* (Feb. 7, 2019), <https://businesslawtoday.org/2019/02/llc-partnership-transfer-restrictions-excluded-ucc-article-9-overrides/> (last visited Jan. 3, 2022).

Again, however; s. 679.4081, F.S., applies only in transactions where the restriction comes from the account debtor—or business entity—not a co-owner or fellow partner.

In 2018, the National Conference of Commissioners on Uniform State Laws and the American Law Institute revised Article 9 to provide that the anti-assignment override provisions “do not apply to a security interest in an ownership interest in a general partnership, limited partnership, or limited liability company.” These amendments are designed to eliminate potential conflicts between Article 9 and the pick-your-partner principle within partnership and LLC law.¹¹ As of November 2021, Colorado, Delaware, Texas, North Carolina, and Virginia had at least partially adopted language similar in effect to the ALI’s 2018 Article 9 revisions. Seven other states, Alabama, Kansas, Kentucky, Maine, Mississippi, New Hampshire, and Ohio have amended their limited liability company, limited partnership, and partnership statutes to address these potential conflicts.¹²

Business Organizations and the “Pick-Your-Partner” Principle

The pick your partner principle allows a co-owner of a privately held business to determine who else may serve as a co-owner, usually by requiring express permission or a related action from a co-owner or the business entity to transfer his or her ownership interest to another party.¹³ A partner or member’s ownership interest in the business organization consists of governance rights and economic rights.¹⁴ Most LLC or partnership interests are classified as a general intangible under ch. 679, F.S. However, the economic interest portion of a member’s ownership interest is classified as a payment intangible.¹⁵

In conflict with ss. 679.4061 and 679.4081, F.S., Florida LLC law states that a member cannot transfer his or her full ownership interest in the LLC, but may transfer his or her economic interest. Additionally, s. 605.0502 F.S., permits co-owners of an LLC or partnership to contractually add additional restrictions to the transfer of an ownership interest, including a restriction on the transfer of any of the ownership interest. These limitations reduce the economic value of a member’s interest and help to ensure that the LLC or partnership continues to exist in its original form—a closely held business operated with a known individual or group.¹⁶

The Florida Business Law Section illustrates the conflict as follows:

Two individuals go into business together and form an LLC. Each owner is a 50/50 member in the LLC. Their operating agreement (like most operating agreements) restricts the ability of one member to convey or encumber their

¹¹ Florida Business Law Section, *Proposed Amendments to Fla. Stat. §§679.4061 and 679.4081 Executive Summary*, p. 2, available at <http://www.flabizlaw.org/files/Summary%20and%20Materials%20-%20UCC%209-406%20and%209-408%20Amendments%20%28v2%29.pdf> (last visited Jan. 3, 2022).

¹² Uniform Law Commission, *State Overrides of UCC 9-406 and 9-408*, (November 2021) (on file with the Senate Committee on Judiciary).

¹³ Bjerre, et al., *supra* note 10.

¹⁴ Bjerre, et al., *supra* note 10, at 2.

¹⁵ Florida Business Law Section, *supra* note 11 at 1.

¹⁶ See Hank Jackson, *Anatomy of a Business Divorce: Florida LLCs*, FLA. BAR JOURNAL, Vol. 95, No. 3, p. 8 (May/June 2021), available at <https://www.floridabar.org/the-florida-bar-journal/anatomy-of-a-business-divorce-florida-llcs/#u6a6b> (last visited Jan. 3, 2022).

membership interest without the consent of the other member, in keeping with the “pick your partner” principle engrained in LLC and partnership law. If one partner unilaterally encumbered their 50% membership interest to secure a personal loan from a bank (in violation of the operating agreement), then arguably, Section 9-406 and 9-408 would “override” the restriction in the operation agreement. If the member defaulted on the loan, the lender could foreclose on its security interest in the LLC membership interest and take ownership of the membership interest. The other member would now be saddled with a bank as its new business partner, a result not contemplated or permitted by the members’ contract (the operating agreement).

Some firms attempt to transact their way out of the anti-assignment override provision by creating their ownership interests in the business entity as an investment security, which is subject to Article 8 of the model UCC instead of Article 9. However, this requires additional legal structuring at the outset, and does not shield the interest from litigation over its classification.¹⁷

III. Effect of Proposed Changes:

Sections 1 and 2 of the bill exclude ownership interests in a general partnership, a limited partnership, or an LLC from the “anti-assignment override” provisions found in ss. 679.4061 and 679.4081, F.S., respectively. Therefore, the bill gives priority to a statute or agreement that restricts the transfer of a general intangible (ownership interest) and a security interest in a payment intangible (the monetary interest portion of an ownership interest) within the context of a general partnership, limited partnership, or LLC.

The bill will conform Florida’s version of the UCC to reflect the 2018 updates made to Article 9 of the model UCC by the National Conference of Commissioners on Uniform State Laws and the American Law Institute to void the “anti-assignment override” provisions in the context of a general partnership, a limited partnership, or a limited liability company.

The bill takes effect January 1, 2023.

IV. Constitutional Issues:

A. Municipality/County Mandates Restrictions:

None.

B. Public Records/Open Meetings Issues:

None.

¹⁷ Bjerre, et al., *supra* note 10, at 6.

C. Trust Funds Restrictions:

None.

D. State Tax or Fee Increases:

None.

E. Other Constitutional Issues:

None identified.

V. Fiscal Impact Statement:

A. Tax/Fee Issues:

None.

B. Private Sector Impact:

This clarification may reduce transaction costs incurred when establishing specific business entities by removing the need to “opt-in” to Article 8 by defining the underlying ownership interests as a security, which is not subject to ch. 679, F.S. Additionally, this clarification may reduce litigation costs related to disputes of the character of an ownership interest in a general partnership, limited partnership, or limited liability company.¹⁸

C. Government Sector Impact:

None.

VI. Technical Deficiencies:

None.

VII. Related Issues:

None.

VIII. Statutes Affected:

This bill substantially amends the following sections of the Florida Statutes: 679.4061 and 679.4081.

¹⁸ Florida Business Law Section, *Proposed Amendments to Fla. Stat. §§679.4061 and 679.4081 Executive Summary*, p. 2, available at <http://www.flabizlaw.org/files/Summary%20and%20Materials%20-%20UCC%209-406%20and%209-408%20Amendments%20%28v2%29.pdf> (last visited Jan. 4, 2022).

IX. Additional Information:

- A. **Committee Substitute – Statement of Substantial Changes:**
(Summarizing differences between the Committee Substitute and the prior version of the bill.)

CS by Judiciary on January 10, 2022:

The committee substitute changes the effective date of the bill from July 1, 2022 to January 1, 2023.

- B. **Amendments:**

None.