Cal. Prac. Guide Pass--Through Entities Ch. 6-A

California Practice Guide--Pass-Through Entities | August 2024 Update
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Chapter 6. Limited Liability Company

A. General Considerations

[6:1] A limited liability company (LLC) has been described as a "hybrid" between a partnership and a corporation. It enjoys the "pass-through" tax treatment of a partnership with the limited liability accorded corporate shareholders. [See Corps.C. § 17701.01 et seq.; *Ontiveros v. Constable* (2018) 27 CA5th 259, 273, 237 CR3d 892, 901-902; *Western Sur. Co. v. La Cumbre Office Partners, LLC* (2017) 8 CA5th 125, 131, 213 CR3d 460, 464; *People v. Pacific Landmark* (2005) 129 CA4th 1203, 1211-1212, 29 CR3d 193, 198; see also *Robinson v. Glynn* (4th Cir. 2003) 349 F3d 166, 168 ("LLCs are noncorporate business entities that offer their members limited liability, tax benefits, and organizational flexibility")]

1. [6:2] **Governing Law:** LLCs are governed by the California Revised Uniform Limited Liability Company Act (CRULLCA, Corps.C. § 17701.01 et seq.). [Corps.C. §§ 17701.01, 17713.04(a)]

Generally, CRULLCA applies to all California LLCs existing on or after January 1, 2014 (the effective date of CRULLCA), and to all foreign LLCs registered to do business in California on or after January 1, 2014, regardless of when organized or registered to do business in this state (*see ¶ 6:1236*). [Corps.C. § 17713.04(a); see *Kennedy v. Kennedy* (2015) 235 CA4th

1474, 1486-1491, 186 CR3d 198, 206-211; see also *DD Hair Lounge, LLC v. State Farm Gen. Ins. Co.* (2018) 20 CA5th 1238, 1243-1246, 230 CR3d 136, 138-141, *discussed at ¶ 6:822*]

a. [6:3] **Exception—applicability to pre-2014 LLCs:** CRULLCA replaced California's initial LLC Act, the Beverly-Killea Limited Liability Company Act, ("Beverly-Killea LLC Act," former Corps.C. §§ 17000-17657), which was enacted in 1994. However, the Beverly-Killea LLC Act continues to apply to all acts or transactions by an LLC or by its members or managers occurring prior to 2014, as well as to any operating agreement or other contract entered into by the LLC or by its members or managers prior to 2014. [Corps.C. § 17713.04(b); see Corps.C. § 17713.03—CRULLCA "does not affect an action commenced, proceeding brought, or right accrued or accruing" before 2014; see also *Western Sur. Co. v. La Cumbre Office Partners, LLC* (2017) 8 CA5th 125, 131, 213 CR3d 460, 463-464; *Kennedy v. Kennedy* (2015) 235 CA4th 1474, 1491, 186 CR3d 198, 211; *CB Richard Ellis, Inc. v. Terra Nostra Consultants* (2014) 230 CA4th 405, 411, 178 CR3d 640, 644, fn. 4]

b. [6:4] **Relation to Uniform LLC Act:** CRULLCA is primarily based on the Revised Uniform Limited Liability Company Act prepared by the National Conference of Commissioners on Uniform State Laws (NCCUSL). (The Uniform Act, which was adopted in 2006 and amended in 2011 and 2013, can be found on the NCCUSL website (*www.uniformlaws.org*).) CRULLCA was enacted in part to bring California LLC law more in line with the LLC laws of other states, thus making it easier for LLCs to operate in California *and in other states*. Additionally, CRULLCA was intended to conform in certain respects to California law governing limited partnerships.

2. [6:5] **One Member Sufficient:** An LLC need have only one member. [Corps.C. § 17701.02(s)]

3. [6:6] **Tax Treatment:** Generally, an LLC is treated as a *conduit* (i.e., a partnership) for federal tax purposes: Profits and losses are passed through to the LLC members and, in most other respects (e.g., informational returns, basis allocation), the members are subject to the same federal tax rules and treatment as partners. [See generally, *Ontiveros v. Constable* (2018) 27 CA5th 259, 273, 237 CR3d 892, 901-902; *Swart Enterprises, Inc. v. Franchise Tax Bd.* (2017) 7 CA5th 497, 505, 212 CR3d 670, 675 & fn. 3; *City of Los Angeles v. Furman Selz Capital Mgmt., L.L.C.* (2004) 121 CA4th 505, 513-514, 17 CR3d 139, 142-144; *see Ch. 8* for a detailed discussion of the tax treatment of LLCs]

Comment: Some LLC's may elect to be taxed as corporations (*see* ¶ 8:7 ff.).

a. [6:7] **California franchise taxes:** LLCs must pay the same $800 annual franchise tax that limited partnerships and corporations must pay. [Rev. & Tax.C. §§ 17941(a), (d), 23153(d)(1); *see ¶ 8:203*]

Additionally, LLCs must pay annual fees for any year in which their total California income is $250,000 or more. [Rev. & Tax.C. § 17942(a); *see ¶ 8:204 ff.*]

(1) [6:7.1] **First-year exemption:** California limited liability companies that file articles of organization and foreign limited liability companies that register with the Secretary of State on or after January 1, 2021 and before January 1, 2024 are exempt from the minimum franchise tax for their *first* taxable year. [Rev. & Tax.C. § 17941(g)(1)]

(2) [6:7.2] **Foreign passive member not subject to tax:** *See ¶ 6:1212*.

4. [6:8] **Members' Limited Liability:** Ordinarily, only the LLC can be held responsible for the entity's debts. Subject to narrow exceptions, the LLC members are not personally liable for the LLC's obligations and/or liabilities and thus enjoy the same "limited liability" as corporate shareholders. [Corps.C. § 17703.04; *see ¶ 6:209 ff.*]

5. [6:9] **Centralized Management Optional:** All of the members may partake in management of the LLC (akin to a general partnership) or may, in the LLC's articles of organization, provide for centralized management (akin to a limited partnership or, in certain respects, a corporation). *See discussion at ¶ 6:450 ff.*

a. [6:10] **Caution—securities law considerations:** Members who do not participate in LLC management may be deemed passive *investors*, and the membership interests may be deemed *securities*. *See* ¶ 7:81 ff.

6. [6:11] **Flexibility:** The LLC form provides far greater flexibility than a corporation or a limited partnership. For a comparison of the LLC form with the corporate and limited partnership forms of doing business, *see Ch. 2*.

7. [6:12] **Separate Legal Entity:** Like partnerships and corporations, an LLC is recognized as a legal entity separate and apart from its members. It has all the powers of a natural person in carrying out its activities, including to sue and be sued, make contracts, borrow and lend money, acquire and sell property, invest, make donations, etc. [See Corps.C. §§ 17701.04(a), 17701.05; *PacLink Communications Int'l, Inc. v. Sup.Ct. (Yeung)* (2001) 90 CA4th 958, 963, 109 CR2d 436, 439; *Abrahim & Sons Enterprises v. Equilon Enterprises, LLC* (9th Cir. 2002) 292 F3d 958, 962 (applying Calif. law)]

(*Caution:* The operating agreement may not vary the LLC's capacity to sue and be sued in its own name; *see ¶ 6:105*.)

a. [6:13] **No member claim to LLC assets:** Like corporate shareholders, a member has no direct ownership interest in specific company property. Once members contribute assets to an LLC, those assets become assets of the LLC and not assets of the members. [*Kwok v. Transnation Title Ins. Co.* (2009) 170 CA4th 1562, 1570-1571, 89 CR3d 141, 147; *Abrahim & Sons Enterprises v. Equilon Enterprises, LLC* (9th Cir. 2002) 292 F3d 958, 963]

8. [6:14] **Perpetual Duration:** An LLC has perpetual duration (unless the articles or operating agreement provide otherwise). [Corps.C. § 17701.04(c)]

[6:15] ***Reserved.***

9. Permissible Business

a. [6:16] **Any lawful purpose:** An LLC may have any lawful purpose, whether for profit or not, *except* the banking business, the business of issuing policies of insurance and assuming insurance risks, or the trust company business. (LLCs may therefore be formed for nonprofit purposes.) [Corps.C. § 17701.04(b)]

b. [6:17] **Available to licensed businesses only if permitted by licensing authority:** An LLC may render services that require a license, certificate or registration authorized by the Business and Professions Code, the Chiropractic Act, the Osteopathic Act or the Ship Brokers Act *only* if permitted by the provisions of the applicable law. [Corps.C. § 17701.04(b), (e); *see ¶ 2:11, 2:205*]

c. [6:18] **Limited availability to health care service plan:** An LLC may operate as a licensed health care service plan (Health & Saf.C. § 1340), but only if the LLC is a subsidiary of a licensed health care service plan and the LLC serves an existing line of its parent's business. [Corps.C. § 17701.04(d)]

(1) [6:19] **No limited liability:** The limited liability ordinarily enjoyed by LLC members (¶ 6:209) does *not* apply where the LLC operates as a health care service plan. [Corps.C. § 17701.04(d)]

[6:20] ***Reserved.***

10. Securities Laws Considerations

a. [6:21] **California law:** Under the Corporate Securities Law, LLC membership interests are securities unless *all* of the members are *actively engaged in management*. [Corps.C. § 25019; *see discussion at ¶ 7:81 ff.*]

b. [6:22] **Federal law:** The 1933 Act does not mention limited liability companies. As with general and limited partnerships, the issue is whether an LLC membership interest is an "investment contract" within the statutory definition of "security." [SA § 2(a)(1); *see discussion at ¶ 7:90 ff.*]

[6:23 - 6:29] ***Reserved.***

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B. Formation

1. [6:30] **Articles of Organization:** One or more persons may form an LLC by signing and delivering articles of organization to the Secretary of State. The articles must be on the form prescribed by the Secretary of State. An LLC is formed when the articles are filed. [Corps.C. § 17702.01(a), (d)]

a. [6:31] **Required contents:** The articles must state:

- That the purpose of the LLC is to engage in any lawful act or activity for which an LLC may be organized;
- The LLC's name (*see ¶ 6:33 ff.*);
- The street address of the LLC's initial principal office and the mailing address of the LLC, if different;
- The name and street address of the initial agent for service of process (but the street address must not be set forth if the agent is a corporation);
- If the LLC is to be manager-managed, a statement to that effect; and
- If the LLC is to be managed by only one manager, a statement to that effect. [Corps.C. § 17702.01(b)]

FORM: The Secretary of State's standard form Articles of Organization (Form LLC-1) is available online at the Secretary of State's website (*www.sos.ca.gov*).

[6:32] ***Reserved.***

(1) LLC name

(a) [6:33] **Must contain LLC designation:** The LLC's name *must* contain the words "limited liability company" or the abbreviation "L.L.C." or "LLC." Also, "limited" may be abbreviated as "Ltd." and "company" may be abbreviated as "Co." [Corps.C. § 17701.08(a)]

(b) [6:34] **No "bank," "corp.," "trust" or "insurer":** The name must not include the words "bank," "trust," "trustee," "incorporated," "inc.," "corporation," "corp.," or "PC." Nor may it contain the words "insurer," "insurance company," "assurance," "surety" or any other words suggesting that it is in the insurance business unless the name contains other words removing the implication that the LLC is in the insurance business. The addition of the words "agency," "agent," "services" or "broker" (e.g., "insurance agency" or "insurance broker") may remove the implication. [Corps.C. § 17701.08(e); 2 CCR § 21003(d)]

(c) [6:35] **"Olympic" names restricted:** The name must not include "Olympic," "Olympiad," "Citius Altius Fortuis," "Paralympic," "Paralympiad," "Pan-American," "America Espirito Sport Fraternite" or a combination or simulation of these words (unless those words were used in the business name before September 21, 1950, or in the case of the word "Olympic," the word is not combined with any of the other foregoing names). [36 USC § 220506(a)(4),(d)(2), (3)]

(d) [6:36] **General naming standard:** The name of an LLC shall not be a name that the Secretary of State determines is "likely to mislead the public" (¶ 6:38), and shall be "distinguishable in the records of the Secretary of State" (¶ 6:39 ff.) from the name of any other LLC that has previously filed articles of organization with the Secretary of State, has registered as a foreign LLC with the Secretary of State, or has been reserved with the Secretary of State. [Corps.C. § 17701.08(b); 2 CCR § 21001.2]

1) [6:37] **Comment:** The 2020 amendments to the Corporations Code streamlined the naming requirements for California entities so that they are the same for domestic and foreign corporations, limited partnerships and limited liability companies. [Corps.C. § 201 (corporations); Corps.C. § 15901.08 (limited partnerships); Corps.C. § 17701.08 (limited liability companies)]

2) [6:38] **Name "likely to mislead the public" barred:** Under the Secretary of State's regulations adopted in response to the 2020 Corporations Code amendments, a proposed name is likely to mislead the public when:

- It implies a government affiliation;
- It creates a false implication that the entity is a professional corporation;
- It creates a false implication that it is a business entity formed pursuant to a law different than that under which it is actually formed; or
- It creates a false implication that the business entity's purpose is to be an insurer. [2 CCR § 21003(a)-(d)]

3) [6:39] **Name must be "distinguishable" in Secretary of State's records:** A limited liability company's name is "distinguishable in the records of the Secretary of State" from an existing name when it is not the same as an existing name and, subject to enumerated exceptions (¶ 6:40), it "contains one or more different letters or numerals or has a different sequence of the same letters or numerals that is plainly recognizable by means of sight by the Secretary of State or a designee of the Secretary of State." [2 CCR § 21004(a)]

a) [6:40] **Names *not distinguishable:*** A proposed name is *not* distinguishable in the records of the Secretary of State from an existing name if the names are the same or differ only in one or more of the following ways:

- The difference between the proposed name and existing name is the existence or absence of business entity identifiers;
- The difference between the proposed name and existing name is the use of upper case letters or lower case letters or the use of superscript or subscript letters or numerals;
- The difference between the proposed name and existing name is the addition or omission of distinctive lettering or typeface, punctuation, symbols or spaces; or
- The difference between the proposed name and existing name is the use of an ampersand in place of the word "and" or vice-versa. [2 CCR § 21004(b)(1)-(4)]

b) [6:40.1] **Examples of names *not distinguishable:*** ABC LLC is not distinguishable from A-B-C LLC or A.B.C. LLC. Good Time Rest Home, LLC is not distinguishable from Goodtime Rest Home, LLC. D.R.E.A.M. LLC is not distinguishable from Dream LLC. [2 CCR § 21004(b)(3)]

However, a proposed name might be distinguishable "when the difference between the proposed name and existing name is the addition or omission of a space or spaces so that the proposed name creates a new word or words that have different meanings," e.g. Got Ham LP is distinguishable from Gotham, LP and thus, acceptable. [2 CCR § 21004(b)(5)]

➪ [6:40.2] ***PRACTICE POINTER:*** That a proposed name of a limited liability company is distinguishable in the records of the Secretary of State from an existing name does not necessarily mean that the name may be lawfully adopted and used. If, for example, a person not the owner or authorized user of Blackacre Property I, LLC proposes to form a fund with the name Blackacre Property II, LLC, it may be subject to a claim by the owners of Blackacre Property I, LLC that the adoption and use of the proposed name infringes on the intellectual property rights of the former or would constitute unfair competition.

(e) [6:41] **No consent exception:** The naming requirements streamlining legislation eliminated the provision that permitted a limited liability company to apply to the Secretary of State for authorization to use a name that does not comply with the naming requirements of the CRULLCA under certain circumstances, including where the present user

consents to its use. [See former Corps.C. § 17701.08(c) (Stats. 2012, Ch. 419)] Additionally, the Secretary of State's regulations setting forth procedures for obtaining permission to use a similar name have been rescinded.

(f) [6:42] **Compare—conflict with corporate, limited partnership or fictitious business name:** The Secretary of State records corporations, limited partnerships and LLCs in separate databases, and does not cross-check against the corporate or limited partnership databases when searching LLC names. Thus, an LLC could adopt a name that is identical (other than the "LLC" designation, ¶ 6:33) to that of an existing corporation or limited partnership organized (or registered) in California.

A rudimentary search of similar corporate or limited partnership names may be made using the Business Search function on the Secretary of State's website (¶ 6:53). However, the only sure way to avoid selecting an LLC name that is confusingly similar to an existing corporate or limited partnership name is to request a separate name availability check for that name as a corporation or limited partnership (*see ¶ 5:100*).

Also, an available LLC name may be confusingly similar to a fictitious business name. Counsel may wish to perform a search of fictitious business names filed in the local county clerk's office. *See ¶ 3:74 ff.*

[6:43 - 6:49] ***Reserved.***

(g) [6:50] **Procedure for checking name availability:** The availability of any LLC name can be checked by writing to (or appearing in person at) the Secretary of State's Office, Name Availability Unit, 1500 11th Street, 3rd Floor, Sacramento, CA 95814. There is no charge for this service. [See 2 CCR § 21903(c)(3) (amended eff. 4/7/22)]

[6:51] ***Reserved.***

➪ [6:52] ***PRACTICE POINTERS:*** Ask the client to give you a list of several acceptable names, in order of preference. There is a limit of three names per inquiry letter when checking availability by mail, and several attempts may be required before an available name is obtained.

Also, bear in mind that this is only a *preliminary* check. A final name availability determination is made only when the articles are submitted for filing, at which time the Secretary of State can still reject the name (unless it was reserved by you or your client). [See 2 CCR § 21005(b)]

1) [6:53] **Compare—web check of similar names:** The Secretary of State's website contains a feature known as Business Search (*bizfileonline.sos.ca.gov*), which permits anyone to obtain basic information about an LLC (LLC number, status, address, agent for service of process). A rudimentary name availability search may be performed by inserting an LLC name. A searched name that is the same as the name of an active LLC will not be available. But even if no active LLC by that or a "nondistinguishable" name appears, the name might still be unavailable: Unlike a name availability search, this feature does *not* track name reservations (¶ 6:55) or certain documents in the Secretary of State's office that await filing and that contain names of new LLCs, such as articles of organization or qualifications of foreign LLCs to do business in California.

Business Search can also be used to make a rudimentary search of *corporations* and *limited partnerships* having names similar to the name selected for the LLC (*see ¶ 6:42*). But here again, this is not as reliable as a name availability search.

2) [6:54] **Cross-checking with other states:** In addition to clearing name availability in California, counsel should also make sure the desired name is available in *any other state in which the LLC may be required to qualify to do business*. (Such qualification may be refused if the LLC name is too similar to another already on file.)

(h) [6:55] **Name reservation:** An available name may be reserved for a period of up to 60 days. A name reservation request may be mailed (along with a self-addressed envelope) to the Secretary of State's Office, Business Programs Division, 1500 11th Street, 3rd Floor, Sacramento, CA 95814. There is a $10 fee for each reserved name. [Corps.C. § 17701.09(a)]

- ***FORM:*** The Secretary of State's standard Name Reservation Request Form is available online at the Secretary of State's website (*www.sos.ca.gov*).

1) [6:56] **Certificate of name reservation:** Upon payment of the appropriate fee, the Secretary of State will issue a *certificate* reserving the designated name(s) for a 60-day period (¶ 6:55). [Corps.C. § 17701.09(a)]

➪ [6:57] ***PRACTICE POINTER:*** When submitting the articles of organization, *include a copy of the name reservation certificate*. Otherwise, the Secretary of State may "bounce" the articles on the ground the name is taken … not realizing it was you who took it.

2) [6:58] **Name reservation *not renewable:*** The 60-day reservation period is not extendable; and no two certificates can be issued to the same applicant or firm for use by the same clients. [Corps.C. § 17701.09(a)]

➪ [6:59] ***PRACTICE POINTER:*** Although you cannot renew your reservation beyond the 60-day period, if you allow one business day to elapse thereafter, you can file a *new request* to reserve the same name. As long as no one else applied during that one-day interim, you will be able to obtain a new 60-day certificate reserving the name.

3) [6:60] **Transfer of name reservation:** A name reservation may be transferred to another person by delivery to the Secretary of State of a notice of transfer. [Corps.C. § 17701.09(b)]

[6:61 - 6:69] ***Reserved.***

(i) [6:70] **Compliance with fictitious business name statute:** An LLC that conducts business in a name other than the name stated in its articles of organization must comply with the fictitious business name statute. [Bus. & Prof.C. § 17900(b)(5); *see ¶ 3:75 ff.*]

(2) [6:71] **Member-managed vs. manager-managed LLC:** An LLC is member-managed *unless* the articles provide otherwise by words to the effect that, e.g., the LLC will be "manager-managed" or "managed by managers," or management will be "vested in managers." (At present, the organizer need only check off one of the appropriate boxes on the Secretary of State's standard form articles.) [Corps.C. §§ 17702.01(b)(5), 17704.07(a); *see ¶ 6:450*]

[6:72 - 6:79] ***Reserved.***

b. [6:80] **Optional contents:** The articles of organization may also contain any other provision not inconsistent with law. (Provisions that would vary certain statutory protections and requirements, and hence are forbidden to be in an operating agreement, likewise may not be set forth in the articles; see Corps.C. §§ 17701.10(c), 17701.12(c).) [Corps.C. § 17702.01(c)]

(1) [6:81] **Voting by members:** The articles (or a *written* operating agreement) may provide to all members, or to certain identified members of a specified class or group of members, the right to vote separately or with all or any class or group of members on any matter. Voting may be on a per capita, number, financial interest, class, group or any other basis. [Corps.C. § 17704.07(r)]

(2) [6:82] **Classes of members:** The articles (or the operating agreement) may provide for the creation of classes of members having those relative rights, powers and duties as the articles (or operating agreement) may provide. [Corps.C. § 17712.01]

(3) [6:83] **Series LLCs (available only to foreign LLCs):** At least 18 states—*not including California*—have authorized "series" LLCs. Series LLCs are, in effect, separate divisions of an LLC and are formed to own and operate separate assets or engage in separate activities from the other series of the LLC. [See L. Ribstein, R. Keatinge & T. Rutledge, *Ribstein & Keatinge on Limited Liability Companies,* Appendix 26-2 (2020)] Each series has no liability for the debts and obligations of the other series: In effect, each series has its own "liability shield." The appeal of series LLCs is purportedly to ease the formation and administration of multiple investment entities (since only the "parent" LLC has a full operating agreement, with separate series designations setting forth those unique aspects of each series), and reduced filing and organizational fees. Series LLCs have also been used by investment funds that create a series of separate funds while operating under a single registration under the Investment Company Act of 1940.

Series LLCs have yet to gain wide popularity, not only because of the limited number of states that have authorized their use, but also because of uncertainties as to how the series would be treated in states where they do business but where series LLCs have not been authorized. There are also concerns as to the treatment of series LLCs under the Uniform Commercial Code and in bankruptcy proceedings.

(a) [6:83.1] **Example—Delaware law:** The most notable state authorizing series LLCs is Delaware. Under the Delaware statute, followed by other states, an LLC agreement may establish, or provide for the establishment of, one or more designated series of members, managers or LLC interests or assets. Any series may have a separate business purpose or investment objective. It may also have separate rights, powers or duties with respect to specified property or LLC

obligations, as well as separate treatment of profits and losses associated with specified property or obligations. [See 6 Del.C. § 18-215]

(b) [6:83.2] **Not authorized or recognized in California:** CRULLCA does not permit series LLCs. Consequently, the Secretary of State does not recognize series LLCs as separate entities, requiring the "parent" LLC to register as a foreign LLC (*see ¶ 6:1200 ff.*) if any of its series LLCs does business in California.

[6:84] ***Reserved.***

(c) Tax treatment

1) [6:85] **Federal law:** Under proposed regulations, series LLCs would be treated as an entity for federal tax purposes whether or not they are treated as separate entities for state law purposes. Accordingly, each series would be entitled to choose its own entity classification independent of the classification of the other series of that LLC, and each series would be liable for federal income taxes related only to that series. [REG-119921-09 (2010), proposing amendments to Treas.Reg. §§ 301.6011-6, 301.6071-2, 301.7701-1]

2) [6:86] **California law:** The Franchise Tax Board takes the position that each series of a foreign LLC doing business in California is a separate entity for franchise tax purposes, and therefore must file its own return on Form 568 and pay its own separate LLC annual tax ($800) and statutory fee if it registered to do business or is doing business in California. [See FTB 3556 LLC MEO, Limited Liability Company Filing Information and Instructions to FTB Form 568 (Part F, p. 8 ("Series LLCs"))]

[6:87 - 6:88] ***Reserved.***

(d) [6:89] **Additional sources of information:** For a general discussion of series LLCs, see L. Ribstein, R. Keatinge & T. Rutledge, *Ribstein & Keatinge on Limited Liability Companies,* Ch. 26 (2020); M. Sargent & W. Schwidetzky, *Limited Liability Company Handbook*, Ch. 2 (Thomson Reuters 2017); ABA Business Law Section Committee on LLCs, Partnerships and Unincorporated Entities, "Limited Liability Company Agreement for a Delaware Limited Liability Company with Protected Series," 74 *Bus. Law.* 1105 (2019); B. Ely & W. Thistle, "An Update on the State Tax Treatment of LLCs and LLPs,"*J. Multistate Taxation & Incentives* 16 (March/April 2019); T. Rutledge, "The Internal Affairs Doctrine and Limited Liability of Individual Series Within a Series LLC,"*Business Entities* (May/June 2015); D. Scotten, "Series LLCs: An Organizational Form That Should Be Used Cautiously (For Now),"*Business Law News* (State Bar of Calif. Bus. Law Section 2009); J. Leigh Griffith & A. Gonzales, "Series LLCs — Current Issues, Multi-State Issues and Potential Uniform Limited Liability Company Protected Series Act (Parts 1 & 2),"*Taxes* (Oct. 2016, at 63-76) (April 2017, at 35-49).

c. [6:90] **Execution:** The articles must be signed by at least one person acting as an organizer. [Corps.C. § 17702.03(a)(2); see Corps.C. § 17702.01(a)—one or more persons may act as organizers to form LLC; Corps.C. § 17701.02(u)—"organizer" refers to any person that acts under Corps.C. § 17701.01 to form LLC]

➪ [6:90.1] ***PRACTICE POINTER*:** Common practice is for counsel or an assistant to sign and file articles of organization, with the operating agreement expressly authorizing and ratifying counsel's or such assistant's acts in doing so. [See Corps.C. § 17702.03(b)—except as otherwise expressly provided by CRULLCA or Corps.C. § 17702.03(a), any record filed under CRULLCA may be signed by an agent; Forms 6:B (Single-Member Operating Agreement § 1.2), 6:C (Multi-Member Operating Agreement § 1.1)]

d. [6:91] **Filing fee:** The fee for filing the articles of organization is $70 (plus a $15 special handling fee if the document is delivered personally to the Secretary of State's office). [Gov.C. §§ 12182(a), 12190(b); 2 CCR § 21903(c)]

(1) [6:92] **Cancellation by Secretary of State if check bounces:** The Secretary of State may cancel the filing of the articles if a check or other form of payment of the filing fee is not paid upon presentation. (The Secretary of State will first give the organizer an opportunity to submit a cashier's check or equivalent.) [Corps.C. § 17702.01(f)]

e. [6:93] **Optional recording in county recorder's office:** A certified copy of the filed articles of organization may be recorded in the county recorder's office. The recording creates a conclusive presumption in favor of any bona fide purchaser or encumbrancer for value of LLC real property located in that county of the statements contained in the recorded articles. [Corps.C. § 17702.03(c)]

[6:94 - 6:99] ***Reserved.***

2. [6:100] **Operating Agreement:** To validly complete the formation of an LLC, the members should enter into an operating agreement either before or after filing the articles. But the operating agreement need not be in writing; indeed, it may consist of no more than an oral agreement among the initial members to organize the limited liability company. (However, certain statutory provisions can be limited only by a *written* operating agreement; see Corps.C. § 17701.10(d), ¶ 6:130 ff.) [Corps.C. §§ 17701.02(s), 17701.07(a), 17701.10(a), 17701.11]

[6:101] **Compare—prior law:** Unlike the predecessor statute, the Beverly-Killea LLC Act (¶ 6:3), CRULLCA does not explicitly require that the members enter into an operating agreement; rather, the requirement is implicit in CRULLCA. [See former Corps.C. § 17050(a), (b)]

➪ [6:101.1] ***PRACTICE POINTER:*** The need for a *written* operating agreement in a multi-member LLC is obvious. But even in a *single*-member LLC, a written operating agreement should be prepared … because lenders and other institutional third persons dealing with the LLC will usually insist on seeing a copy of the operating agreement.

a. [6:102] **Purpose:** With certain exceptions set forth below (¶ 6:103), the operating agreement governs:

• Relations among the members as members;

• Relations between the members and the LLC;

• The rights and duties of the manager or managers;

• The LLC's activities and the conduct of those activities; and

• The method of amending the operating agreement. [Corps.C. § 17701.10(a)]

(1) [6:103] **Amendments subject to condition or approval by nonparty:** The operating agreement may specify that any amendment must be approved by a person who is not a party to the operating agreement (e.g., a lender or the corporate parent of a member), or that an amendment requires satisfaction of a condition. An amendment is ineffective if it does not include the required approval or satisfy the specified condition. [Corps.C. § 17701.12(a)]

b. [6:104] **Prohibited provisions:** CRULLCA contains many provisions that come into play only if the operating agreement is silent on certain matters. LLC members are given considerable flexibility in fashioning their relationship and the method of operating the LLC. However, certain provisions of CRULLCA are absolute and cannot be altered by the members, whether by way of the operating agreement or by way of the articles of organization. [Corps.C. §§ 17701.10(c) & (d) (restrictions on provisions that may be set forth in operating agreement), 17701.12(c) (articles of organization may not contain any provision that would be ineffective if contained in operating agreement), 17702.01(c); *see ¶ 6:80*]

The CRULLCA provisions that cannot be altered, as set forth below (¶ 6:105 ff.), are important, for any provisions not set forth below may be modified by way of the operating agreement. [See Corps.C. § 17701.10(b), (d)]

Specifically, the operating agreement may *not* do any of the following:

(1) [6:105] **Capacity to sue and be sued in own name:** The operating agreement may not vary the LLC's capacity to sue and be sued in its own name (Corps.C. § 17701.05(b)). [Corps.C. § 17701.10(c)(1)]

(2) [6:106] **California law as governing internal affairs and member/manager liability and authority:** The operating agreement may not vary the applicability of *California* law to:

• The LLC's *internal affairs*;

• The *liability* of a member as member and a manager as manager for the *LLC's debts, obligations or other liabilities*; or

• The *authority* of the LLC's members and agents. [Corps.C. § 17701.10(c)(2); see Corps.C. § 17701.06]

(3) [6:107] **Court order re signing of records:** Nor may the operating agreement vary the power of a court to order a person to sign or deliver a record for filing with the Secretary of State (Corps.C. § 17702.04). [Corps.C. § 17701.10(c)(3)]

(4) [6:108] **Fiduciary duties:** Except as set forth below (¶ 6:109 ff.), the operating agreement may not eliminate the members' or managers' fiduciary duties, including the duty of loyalty, or the contractual obligation of good faith and fair dealing toward the LLC and each other. Nor may the agreement eliminate or "unreasonably reduce" the members' duty of care. [Corps.C. § 17701.10(c)(4), (5), (14), (15); see Corps.C. § 17704.09]

(a) [6:109] **Modification of manager's and member's fiduciary duties:** A *manager's* fiduciary duties to a *manager*-managed LLC and its members may be modified, and a *member's* fiduciary duties to a *member*-managed LLC and its members may be modified, but only in a *written* operating agreement "with the *informed consent* of the members." The mere act of becoming a member, which ordinarily constitutes deemed assent to the operating agreement (Corps.C. § 17701.11(b)), is *not* informed consent. [Corps.C. § 17701.10(e) (emphasis added)]

1) [6:109.1] **Comment:** CRULLCA does not explain the concept of "informed consent" or how it is to be obtained or evidenced. "Informed consent" is likely to vary depending upon the circumstances.

- In the extreme example of the formation of an LLC whose sole manager is a designated professional management company that wishes to modify certain fiduciary obligations, it may be incumbent upon the manager (or its counsel) to explain in writing the consequences of the modification and obtain the members' written consent thereto.

- At the other extreme, where several individuals form a member-managed LLC and wish to give each other some flexibility in performing their duties (e.g., all members devote only part time to the LLC and pursue other activities), it is not clear how the members must evidence their mutual "informed consent" to the modification of their fiduciary duties. It may be adequate for the operating agreement merely to set forth the general risks that the members are assuming by virtue of the modification and to state that the members expressly consent thereto. (Of course, the risk of failing to evidence "informed consent" is that a member who seeks the benefit of a modified fiduciary duty may find the modification unenforceable.)

(b) [6:110] **Shifting of responsibilities among members:** The operating agreement of a member-managed LLC may shift a member's responsibilities under CRULLCA to one or more other members. In doing so, the operating agreement may also *limit* or even *eliminate* any fiduciary duty that would otherwise have pertained to any such responsibility. [Corps.C. § 17701.10(f)]

(c) [6:111] **Indemnification by LLC:** The operating agreement may *alter* or even *eliminate* a member's or manager's right to indemnification from the LLC for liabilities incurred in acting on behalf of the LLC. [Corps.C. § 17701.10(g)]

(d) [6:112] **Duty of care; member's/manager's liability to LLC:** The agreement may reduce—but not "unreasonably"—the duty of care. [Corps.C. § 17701.10(a)(15)]

The agreement may also *limit* or even *eliminate* a member's or manager's *liability to the LLC for money damages except* for:

- Breach of the duty of *loyalty*;

- A *financial benefit* received by the member or manager to which the member or manager is *not entitled*;

- A member's liability for *improper distributions* (Corps.C. § 17704.06, ¶ 6:338);

- *Intentional infliction of harm* on the LLC or a member; or

- *Intention* violation of *criminal* law. [Corps.C. § 17701.10(g)]

➪ [6:113] ***PRACTICE POINTER:*** The duty of care "is limited to refraining from engaging in grossly negligent or reckless conduct, intentional misconduct, or a knowing violation of law." Thus, unless the LLC agreement provides otherwise, mere negligence does not violate the duty of care. [Corps.C. § 17704.09(c); *see ¶ 6:520*]

This does not leave much room for "reasonable reduction." There are clearly public policy implications of relieving a manager or member based on conduct amounting to gross negligence or recklessness. [See Civ.C. § 1668—"all contracts which have for their object, directly or indirectly, to exempt anyone from responsibility for his own fraud, or willful injury to the person or property of another, or violation of law, whether willful or negligent, are against

the policy of the law"; *City of Santa Barbara v. Sup.Ct. (Janeway)* (2007) 41 C4th 747, 776-777, 62 CR3d 527, 551—release of liability for gross negligence unenforceable (personal injury case)]

Moreover, it is fairly predictable that courts will be reluctant to condone manager or member conduct that is beyond gross negligence or recklessness even if agreed to by the members. At a minimum, it can be expected that a court would closely examine the nature of any consent obtained from the members to satisfy itself the consent was "informed" before permitting any such relaxation of the duty of care. [See Corps.C. § 17701.10(e) (¶ 6:109)]

(e) [6:114] **Permitted modifications of duty of loyalty:** Although the operating agreement may not altogether eliminate the duty of loyalty, it may identify *specific types or categories of activities* that do *not* violate the duty, if not "manifestly unreasonable." The operating agreement may also specify the number or percentage of members that may *authorize or ratify*, after *full disclosure* to *all* members of all material facts, a specific act or transaction that would otherwise violate the duty of loyalty. [Corps.C. § 17701.10(c)(14)]

(f) [6:115] **Good faith and fair dealing—standards permitted:** Although the operating agreement may not eliminate the obligation of good faith and fair dealing, the agreement may prescribe the standards by which the performance of the obligation is to be measured so long as the standards are "not manifestly unreasonable" as determined at the time the standards are prescribed, and so long as the standards are agreed to "with the *informed consent* of the members." The mere act of becoming a member, which ordinarily constitutes deemed assent to the operating agreement (Corps.C. § 17701.11(b)), is *not* informed consent. [Corps.C. § 17701.10(c)(5), (e) (emphasis added); *see ¶ 6:109.1*]

(5) [6:116] **Member's rights to information and access to records:** The operating agreement may not vary a member's right to information about the LLC, to inspect LLC records, to receive an annual report, to receive information required to prepare tax returns, or any other rights under Corps.C. § 17704.10. [Corps.C. § 17701.10(d)(2)]

(a) [6:116.1] **Comment:** This should not be read to imply that a member's inspection and information rights are absolute. Corps.C. § 17704.10 itself states that these rights are restricted to "purposes reasonably related to the interest of that person as a member …" [Corps.C. § 17704.10(a), (b); *see ¶ 6:615, 6:616*]

(6) [6:117] **Dissolution of LLC:** The operating agreement may not vary the statutory provisions governing dissolution of an LLC (Corps.C. §§ 17707.01-17707.09), except "as stated therein." [Corps.C. § 17701.10(c)(7), (8); *see ¶ 6:780 ff.*]

(a) [6:118] **Permitted variations:** The provisions of Corps.C. §§ 17707.01 through 17707.09 that may be varied by the *written* operating agreement (or articles of organization) are:

- The vote required to commence voluntary dissolution (i.e., a vote of 50% or more of the members' voting interests may be required to commence dissolution) (Corps.C. § 17707.01(b), ¶ 6:786);
- The provisions granting reasonable compensation to the persons winding up the LLC's affairs (Corps.C. § 17707.04(c), ¶ 6:829); and
- The distribution of the LLC's assets to the members after the LLC's debts or liabilities have been paid or adequately provided for (Corps.C. § 17707.05(a), ¶ 6:840).

(7) [6:119] **Member's right to bring class or derivative action:** The operating agreement may not "unreasonably restrict" a member's right to bring a class action on behalf of members (Corps.C. § 17709.01, ¶ 6:710) or a derivative action (Corps.C. § 17709.02, ¶ 6:711 ff.). [Corps.C. § 17701.10(c)(9)]

(8) [6:120] **Approval of merger or conversion resulting in personal liability:** The operating agreement may not restrict a member's right to approve a conversion or merger if the member would have personal liability with respect to a surviving or converted entity. [Corps.C. § 17701.10(c)(10)]

(a) [6:121] **Comment:** Corps.C. § 17701.10(c)(10) appears redundant in that Corps.C. § 17701.10(c)(12) prohibits the operating agreement from varying *any* of the statutory provisions regarding mergers or conversions (Corps.C. § 17710.01 et seq., ¶ 6:900 ff.) except as those statutory provisions may permit. Where the LLC members would become personally liable for any obligations of the converted or surviving entity, approval by *all* of the members of the LLC is required unless the plan of conversion or merger agreement provides for dissenters' rights. [Corps.C. §§ 17710.03(b)(2) (conversions), 17710.12(a) (mergers)]

In prohibiting restrictions on a member's right to approve a merger or conversion that would result in the member's personal liability, it is not clear whether § 17701.10(c)(10) would give such members a veto right over the conversion

or merger even if the plan of conversion or merger agreement grants the members dissenters' rights. Section 17701.10(c)(10) would be wholly redundant if it did not, in effect, grant such a veto right. On the other hand, this veto right would nullify the "safety valve" of §§ 17710.03(b)(2) and 17710.12(a), which qualify their requirements for unanimous approval of a conversion or merger so long as the members are granted dissenters' rights.

(9) [6:122] **Third party rights:** The operating agreement may not restrict the rights under CRULLCA of a person other than a member or manager. But the operating agreement may restrict the obligations of the LLC and its members to a *transferee* or *dissociated* member (other than as CRULLCA may explicitly provide otherwise). [Corps.C. § 17701.10(c)(11); see Corps.C. §§ 17704.10(h), 17701.10(d)(2) (operating agreement may not modify transferee's information access rights), 17701.12(b)]

(10) [6:123] **Merger/conversion provisions:** The operating agreement may not vary any of the statutory provisions governing conversions and mergers (Corps.C. § 17710.01 et seq., ¶ 6:900 ff.), except as those provisions may specifically provide. [Corps.C. §§ 17701.10(c)(12), (d)(4), 17704.07(t)]

(11) [6:124] **Dissenters' rights:** The operating agreement may not vary any provision governing dissenters' rights (Corps.C. § 17711.01 et seq., ¶ 6:1050 ff.). [Corps.C. § 17701.10(c)(13)]

(12) [6:125] **Definitional sections:** CRULLCA contains various definitions of terms used in the law, ranging from "acknowledged" to "vote" (Corps.C. § 17701.02). The operating agreement may not vary these definitions except as the definitions may specifically provide. [Corps.C. § 17701.10(d)(1)]

(13) [6:126] **No amendment of articles by less than majority of interests in current profits:** *See ¶ 6:302*.

[6:127 - 6:129] ***Reserved.***

c. [6:130] **Compare—statutory provisions that may be varied by *written operating agreement:*** As set forth below (¶ 6:131 ff.), certain statutory provisions, other than the "prohibited provisions" set forth in ¶ 6:104 ff., may be varied as among the members or as between the members and the LLC by the operating agreement, but only if the agreement is *in writing*. [Corps.C. § 17701.10(d)]

(1) [6:131] **Member or manager as agent of LLC:** The written operating agreement may vary the requirements of Corps.C. § 17703.01, which gives members and managers the authority to act for and bind the LLC. [Corps.C. § 17701.10(d)]

(2) [6:132] **Internal governance provisions:** Corps.C. § 17704.07 sets forth extensive internal governance rules for LLCs. The provisions of Corps.C. § 17704.07(s) (amendment of articles of organization; *see ¶ 6:302*) and (t) (voting on dissolution or merger; *see ¶ 6:123*) may *not* be varied. [Corps.C. § 17701.10(d)(4)]

But a *written* operating agreement may vary the provisions of:

- Corps.C. § 17704.07(f) through (r), dealing with meetings and actions by written consent of the members, including place of meetings, notice of meetings, who may call meetings, quorum requirements, adjournment, proxies, record date for determining membership interests, voting by classes, etc. (*see ¶ 6:240 ff.*); and

- Corps.C. § 17704.07(u) through (w), dealing with the appointment and powers of LLC officers (*see ¶ 6:560 ff.*). [Corps.C. § 17701.10(d)]

(All other provisions of Corps.C. § 17704.07—i.e., Corps.C. § 17704.07(a) through (e) dealing generally with management of the LLC—may be varied by an operating agreement that need not be in writing.)

(3) [6:133] **Indemnification and insurance:** A written operating agreement may modify the requirements of Corps.C. § 17704.08, which provides for indemnification of members, managers, employees and agents for obligations incurred in the LLC's operations, and which allows the LLC to obtain liability insurance on behalf of such persons. [Corps.C. § 17701.10(d); *see ¶ 6:541 ff.*]

(4) [6:134] **Principal office; agent for service of process; information to be kept at office?** Corps.C. § 17701.10(d) expressly states that the written operating agreement may vary § 17701.13, which governs the LLC's office, agent for service of process, and the documents required to be maintained by an LLC. However, this provision directly contradicts Corps.C. § 17701.10(c)(6), which prohibits the operating agreement from varying the requirements of Corps.C. § 17701.13. [Corps.C. § 17701.10(d); see Corps.C. § 17701.10(c)(6)]

[6:135 - 6:139] ***Reserved.***

d. [6:140] **Optional provisions; forms:** The operating agreement generally sets forth the relation of the members to each other and to the LLC and usually contains many provisions not required by CRULLCA. Some of those are described below (¶ 6:142 ff.).

• ***FORMS***

— Single-Member Operating Agreement, *see Form 6:A*.

— Single-Member Operating Agreement Additional and Alternative Provisions, *see Form 6:B*.

— Multi-Member Operating Agreement, *see Form 6:C*.

— Additional and Alternative Provisions, *see Forms 6:C.1 ff.*

[6:141] ***Reserved.***

(1) Litigation and arbitration of disputes with members

(a) [6:142] **Consent to jurisdiction of specified court:** A *written* operating agreement (or other writing) may also provide that its members are subject to the *exclusive* jurisdiction of the California courts, or to the *nonexclusive* jurisdiction of the courts of a specified jurisdiction and the California courts. [Corps.C. § 17701.17(a)]

(b) [6:143] **Consent to arbitration:** A *written* operating agreement (or other writing) may also provide for arbitration of a dispute with a member. Arbitration may be *exclusively* in California or *nonexclusively* in another state or states and California. [Corps.C. § 17701.17(b)]

(c) [6:144] **Consent to specified service of process:** A member may consent to be served with process in the manner prescribed in the *written* operating agreement (or other writing). [Corps.C. § 17701.17(c)]

(2) [6:145] **Classes of members:** The operating agreement (or the articles of organization) may provide for the creation of classes of members having those relative rights, powers and duties as the articles (or operating agreement) may provide, including rights, powers and duties senior to other classes of members. [Corps.C. § 17712.01]

(3) [6:146] **Personal guaranty of LLC obligations:** Ordinarily, LLC members are not personally liable for LLC debts, liabilities or other obligations. [Corps.C. § 17703.04(a)]

Of course, banks or other financial institutions frequently will not lend money to an LLC unless the LLC members personally guarantee the debt. Similarly, landlords often will not enter into a lease with an LLC unless the LLC members personally guarantee the rent payments. If the LLC anticipates obtaining loans or other financing, or leasing property, it may wish to include a provision in the *written* operating agreement (or the articles of organization) whereby the members agree (up to a specified maximum amount) to personally guarantee the LLC's obligations. Without such a provision, LLC members may still personally guarantee LLC debt *if they individually choose to do so*. But some members may balk at so doing. [Corps.C. § 17703.04(c), (e); see ¶ 6:211]

➪ [6:147] ***PRACTICE POINTER:*** The operating agreement may provide that, if a lender or landlord demands personal guaranties, the members agree to personally guarantee LLC debt in proportion to their membership interests. However, a lender or landlord will generally insist that the guaranty be *joint and several*. The operating agreement may give members who pay on a joint and several guaranty rights to contribution from the other members.

[6:148] ***Reserved.***

e. [6:149] **Effective as to new members and transferees:** A person who becomes an LLC member (*see ¶ 6:150*) is deemed to assent to the operating agreement. [Corps.C. § 17701.11(b)]

The operating agreement governs the obligations of the LLC and its members to a transferee or dissociated member. [Corps.C. § 17701.12(b); see Corps.C. § 17701.10(c)(11)]

➪ [6:150] ***PRACTICE POINTER:*** Ordinarily, a person becomes a member as provided in the operating agreement or as agreed between the person and the LLC's organizers. [Corps.C. § 17704.01(a), (b), (c)(1)]

Prudence dictates that a person's membership in the LLC be memorialized by having the person sign the operating agreement, a separate joinder to the operating agreement, or a subscription or purchase agreement in which the person agrees to make their capital contribution and agrees to be bound by the operating agreement. *See* ¶ 6:200 ff.

f. [6:151] **Inconsistencies between operating agreement and documents filed with Secretary of State:** Where a provision in a document filed with the Secretary of State is inconsistent with the operating agreement, the *operating agreement* nonetheless prevails as to *members, managers, dissociated members* and *transferees*. However, the *filed document* prevails as to *other persons* to the extent they reasonably rely on it. [Corps.C. § 17701.12(d)]

In any event, provisions contained in a filed document that would be ineffective if contained in the operating agreement (i.e., statutory provisions that may not be eliminated or varied by the operating agreement; *see ¶ 6:104 ff.*) are likewise ineffective. [Corps.C. § 17701.12(c)]

[6:152 - 6:159] ***Reserved.***

3. [6:160] **Formation by Conversion from Other Entity:** An LLC may be formed by the conversion of a California general partnership, limited partnership or corporation into an LLC. An LLC may also be formed by the conversion of another California business entity, or a foreign business entity into an LLC, if the California or foreign entity is authorized by the laws under which it is organized to effect the conversion. [Corps.C. § 17710.08(a)]

[6:161] ***Reserved.***

a. General provisions governing conversion

(1) [6:162] **Plan of conversion:** An entity that desires to convert into an LLC must approve a plan of conversion or the instrument that is required to be approved to effect the conversion pursuant to the laws under which the entity is organized. [Corps.C. § 17710.08(b)]

(2) [6:163] **Approval of conversion:** The conversion must be approved by the number or percentage of partners, shareholders or holders of interest of the converting entity as is required by the laws under which the entity is organized, or such other percentage (subject to applicable law) as may be set forth in the converting entity's "charter" documents (e.g., partnership agreement or articles of incorporation). [Corps.C. § 17710.08(c)]

(3) [6:164] **Effective date of conversion:** The conversion is effective at the time set forth under the laws under which the converting entity is organized so long as the articles of organization containing a statement of conversion have been filed with the Secretary of State. If the converting entity's governing law is silent as to the effectiveness of the conversion, the conversion is effective upon the completion of all acts required under CRULLCA to form an LLC. [Corps.C. § 17710.08(d)]

• ***FORM:*** The Secretary of State's standard form Limited Liability Company Articles of Organization—Conversion (LLC-1A) is available online at the Secretary of State's website (*www.sos.ca.gov*).

(a) [6:165] **Filing fee:** If the converting entity is a California corporation, the filing fee is $150 (plus a $15 special handling fee if the document is delivered personally to the Secretary of State's office). For all other conversions, the filing fee is $70 (plus the special handling fee when applicable). [Gov.C. § 12184(a), Secretary of State Instructions; 2 CCR § 21903(c)]

(4) [6:166] **Conversion from foreign entity transacting business in California—certificate of cancellation not required:** If a foreign *limited partnership* or *LLC* that is authorized to transact business in California converts into a California LLC, the filing of articles of organization containing a statement of conversion has the effect of the filing of a certificate of cancellation (*see ¶ 6:855 ff.*) by the converting foreign limited partnership or LLC. No separate certificate of cancellation is required. [Corps.C. § 17710.08(e)]

If a foreign *corporation* that is qualified to transact business in California converts into a California LLC, the filing of articles of organization containing a statement of conversion, has the effect of an automatic surrender of the foreign

corporation's right to transact business in California. (I.e., the foreign corporation's qualification to do business in California is surrendered.) [Corps.C. § 17710.08(e)]

[6:167] ***Reserved.***

b. Provisions specific to converting entity

(1) [6:168] **Conversion from general partnership:** *See* ¶ 3:650 ff.
(2) [6:169] **Conversion from limited partnership:** *See* ¶ 5:740 ff.
(3) [6:170] **Conversion from corporation:** See Friedman, Soza & Jann, *Cal. Prac. Guide: Corporations* (TRG), Ch. 8.

4. [6:171] **Selection of Fiscal Year:** For the tax rules governing the selection by an LLC of its fiscal year, *see* ¶ *8:121 ff.*

5. [6:172] **Designation of "Partnership Representative":** Like a general or limited partnership, an LLC is required to designate a "partnership representative" (known prior to 2018 as the "tax matters partner") to deal with any IRS challenges or audits. [IRC § 6223(a); *see* ¶ *3:130, 8:250 ff.*]

[6:173 - 6:199] ***Reserved.***

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Chapter 6. Limited Liability Company

C. Members

[6:200] The rights and obligations of the LLC members (owners) can be as simple or complex as desired. Unless the rights and obligations are extremely simple, they are usually set forth in some detail in the operating agreement.

[6:201 - 6:202] ***Reserved.***

1. How Person Becomes Member

a. At LLC formation

(1) [6:203] **One-member LLC:** If the LLC is to have only one member upon formation, the person becomes a member as agreed by that person and the organizer of the LLC. The person and the organizer may, but need not, be different persons. If different, the organizer acts on behalf of the initial member. [Corps.C. § 17704.01(a)]

(2) [6:204] **Multiple-member LLC:** If the LLC is to have more than one member upon formation, those persons become members as agreed by them before formation of the LLC. [Corps.C. § 17704.01(b)]

The organizer acts on behalf of the persons in forming the LLC and may, but need not, be one of those persons. [Corps.C. § 17704.01(b)]

b. [6:205] **After LLC formation—ordinarily, as set forth in operating agreement or with all members' consent:** After formation of the LLC, a person becomes a member in the manner set forth in the *operating agreement*, or as the result of a *conversion* from another business entity or a *merger* with another business entity. [Corps.C. § 17704.01(c)(1), (2)]

Where an LLC *ceases to have any members*, the last person to have been a member, or their legal representative, may, within 90 days after the LLC ceases to have any members, designate a person to become a member. The person becomes a member upon consent to becoming a member. [Corps.C. § 17704.01(c)(4)]

In all other situations—notably, where the operating agreement is silent on how a person becomes a member—a person becomes a member with the consent of *all* members. [Corps.C. § 17704.01(c)(3)]

c. [6:205.1] **Equity incentive compensation plans and options:** *See ¶ 6:728 ff.*

d. [6:206] **No contribution required:** A person may become a member without making or being required to make a contribution to the LLC. Nor need a person acquire an existing member's transferable interest to become a member. [Corps.C. § 17704.01(d)]

➪ [6:207] ***PRACTICE POINTER:*** Although capital contributions are not required, members of an LLC that is thinly capitalized may be personally liable for LLC obligations under the alter ego doctrine. [Corps.C. § 17703.04(b); *see ¶ 6:213*]

2. [6:208] **Classes of Members:** The articles or the operating agreement may provide for the creation of classes of members having those relative rights, powers and duties as the articles or operating agreement may provide, including rights, powers and duties senior to other classes of members. [Corps.C. § 17712.01]

3. [6:209] **Ordinarily, No Liability for LLC Obligations:** The major advantage of the LLC is that, like a corporation, the owners may limit their liability to their ownership interests. LLC members are not liable for LLC debts, obligations or other liabilities except in limited circumstances as set forth below (¶ 6:211 ff.). I.e., liability for LLC obligations is the exception and not the rule. And the exceptions generally parallel those applicable to corporate shareholders. [Corps.C. § 17703.04(a); see *Curci Investments, LLC v. Baldwin* (2017) 14 CA5th 214, 220-221, 221 CR3d 847, 850-851; *CB Richard Ellis, Inc. v. Terra Nostra Consultants* (2014) 230 CA4th 405, 411, 178 CR3d 640, 644; *Kwok v. Transnation Title Ins. Co.* (2009) 170 CA4th 1562, 1571, 89 CR3d 141, 147]

[6:210] ***Reserved.***

a. Exceptions—members liable for LLC obligations

(1) [6:211] **Liability by guaranty or other express agreement:** LLC members may be personally liable for the LLC's obligations if they entered into a *written* guaranty of the obligations or similar contract with a third party. [See Corps.C. § 17703.04(c)]

LLC members may also be personally liable for all or any of the LLC's debts, obligations or liabilities if they so agree in the articles of organization or *written* operating agreement. [Corps.C. § 17703.04(e)]

(2) [6:212] **Tortious conduct:** Of course, an LLC member may be liable to third parties for the member's participation in *tortious conduct* causing injury to the third parties. [Corps.C. § 17703.04(c)]

(3) [6:213] **"Alter ego" liability:** A member may also be liable for an LLC's obligations under the common law "alter ego doctrine" to the same extent as a corporate shareholder (i.e., the alter ego doctrine applies equally to LLCs) … except that the failure to hold or observe formalities pertaining to LLC member or manager meetings is not a factor establishing alter ego liability if the LLC's articles or operating agreement do not expressly require such meetings. [Corps.C. § 17703.04(b); see *Capon v. Monopoly Game LLC* (2011) 193 CA4th 344, 357, 122 CR3d 536, 546 & fn. 12; *People v. Pacific Landmark* (2005) 129 CA4th 1203, 1212, 29 CR3d 193, 199; *Walsh v. Kindred Healthcare* (ND CA 2011) 798 F.Supp.2d 1073, 1082 (applying Calif. law); see also *Warburton/Buttner v. Sup.Ct. (Tunica-Biloxi Tribe of La.)* (2002) 103 CA4th 1170, 1187-1188, 127 CR2d 706, 720—discovery relating to alter ego doctrine may be permitted against LLC owned by native American tribe (not resolving sovereign immunity issue)]

(a) [6:214] **Requirements:** As in the corporate alter ego doctrine, the LLC entity may be disregarded (the veil "pierced") and the members held personally liable for LLC debts when:

- The members disregarded the LLC, treating the LLC as their "alter ego" rather than as a separate entity; *and*
- Upholding the LLC form and allowing the members to escape personal liability for the LLC's debts would perpetrate a fraud, circumvent a statute or promote an injustice. [See *Capon v. Monopoly Game LLC* (2011) 193 CA4th 344,

356-358, 122 CR3d 536, 546-547—alter ego doctrine may not be used to allow persons who control LLC to disregard LLC as separate entity; *Walsh v. Kindred Healthcare* (ND CA 2011) 798 F.Supp.2d 1073, 1082; see also *LSREF2 Clover Property 4, LLC v. Festival Retail Fund 1, LP* (2016) 3 CA5th 1067, 1081, 208 CR3d 200, 212]

(b) [6:215] **Amending judgment to add alter ego as judgment debtor:** Upon motion, a judgment against an LLC may be amended to add as a judgment debtor a *nonparty* alter ego who *controlled* the underlying litigation and whose interests were therefore represented in the lawsuit. This is an "equitable procedure" based on the theory that, because the alter ego controlled the underlying litigation to represent its own interests, the court is simply inserting the "correct name of the real defendant" rather than adding a "new defendant." [*Highland Springs Conference & Training Ctr. v. City of Banning* (2016) 244 CA4th 267, 280, 199 CR3d 226, 235]

(c) [6:216] **Reverse piercing to add controlled LLC as judgment debtor:** "Reverse piercing" may be available to allow a creditor of an LLC member to reach the LLC's assets where there are no innocent LLC members who would be prejudiced thereby. It is an equitable doctrine available when the ends of justice so require, and is most commonly used to add an entity controlled by a judgment debtor where there is an existing judgment against the debtor. Where an LLC member has consistently evaded its obligations to a creditor, allowing reverse piercing would provide the creditor with a more viable remedy than traditional collection procedures. [*Curci Investments, LLC v. Baldwin* (2017) 14 CA5th 214, 222-221, 221 CR3d 847, 850-851 (husband and wife debtors who held all membership interests of LLC formed as vehicle for holding and investing debtor's money made no payments on creditor's $5.5 million promissory note for 5 years while distributing $178 million to husband and wife); *Blizzard Energy, Inc. v. Schaefers* (2021) 71 CA5th 832, 846-847, 286 CR3d 658, 669-670—charging order against distributions to LLC member is not judgment creditor's exclusive remedy (Corps.C. § 17705.03 "does not preclude reverse veil piercing to add the LLC as a judgment debtor")]

Cross-refer: For a comprehensive discussion of the alter ego doctrine as applied to corporations, see Friedman, Soza & Jann, *Cal. Prac. Guide: Corporations* (TRG), Ch. 2.

[6:217 - 6:219] ***Reserved.***

(4) [6:220] **"Responsible person" tax liabilities:** Certain tax statutes impose *personal* liability upon an LLC member who is responsible for filing returns and paying taxes. For example:

(a) [6:221] **Federal taxes:** A person who is "responsible" for the LLC's payroll or financial affairs and who has authority to disburse LLC funds may be *personally liable* for willfully failing to collect and pay federal taxes, such as employment withholding, including FICA or FUTA (unemployment) taxes. [IRC § 6672; Treas.Reg. § 301.6672-1; see *Kaplan v. United States* (2014) 115 Fed.Cl. 491, 493-494]

Cross-refer: For a more detailed discussion of federal "responsible person" tax liability, see Friedman, Soza & Jann, *Cal. Prac. Guide: Corporations* (TRG), Ch. 6.

(b) [6:222] **State unemployment insurance contributions:** A person having charge of an LLC's affairs and who *willfully fails* to pay required contributions to the State Unemployment Fund may be personally liable for the required amount, together with interest and any penalties thereon. [Unemp.Ins.C. § 1735]

(c) [6:223] **State sales taxes:** Upon termination, dissolution or abandonment of the LLC, a person who had control or supervision of, or responsibility for, paying the LLC's sales and use taxes may be personally liable for any taxes (and interest and penalties) that he or she *willfully failed to pay.* [Rev. & Tax.C. § 6829; *see ¶ 6:833*]

b. [6:224] **Insurance/guarantee where required by law:** LLCs are required to carry insurance (or provide an undertaking) to the same extent as is required by any California law, rule or regulation that would apply if the LLC were a corporation. [Corps.C. § 17703.04(d)]

c. [6:225] **Caution—operating agreement may not vary applicability of California law:** The operating agreement may not vary the applicability of California law to the liability of members (and managers) for the LLC's obligations; *see ¶ 6:106*.

[6:226 - 6:229] ***Reserved.***

4. [6:230] **Capital Contributions:** A member need not make a capital contribution to the LLC (*see ¶ 6:206*). In any event, the permissible consideration for contributions is very broad: A contribution may consist of tangible or intangible property or

other benefit, including money, services performed, promissory notes, other agreements to contribute money or property, and contracts for services to be performed. Thus, any "benefit" to the LLC will qualify. [Corps.C. §§ 17704.01(d), 17704.02]

a. [6:231] **Allocation of profits and losses according to contributions:** Unless the operating agreement provides otherwise, the LLC's profits and losses are allocated among the members in proportion to the *value of the members' contributions* (as stated in the LLC's required records; *see* ¶ *6:604*). [Corps.C. § 17704.04(e)]

b. [6:232] **Failure to make contribution excused by members' unanimous vote:** Where a person agreed to make a contribution, the obligation to make the contribution may be compromised only by the consent of *all* members (unless the operating agreement provides otherwise). The obligation is not excused by the person's death, disability or other inability to perform personally. The person or the person's estate is obligated to contribute money equal to the value of the unpaid contribution, at the option of the LLC. [Corps.C. § 17704.03(a), (b)]

(1) [6:233] **Comment:** The reference to the "option" of the LLC is confusing because no option is presented. Presumably the option is requiring the making of an in-kind contribution, if promised by the member, or the payment of money equal to the value of the unpaid in-kind contribution.

c. [6:234] **Conditional contribution:** A contribution may be conditional upon the occurrence of a certain event, or on the call of the LLC (as where the LLC needs additional capital and the operating agreement gives the LLC authority to require the members to "pony up" additional funds). In any event, a conditional obligation to make a contribution may not be enforced unless the condition has been satisfied or, alternatively, *waived* by the member. [Corps.C. § 17704.03(b)]

d. [6:235] **Creditors' enforcement of required contributions:** A creditor of the LLC that extends credit or otherwise acted in reliance on a member's obligation to make a contribution may enforce the obligation. Creditors also have the ability to seek equitable remedies or other rights under the Uniform Voidable Transactions Act (Civ.C. § 3439 et seq.). [Corps.C. § 17704.03(c), (d)]

[6:236 - 6:239] ***Reserved.***

5. [6:240] **Meetings and Actions:** CRULLCA contains extensive provisions governing meetings and actions of LLC members. These provisions can be modified by the operating agreement. Indeed, they are frequently modified drastically, or even eliminated, in small LLCs having only a few members.

a. [6:241] **Regular meetings not required:** Unlike a corporation, which is required to hold at least annual meetings of shareholders and directors, and which generally holds more frequent meetings of directors, LLCs are not required to hold any regular meetings of members or managers. Of course, the LLC may choose to do so in its operating agreement.

➪ [6:242] ***PRACTICE POINTER:*** It is better to forgo *regular* meetings unless the members affirmatively feel otherwise. If the operating agreement provides for regular meetings, the failure to hold such meetings could be one factor in determining alter ego liability. [Corps.C. § 17703.04(b), ¶ 6:213]

b. [6:243] **Place:** The *written* operating agreement or articles of organization may set the location of meetings. If neither the operating agreement nor the articles set the location, meetings shall be held at the LLC's principal office. [Corps.C. § 17704.07(f)]

c. [6:244] **Electronic meetings permitted:** Unless prohibited by the articles of organization, the operating agreement may permit meetings of members to be held electronically in whole or in part. Electronic meetings may be conducted by means of conference telephone, video screen communication or posting on an electronic message board or network so long as all members participating in the meeting can *hear* one another or, alternatively, concurrently communicate with one another by way of electronic message. All members must have a reasonable opportunity to participate in the meeting and to vote on matters submitted to the members. A record of the vote must be maintained by the LLC. Participation in a meeting by video or other electronic means, whether by the actual member or the member's proxy, constitutes presence in person at the meeting. [Corps.C. § 17704.07(f), (k), (q); see Corps.C. § 17701.02(i)]

➪ [6:245] ***PRACTICE POINTER:*** The Code provisions for electronic meetings are not well drafted and could be subject to various interpretations. To avoid potential disputes, members who desire electronic meetings should set forth the methods of conducting electronic meetings in the operating agreement. This is especially important in a time when electronic technology is constantly evolving, and some members may be more "computer savvy" and have more sophisticated communications equipment than other members.

d. [6:246] **Who may call:** Meetings may be called for the purpose of addressing any matters on which the members may *vote*. [Corps.C. § 17704.07(g)]

(1) [6:247] **Call by manager:** In a manager-managed LLC, a meeting of the members may be called by *any manager*. [Corps.C. § 17704.07(g); see Corps.C. § 17701.02(n)—"manager" applies only in manager-managed LLC]

(2) [6:248] **Call by members:** A meeting may also be called by any member or members owning *more than 10%* of the members' interest in current profits. [Corps.C. § 17704.07(g)]

(3) [6:249] **Request to manager (manager-managed LLC):** In a manager-managed LLC, the request for a members' meeting may be directed to a manager. The request should specify the time and date of the meeting, which must be not less than 10 days nor more than 60 days after the manager receives the notice. The manager is then to give notice of the meeting to the members (*see ¶ 6:252 ff.*). If the manager fails to do so within 20 days after receipt of the request, the person calling the meeting may give the notice or may apply to the superior court of the county in which the LLC's principal office is located for an order requiring the LLC to give the notice. [Corps.C. § 17704.07(h)(5); see Corps.C. § 17701.02(n)—"manager" applies only in manager-managed LLC]

(a) [6:250] **Comment:** In a manager-managed LLC, it is not clear whether a *manager* calling a meeting may direct another manager to give notice of the meeting. The procedures to be followed by the managers in a multi-manager LLC should be addressed in the operating agreement.

[6:251] ***Reserved.***

e. Notice

(1) [6:252] **When given:** Notice of a members' meeting must be given to each member entitled to vote *not less than 10 days nor more than 60 days* before the date of the meeting. [Corps.C. § 17704.07(h)(1)]

(2) [6:253] **Contents:** The notice must state the *place*, *date* and *hour* of the meeting and the *general nature of the business to be transacted*. No other business may be transacted at that meeting. If the meeting is to be conducted electronically, the notice must set forth the *means of electronic transmission* to be used. [Corps.C. § 17704.07(h)(1), (*l*)]

(3) [6:254] **How given:** The notice must be in *writing* and must be given personally, by electronic transmission or by mail. If given by mail, the notice must be addressed to the member at the address appearing on the LLC's books or the address given by the member to the LLC for the purpose of notice. If no address appears on the LLC's books or if the member has given no address to the LLC, the notice may be given at the LLC's principal office or, alternatively, by publication at least once in a newspaper of general circulation in the county in which the principal office of the LLC is located. [Corps.C. § 17704.07(h)(1), (2)]

The notice is deemed given when delivered personally, by electronic transmission, deposited in the mail, or sent by other means of written communication. An affidavit of mailing or delivery by electronic transmission of the notice, executed by a manager, is prima facie evidence of the giving of the notice. [Corps.C. § 17704.07(h)(2), (4); see Corps.C. § 17701.02(i)]

(a) [6:255] **Notice returned without delivery:** If a notice addressed to the member at the address appearing on the LLC's books is returned by the U.S. Postal Service marked to indicate that the Postal Service was unable to deliver the notice at that address, all future notices are deemed duly given without further mailing if they are available for the member at the LLC's principal office for a period of one year from the date of the giving of the notice (¶ 6:254) to all other members. [Corps.C. § 17704.07(h)(3)]

(b) [6:256] **Electronic notice:** Special requirements apply to electronic notice. [Corps.C. § 17704.07(h)(4)]

Electronic notice is valid if given by facsimile telecommunication (fax) or electronic mail (email) to the respective fax number or email address for the member on record with the LLC. [Corps.C. §§ 17701.02(i)(1)(A), 17704.07(h)(4)] Alternatively, electronic notice may be made by posting the notice on an electronic message board or network designated by the LLC for the purpose of giving notice of members' meetings, together with a separate notice to the member. Transmission is validly delivered upon the *later* of the (i) posting or (ii) delivery of the separate notice. [Corps.C. § 17701.02(i)(1)(B)]

Other means of electronic notice may be given so long as (i) the member provided an unrevoked *consent* to the use of that means and (ii) the communication creates a *record* capable of retention, retrieval and review and that may thereafter be rendered into clearly legible, tangible form.

1) [6:257] **No electronic notice if undeliverable:** Electronic notice is not valid if the LLC is unable to deliver two consecutive notices to the member by that means or its inability to deliver notice by electronic means becomes known to the person responsible for the giving of notice. [Corps.C. § 17704.07(h)(4)]

[6:258 - 6:260] ***Reserved.***

(4) Waiver of notice

(a) [6:261] **By attendance:** A member's attendance at a meeting constitutes a waiver of notice of the meeting *unless* the member objects, at the beginning of the meeting, to the transaction of any business because the meeting is not lawfully called or convened. Attendance at a meeting is not, however, a waiver of any right to object to the consideration of matters required by CRULLCA to be included in the notice of meeting but not so included, so long as the member objects expressly to such deficiency at the meeting. [Corps.C. § 17704.07(j)]

(b) [6:262] **By express waiver:** A member who is not present at the meeting (either in person or by proxy) may expressly waive notice of the meeting either before or after the meeting. A written waiver need *not* state the business to be transacted at the meeting or the purpose of the meeting *unless* the articles of organization or the operating agreement requires otherwise, or unless the action was approved at the meeting less than unanimously. [Corps.C. § 17704.07(j)]

Likewise, a member who did not attend the meeting is deemed to have waived notice by *consenting* to the holding of the meeting or *approving the minutes* in *writing*. [Corps.C. § 17704.07(j)]

1) [6:263] **Retention of waiver in LLC's records:** All such waivers, consents and approvals must be filed with the LLC's records or made part of the minutes of the meeting. [Corps.C. § 17704.07(j)]

➪ [6:264] ***PRACTICE POINTER:*** As noted at ¶ 6:253, notice of the members' meeting must state the general nature of the business to be transacted. Actions approved at a meeting of members, other than by unanimous approval, are valid only if the general nature of the proposal so approved was stated in the notice of meeting *or in any written waiver of notice*. (Since most substantive matters are not usually approved unanimously, a written waiver should state the general nature of the proposals to be submitted for approval at the meeting.) [Corps.C. § 17704.07(*l*)]

f. [6:265] **Quorum:** A quorum is necessary to transact business or take or approve any action at the meeting. A quorum consists of members holding more than 50% of the interests in current profits (unless the operating agreement provides otherwise). [Corps.C. § 17704.07(m)(1); see Corps.C. § 17701.02(m)]

(1) [6:266] **Loss of quorum during meeting:** The members present at a meeting may continue to transact business notwithstanding loss of a quorum (i.e., by the departure of members during the meeting) so long as any action taken after loss of a quorum (other than adjournment) is approved by the requisite percentage of interests of members. [Corps.C. § 17704.07(m)(2)]

(2) [6:267] **Effect of lack of quorum:** Absent a quorum, the meeting may be adjourned by the vote of a majority of the *interests represented at the meeting* either in person or by proxy. No other business may be transacted unless approved by the requisite percentage of member interests (¶ 6:265). [Corps.C. § 17704.07(m)(3)]

g. [6:268] **Adjournments:** Unless the articles of organization or *written* operating agreement provide otherwise, no notice need be given of an adjourned meeting so long as the time and place of the adjourned meeting (or the means of electronic transmission or video screen communication, if applicable) are announced at the meeting. Any business that may have been transacted at the original meeting may likewise be transacted at the adjourned meeting. [Corps.C. § 17704.07(i)]

(1) [6:269] **Exception requiring new notice:** A notice of the adjourned meeting must be given to all members entitled to vote at the meeting when the adjournment is *for more than 45 days* or when, after the adjournment, a *new record date* is fixed for the adjourned meeting. [Corps.C. § 17704.07(i)]

h. [6:270] **Action by written consent in lieu of meeting:** Any action that may be taken at a meeting of the members may be taken without a meeting if a *written* consent setting forth the action is signed and delivered to the LLC within 60 days of the record date for that action by members having not less than the minimum number of votes that would be necessary to authorize or take that action at a members' meeting. [Corps.C. § 17704.07(n)(1)]

(1) [6:271] **Notice of action to nonconsenting members:** Unless the consents of all members entitled to vote were solicited in writing, "prompt" notice of any member action taken by written consent must be given to all members who did not execute such consents. [Corps.C. § 17704.07(n)(2)]

(a) [6:272] **Matters requiring notice *before action taken:*** Moreover, where the action taken is the approval of certain transactions, such notice must be given to all unsolicited and nonconsenting members at least 10 days before consummation of the transaction (in order to give them the opportunity to challenge the action). [Corps.C. § 17704.07(n)(2)]

The transactions requiring such special notice are:

- Amendment of the articles of organization or operating agreement;
- Dissolution of the LLC (Corps.C. § 17707.01, ¶ 6:786); or
- Merger (Corps.C. § 17710.10, ¶ 6:956). [Corps.C. § 17704.07(n)(2)]

(2) [6:273] **Right to revoke written consent:** A member, or the member's proxyholder, may revoke written consent by notice to the LLC any time *before* the LLC receives sufficient consents from other members to authorize the transaction, but not thereafter. [Corps.C. § 17704.07(n)(3)]

i. [6:274] **Proxies—applicability of corporate law:** The use of proxies in connection with management, meetings, approvals and consents is the same as in the case of corporations under the General Corporation Law (Corps.C. § 100 et seq.). [Corps.C. § 17704.07(o)]

These provisions can be altered by the articles of organization or a written operating agreement. [Corps.C. § 17701.10(d); *see* ¶ *6:118, 6:132*]

Caution: The paragraphs below (¶ 6:275 ff.) describe the provisions of corporate law regarding proxies. There are some distinctions between corporations and LLCs with respect to proxies; and it is not clear whether certain corporate law provisions are truly intended to apply to LLCs.

(1) [6:275] **Members' right to use proxy:** Every member entitled to vote has the right to authorize another person to vote his or her membership interest by proxy. [See Corps.C. § 705(a)]

(a) [6:276] **Operating agreement may provide otherwise:** Corporate articles or bylaws cannot eliminate or alter the right of shareholders to utilize proxies. But statutory provisions regarding proxies are not among the provisions that may not be altered by an operating agreement (*see* ¶ *6:118, 6:132*). Consequently, it would appear that the operating agreement may limit the use of proxies, or even bar them altogether.

(2) [6:277] **LLCs with 100 or more members:** There are additional requirements when the LLC solicits proxies from 10 or more members of an LLC having 100 or more members: The proxy form must afford the member the opportunity to *choose* between *approval or disapproval* of each matter or group of matters intended to be acted upon at the meeting for which the proxy is solicited. It must also provide, "subject to reasonable specified conditions," that where the person solicited specifies a choice with respect to any such matter, the member's interest will be voted in accordance therewith. [Corps.C. § 604(a)]

(3) [6:278] **Duration of proxy:** A proxy is valid for *whatever period of time is stated therein*, subject to the member's right to revoke (¶ 6:281 ff.). [Corps.C. § 705(b)]

If *no* time period is stated in the proxy, it expires automatically *11 months* after execution. [Corps.C. § 705(b)]

(4) [6:279] **Proxyholder as trustee or pledgee?** Normally, proxies are voluntary. However, under corporate law, a person holding title to shares on behalf of another, or solely as security for an obligation owed by the other, may be compelled to give a proxy to the other unless they have agreed otherwise. [Corps.C. § 705(d)]

CRULLCA recognizes the ability of a trust or trustee to be a member, and thus a trustee may vote the trustor/member's membership interest. [See Corps.C. §§ 17701.02(p) ("member" defined), (v) ("person" defined), 17706.01(b)(2)(D), 17706.02(h), (j)]

But while the LLC recognizes pledges and transfers for security purposes, a *pledgee* does *not* have power to vote the pledgor's membership interest. It would thus appear that the LLC provisions governing transferable interests would supersede corporate law provisions allowing pledgees to vote membership interests (unless, of course, the operating agreement allows such persons to vote a member's interest). [See Corps.C. §§ 705(d), 17705.02(b); see also Corps.C.

§ 17706.02(d)(2)(A); see also *In re Lake County Grapevine Nursery Operations* (BC ND CA 2010) 441 BR 653, 655 (*discussed further at ¶ 6:375*)]

[6:280] ***Reserved.***

(5) Revocability of proxy

(a) [6:281] **Revocation by member:** Unless irrevocable (¶ 6:283), a member can revoke his or her proxy any time before the membership interest is voted. Such revocation is effected by:

- A *writing* delivered to the LLC stating that the proxy is revoked;
- Executing a *new proxy* at a later date; or
- Simply *attending the meeting* for which the proxy was given and *voting* the shares personally. (Such attendance revokes a proxy only for the meeting that was attended. An otherwise unexpired proxy continues in effect for later meetings not attended by the member executing the proxy.) [Corps.C. § 705(b)]

(b) [6:282] **Revocation on member's death or incapacity:** A proxy is not automatically revoked upon the death or incapacity of its maker. Rather, it remains valid until *written notice* of such death or incapacity is received by the LLC. Thus, any vote or member action before such notice is received is not affected. [Corps.C. § 705(c)]

(c) [6:283] **Irrevocability?** Under corporate law, a proxy that states it is "irrevocable" cannot be revoked for the period specified therein (even if the member dies or becomes incapacitated) if held by certain designated persons, such as a pledgee, a purchaser of the shares to which the proxy relates, corporate creditors who extended credit in consideration of proxy, a person holding a proxy given by corporate employee in connection with a contract of employment, persons designated under a shareholders' agreement or voting trust (per Corps.C. § 706), a beneficiary of a trust, and a person to whom the proxy was given to secure the performance of a duty or protection of title. [Corps.C. § 705(e)]

Corporate law further provides that an irrevocable proxy may be revoked by a transferee of corporate shares who had no knowledge of the proxy, unless the existence of the proxy appeared on the share certificate or initial transaction statement. [Corps.C. § 705(f)]

As with a pledgee as proxyholder (¶ 6:279), the grant of an irrevocable proxy to vote a member's interest, as well as the lack of statutory restrictions on transfer of corporate shares, conflict with the restrictions imposed by CRULLCA on a member's transferable interest, and hence would appear inapplicable to LLCs (unless the operating agreement provides otherwise). [See Corps.C. § 17705.02(b)]

The sole exception would appear to be for trustees, because CRULLCA recognizes trusts and trustees as members. [See Corps.C. §§ 17701.02(p) ("member" defined), (v) ("person" defined), 17706.01(b)(2)(D), 17706.02(h), (j)]

[6:284 - 6:289] ***Reserved.***

j. [6:290] **Record date for member notice or action:** The members who are entitled to notice and to vote at a members' meeting must be determined as of a "record date." [Corps.C. § 17704.07(p)]

Such record date is fixed as follows:

(1) [6:291] **By manager or holders of at least 10% of membership interests:** A *manager*, or members representing *more than 10%* of the "interests of members" (*see ¶ 6:292*) may fix a record date that is *not more than 60 days* nor *less than 10 days* prior to the date of the meeting, or not more than 60 days prior to any other action (e.g., by written consent). [Corps.C. § 17704.07(p)]

(a) [6:292] **Comment:** The term "interests of members" is not defined. Presumably the "interests of members" tracks the votes held by the members, which are determined in accordance with the articles of organization or a written operating agreement or, if not provided for therein, in accordance with Corps.C. § 17704.07(r) (*see ¶ 6:301, 6:306*).

(2) [6:293] **When manager or 10%-or-more interest holders fail to set date:** The code provides specific provisions governing the determination of a record date when the manager or holders of 10% or more of the membership interests fail to set a date. [Corps.C. § 17704.07(p)]

(a) [6:294] **Member meetings:** The record date for determining which members are entitled to notice of a meeting or to vote at a meeting is the close of business on the business day immediately before notice of the meeting is given. [Corps.C. § 17704.07(p)(1); *see* ¶ *6:254* as to when notice deemed given]

1) [6:295] **If notice waived:** Similarly, when notice of the meeting is waived (i.e., no notice of the meeting was given), the record date for determining which shareholders are entitled to vote at the meeting is the close of business on the business day immediately before the meeting. [Corps.C. § 17704.07(p)(1)]

2) [6:296] **Adjourned meetings:** If the meeting is adjourned, the same record date for determining the members entitled to notice and to vote applies, unless a manager or the members who called the meeting fix a new record date for the adjourned meeting (and the manager or the members who called the meeting *must* fix a new record date if the adjournment is for more than 45 days). [Corps.C. § 17704.07(p)(4)]

(b) [6:297] **Action by written consent:** The record date for determining members entitled to give written consent to LLC action is the day on which the *first* written consent is given. [Corps.C. § 17704.07(p)(2)]

(c) [6:298] **Other purposes:** The record date for determining members for any other purpose (e.g., distributions, ¶ 6:328) is the *later* of (i) the close of business on the day on which the *managers* adopt the resolution relating thereto or (ii) the 60th day prior to the date of the other action. [Corps.C. § 17704.07(p)(3)]

(d) [6:299] **May be varied by operating agreement:** The record date rules of Corps.C. § 17704.07(b) may be varied by a written operating agreement. [Corps.C. § 17701.10(d)]

k. [6:300] **Vote:** Unlike corporate shareholders, who almost always have one vote per share, the allocation of voting power among the managers and members of an LLC can vary widely. Typically, voting power is allocated in accordance with the managers' and members' economic interest in the LLC, with separate manager approval or consent required for amending the operating agreement or articles provisions that directly affect the managers (e.g., their compensation).

(1) [6:301] **Vote set forth in operating agreement or articles:** The operating agreement (or the articles of organization) may provide for voting by members on a per capita, number, financial interest, class, group, or other basis. Members may be divided into classes or groups that may have the right to vote separately or with other classes or groups. [Corps.C. § 17704.07(r); *see* ¶ *6:81*]

(a) [6:302] **Limitation—amendment of articles:** Neither the articles of organization nor the operating agreement may permit the articles to be amended by members having less than a majority in interests in current profits. [Corps.C. § 17704.07(s); see Corps.C. § 17701.02(m)]

Compare: This restriction applies only to amendments to the articles of organization. A written operating agreement can provide for its amendment by whatever procedure and by whatever vote or consent the members agree upon. [See Corps.C. § 17701.10(d)]

(b) [6:303] **Limitation—dissolution:** Dissolution of an LLC by vote of the members requires the approval of *50% or more* of the *voting interests* of the members, or a *greater percentage of the voting interests* of members as may be specified in the articles of organization or a *written* operating agreement. Neither the articles of organization nor the operating agreement may change this requirement. [Corps.C. §§ 17704.07(t), 17707.01(b); see Corps.C. §§ 17701.02(m), 17701.10(d)(4)]

1) [6:304] **Comment:** Prior to 2017, the vote required to dissolve an LLC was "a majority of the members" (per Corps.C. § 17701.02(m)). Now, the vote required to dissolve an LLC is "50 percent or more" of the "voting interests" of the members. [Corps.C. §§ 17707.01(b), 17707.02(a) (dissolution of LLC not engaged in business)]

The change was made to mitigate deadlocks in small LLCs (e.g., an LLC with two members), and to conform the vote required to dissolve an LLC with the shareholder vote required to dissolve a corporation. [See Corps.C. § 1900(a); Assembly Comm. on Banking and Finance, Analysis of AB 722 (3/14/16); Senate Judiciary Comm., Analysis of AB 722 (6/14/16)]

"Voting interests" is not defined in CRULLCA. Accordingly, how members vote on a dissolution of an LLC will be governed by the articles of organization or the operating agreement; or, if not set forth therein, by the members in proportion to their interests in *current profits*. [Corps.C. § 17704.07(r)(1)]

(c) [6:305] **Limitation—conversions and mergers:** A conversion or merger must be approved by *all* managers *and* a majority of each class of membership interests *unless* a greater approval is required by the operating agreement. But if the conversion or merger would result in the members' personal liability for the obligations of the converted or surviving

entity, then the conversion or merger must be approved by *all* members unless the members are given dissenters' rights. Neither the articles of organization nor the operating agreement may change this requirement. [Corps.C. §§ 17704.07(t), 17710.03(b), 17710.12(a); see also Corps.C. § 17701.10(c)(12)—operating agreement may not change any statutory conversion or merger provisions "except as provided therein" (¶ 6:123)]

(2) [6:306] **When no voting provisions in operating agreement or articles:** If neither the operating agreement nor the articles contain voting provisions, then members vote in proportion to their interests in *current profits*. [Corps.C. § 17704.07(r)(1)]

(a) [6:307] **Transfer of transferable interest:** A member who assigned or otherwise transferred the member's transferable interest (*see ¶ 6:360 ff.*) to someone who did not become a member continues to vote in proportion to the interest in current profits that the member would have had if no transfer had been made. [Corps.C. § 17704.07(r)(1)]

(b) [6:308] **Approval by majority of members ordinarily adequate:** Approval by a majority of members is sufficient unless the operating agreement or CRULLCA provides otherwise. [Corps.C. § 17704.07(r)(3); see Corps.C. § 17701.02(m)]

A "majority of the members" refers to those members holding more than 50% of the membership interests in the current profits of the LLC, unless the operating agreement provides otherwise. [Corps.C. § 17701.02(*l*)]

1) [6:309] **Exception—unanimity required when amending articles or operating agreement:** Any amendment to the articles of organization or the operating agreement must be approved by *all* members. (But the operating agreement may reduce this, without limit in the case of amendments to the operating agreement, and to approval or consent by not less than a majority of the members in the case of the articles of organization. *See* ¶ 6:691.) [Corps.C. § 17704.07(r)(2)]

l. [6:310] **Validity of action taken at meeting despite improper procedure:** Actions taken at any meeting of members—however called and noticed and wherever held—are valid so long as a quorum is present and nonattending members waive notice, consent to the holding of the meeting or approve the minutes thereof in writing (*see ¶ 6:260 ff.*). [Corps.C. § 17704.07(j)]

➪ [6:311] ***PRACTICE POINTER:*** This is basically a "saving" provision that validates LLC action regardless of irregularities in the procedures that led to the meeting. Although it is designed more for the protection of third parties who deal with the LLC, it also benefits counsel who are frequently called upon in financing and other significant transactions to deliver an opinion stating that LLC action was duly authorized and that the transaction is binding on the LLC.

[6:312 - 6:319] ***Reserved.***

6. [6:320] **Right to Information:** *See* ¶ 6:615 ff.

7. [6:321] **No Automatic Entitlement to Compensation for Services:** The fact that a member is also a manager does not itself entitle the member to remuneration for services performed in a member-managed LLC … *except* for reasonable compensation for services rendered in winding up the LLC's activities. But here again, the operating agreement may provide for remuneration to its members who perform services for the LLC. [Corps.C. §§ 17701.10(a), 17704.07(e)]

8. [6:322] **Distributions:** The LLC may make distributions to its members in accordance with the operating agreement. Unless the operating agreement provides otherwise, a member has no right to a distribution before the dissolution and winding up of the LLC unless the LLC decides to make an interim distribution. Once the LLC declares a distribution, the members (or transferees) have the status of LLC creditors with respect to the distribution. [Corps.C. §§ 17701.02(f) ("distribution" defined), 17704.04(a), (b), (d)]

a. [6:323] **Compensation for services not a "distribution":** Amounts constituting reasonable compensation for services rendered to the LLC, or reasonable payments made in the ordinary course of business under a bona fide retirement or other benefits program, are not deemed "distributions." [Corps.C. § 17704.05(g)]

b. [6:324] **Allocation of distributions among members:** Where the operating agreement does not provide for the method of determining the amount of the distributions, distributions are to be made on the basis of the *value* of the members' *contributions*, as stated in the LLC's required records (*see ¶ 6:604*) at the time the LLC decides to make the distribution. [Corps.C. § 17704.04(a)]

[6:325] ***Reserved.***

c. Who may receive

(1) [6:326] **Transferees and lienholders:** In addition to members, transferees (of a transferable interest) are entitled to receive any distributions made by the LLC. However, the holder of a pledge, security interest, lien or other encumbrance is *not* entitled to the distribution payable on account of the member's interest. But where a court has entered a *charging order* against a transferable interest to satisfy a judgment against the member or transferee, the distribution must be paid to the holder of the charging interest in accordance with the charging order. [Corps.C. §§ 17705.02(b), 17705.03(a)]

(2) [6:327] **Dissociated member:** A dissociated member has no right to a distribution unless the articles of organization or *written* operating agreement provides otherwise. Beginning on the date of dissociation, the dissociated member has only the right of a transferee of a transferable interest, and then only with respect to any distributions to which a transferee is entitled under the operating agreement. Further, if the dissociation violated the operating agreement, the LLC may offset any resulting damages from any distribution payable to the dissociated member. [Corps.C. § 17704.04(b)]

d. [6:328] **Record date:** The LLC may fix a record date for determining who is entitled to the distribution. Unless the operating agreement provides otherwise, any record date fixed by the LLC must be not more than 60 days prior to the date the LLC determines to make the distribution. [Corps.C. § 17704.07(p)]

If no record date is fixed, the record date for determining the distribution is the *later* of (1) the close of business on the day the managers adopt the resolution to make the distribution or (2) the 60th day prior to the date the distribution is actually made. [Corps.C. § 17704.07(p)(3)]

➪ [6:329] ***PRACTICE POINTER:*** A record date for distributions is largely irrelevant in small LLCs having a limited number of members who do not anticipate transferring their interests. Nevertheless, good "corporate" practice is for the manager to fix a record date when declaring a distribution to the members.

e. [6:330] **Cash vs. in-kind distributions:** A person does not have a right to a distribution in any form other than money. An LLC may distribute an asset in kind if each part of the asset is "fungible with each other part" and each person receives a percentage of the asset equal in value to the person's share of the distribution. [Corps.C. § 17704.04(c)]

f. [6:331] **Prohibited distributions:** To protect LLC creditors, CRULLCA imposes various restrictions on distributions to LLC members.

(1) [6:332] **Financial tests—liquidity vs. assets:** An LLC may *not* make a distribution if, after the distribution:

- The LLC would not be able to pay its debts as they become due in the ordinary course of the LLC's activities; *or*

- The LLC's total assets would be less than the sum of its total liabilities plus the amount that would be needed, if the LLC were to be dissolved at the time of the distribution, to satisfy any preferential rights of members. [Corps.C. § 17704.05(a)]

(a) [6:333] **Financial statements as basis for test:** The LLC may base the distribution on financial statements prepared on the basis of accounting practices and principles that are "reasonable in the circumstances," or on a "fair valuation or other method that is reasonable under the circumstances." [Corps.C. § 17704.05(b)]

➪ [6:334] ***PRACTICE POINTER:*** The statements need *not* be prepared in accordance with generally accepted accounting principles (GAAP). This provision gives the LLC considerable flexibility in determining the basis for making lawful distributions.

(b) [6:335] **Distribution date for financial test purposes:** Ordinarily, the distribution's compliance with the liquidity or assets tests is determined as of the date the distribution is *authorized* so long as payment occurs within 120 days after this date. If payment occurs more than 120 days after the distribution is authorized, compliance with the liquidity or asset test is determined as of the date of *payment*. [Corps.C. § 17704.05(c)(2)]

1) [6:336] **Exception—acquisition of transferable interest; indebtedness:** In the case where the distribution is done to effect a purchase, redemption or other acquisition of a transferable interest in the LLC, the distribution's compliance with the liquidity or assets tests is determined as of the date money (or other property) is transferred or debt is incurred by the LLC. (If the indebtedness is issued by the LLC to the transferee, then each payment of principal and interest on the indebtedness is treated as a distribution, with the validity of each to be measured on the date the principal or interest is paid." [Corps.C. § 17704.05(c)(1)]

(c) [6:337] **Issuance of LLC debt:** Indebtedness of the LLC, including indebtedness issued in connection with or as part of a distribution, is not considered a liability for purposes of the financial tests if the indebtedness expressly provides that payment of principal and interest are made only to the extent that a lawful distribution could then be made to members. [Corps.C. § 17704.05(e)]

(2) [6:338] **Liability for prohibited distribution:** If a member of a member-managed LLC, or a manager of a manager-managed LLC, "consents" (*see ¶ 6:342*) to a distribution that exceeds the amount that lawfully could have been paid under the liquidity or assets test, the member or manager is personally liable to the LLC for the amount of the excess. [Corps.C. § 17704.06(a)]

This liability appears to be joint and several—i.e., each "consenting" member or manager is potentially liable for the full amount of the excess distribution.

(a) [6:339] **Exception re member-managed LLC:** To the extent the operating agreement of a member-managed LLC relieves a member of the authority and responsibility to consent to distributions and imposes that authority and responsibility on one or more other members, liability for unlawful distributions applies to those other members and not to the member that the operating agreement relieves of authority and responsibility. [Corps.C. § 17704.06(b)]

(b) [6:340] **Member's liability in manager-managed LLC:** The fact that an LLC is manager-managed does not necessarily relieve a member from liability for an improper distribution. A member in a manager-managed LLC who receives an unlawful distribution *knowing the distribution was unlawful* is liable to the LLC to the extent that the amount the manager received exceeded the amount that could lawfully have been paid. [Corps.C. § 17704.06(c)]

Unlike the joint and several liability imposed on members in member-managed LLCs (¶ 6:338), the liability here is several only—the member is liable only for the excess received *by him or her*.

(c) [6:341] **Transferee liability:** Similarly, a transferee of a transferable interest who receives a distribution *knowing the distribution was unlawful* is liable to the LLC to the extent that the amount the transferee received exceeded the amount that could lawfully have been paid. This is so whether the distribution was made by a member-managed or a manager-managed LLC. [Corps.C. § 17704.06(c)]

(d) [6:342] **"Consent":** The provision governing liability for improper distributions was taken from, and is virtually identical to, the law applicable to limited partnerships. According to the NCCUSL comment to the model limited partnership act section on which the LP Act provision was based (*see ¶ 5:14*), a general partner's liability for consenting to an unlawful distribution encompasses any form of approval, assent or acquiescence, whether formal or informal, express or tacit. [Corps.C. § 15905.09, "Uniform Limited Partnership Act Comment—Subsection (a)" (*see ¶ 5:19*)]

Of course, such "consent" can only come from a manager or member charged with the responsibility for determining and making the distributions.

(e) [6:343] **Impleader of other persons:** A person sued for an unlawful distribution may seek contribution from any member or manager who authorized the improper distribution and any person who received a distribution, knowing it to be improper, to the extent it exceeded the lawful amount. [Corps.C. § 17704.06(d)]

(f) [6:344] **Four-year statute of limitations:** An action to recover an unlawful distribution must be brought within four years after the date the distribution is made. [Corps.C. § 17704.06(e)]

g. [6:345] **Unpaid distribution—member as creditor:** A member (or transferee) who becomes entitled to receive a distribution has the status of a creditor of the LLC with respect to the distribution. The member's status as a creditor is at parity with the LLC's general unsecured creditors. [Corps.C. § 17704.05(d)]

[6:346 - 6:359] ***Reserved.***

9. [6:360] **Transfer of LLC "Transferable Interest":** Unless the operating agreement provides otherwise, a member may transfer all or part of the member's "transferable interest." A "transferable interest" is a member's right to receive distributions in accordance with the operating agreement. [Corps.C. §§ 17701.02(aa), 17705.02(a)(1)]

A transfer of a transferable interest does not itself cause a member's *dissociation* or a *dissolution* of the LLC. [Corps.C. § 17705.02(a)(2)]

a. [6:361] **Certificate of interest:** An LLC may issue certificates to represent transferable interests. A transfer of a transferable interest may be accomplished by transfer of the certificate. [Corps.C. § 17705.02(d)]

[6:362] ***Reserved.***

b. Transferee's rights

(1) [6:363] **Distributions:** A transferee of a transferable interest has the right to receive distributions. (However, the holder of a pledge, security interest, lien or other encumbrance—other than the holder of *charging interest*—is *not* entitled to the distributions payable on account of the member's interest; *see ¶ 6:326*.) [Corps.C. § 17705.02(b)]

(2) [6:364] **Voting and management:** Unless the transferee becomes a member, transfer of a transferable interest does *not* entitle the transferee to vote or participate in the management or conduct of the LLC. [Corps.C. § 17705.02(a)(3)(A)]

(3) [6:365] **LLC records and information:** Transferees have the same rights to information that members have, subject to the same limitations as are applicable to members, with one exception: In a dissolution and winding up of the LLC, transferees are entitled to an account of the LLC's transactions *only from the date of dissolution*. [Corps.C. § 17705.02(a)(3)(B), (c); see Corps.C. § 17704.10]

(4) [6:366] **Effective upon notice to LLC:** An LLC need not give effect to a transferee's rights until it has notice of the transfer. [Corps.C. § 17705.02(e)]

c. [6:367] **Transferee's potential liability for transferor's obligations:** A transferee who becomes a member is liable for the transferor-member's obligation to make a *contribution* to the LLC (Corps.C. § 17704.03, ¶ 6:230 ff.) and to return the portion of any *unlawful distribution* received by the transferor-member (Corps.C. § 17704.06(c)). However, the transferee is liable only if the liability was *known* to the transferee when he or she became a member. [Corps.C. § 17705.02(h)]

d. [6:368] **Transferor's continued rights and obligations:** A member who transfers his or her transferable interest retains the rights, duties and obligations of a member, other than the right to distributions. However, the member loses all rights as a member upon expulsion from the LLC (per Corps.C. § 17706.02(d)(2), ¶ 6:404). [Corps.C. § 17705.02(g)]

e. [6:369] **Limitation—void transfers:** A transfer of a transferable interest in violation of a restriction on transfer contained in the operating agreement is ineffective as to a person having notice of the restriction as of the time of transfer. [Corps.C. § 17705.02(f)]

(1) [6:370] **Comment—potential application of Commercial Code provisions barring restrictions on transfer:** This provision raises the implication that a transfer of a transferable interest in violation of a restriction on transfer contained in the operating agreement is effective—i.e., the transfer must be recognized by the LLC—if the transferee did not have notice of the restriction at the time of transfer. This may happen, for example, where the transferable interest is not represented by a certificate with a prominent legend noting the restriction. This implication is also supported by the common law hostility to restraints on alienation.

Recognition of this principle can be found in California Commercial Code provisions that impose restrictions on an LLC's power to prohibit transferability (including as security for a loan) of a "transferable interest." [Comm'l C. §§ 9406(d), 9408(d); see Comm'l C. § 9408(c)—declaring "ineffective" any rule of law, statute or regulation prohibiting transfer of transferable interest, including grant of security interest therein]

However, this ban on transfer restrictions applies only if and to the extent that the LLC is a party to the agreement containing the transfer restriction. Rarely, if ever, is an LLC a party to its operating agreement, even if the LLC is bound thereby. The Uniform Commercial Code Permanent Editorial Board has revised UCC §§ 9-406 and 9-408 to clarify that these sections do not apply to security interests granted with respect to LLC transferable interests. The revised sections will not become effective in California until adopted by the Legislature. [See C. Bjerre, D. Kleinberger, E. Smith & S. Weise, "LLC and Partnership Transfer Restrictions Excluded from UCC Article 9 Overrides,"*Bus. Law Today* (ABA Bus. Law Section 2/7/19)]

f. [6:371] **Member's voluntary grant of security interest:** Transfers are not limited to outright conveyances or sales. A member may pledge, mortgage or otherwise grant a security interest in the member's transferable interest. [See Corps.C. § 17701.02(z)—"transfer" includes mortgage, security interest and encumbrance; also see *Feresi v. The Livery, LLC* (2015) 232 CA4th 419, 425, 182 CR3d 169, 173-174]

(1) [6:372] **No compliance with California securities laws required:** To the extent that the membership or transferable interest is a security (*see ¶ 7:81 ff.*), a "bona fide secured transaction" with respect to the interest is not a "sale" or "offer" of a security and hence does not require compliance with California securities laws. [Corps.C. § 25017(f)]

(a) [6:373] **Compare—federal law:** There is no comparable statutory provision that would effectively "exempt" the creation of a security interest from the federal securities laws. Generally, however, the grant of a security interest in, or a pledge of, a transferrable interest in an LLC should qualify under the judicially created "commercial loan exemption." *See ¶ 7:115*.

(2) [6:374] **Holder of security interest not entitled to membership rights:** The pledge or granting of a security interest, lien or other encumbrance on a member's transferable interest does not cause the member to cease to be a member or grant to the holder of the security interest "or to anyone else" (i.e., a transferee) the power to exercise any of the member's rights or powers, including, e.g., the right to receive distributions. [Corps.C. § 17705.02(b)]

(a) [6:375] **No right to vote:** A pledgee does not have any LLC voting rights with respect to the interest. "[W]hen membership rights are pledged as collateral the pledging member retains the voting rights until the secured creditor has enforced the security agreement and become the member. Thus, neither the pledging of the membership rights as security nor the declaration of a breach by the secured party is sufficient to divest the pledging member of the right to vote. To hold otherwise would permit someone who is not a member or manager to control a limited liability company." [*In re Lake County Grapevine Nursery Operations* (BC ND CA 2010) 441 BR 653, 655 (decided under prior law)]

(b) [6:376] **Comment:** Transferees of LLC interests often seek to avoid restrictions on their membership and voting rights through contractual grants of proxies and powers-of-attorney from their transferors purporting to empower the transferee to exercise the transferor member's management and voting rights for and on behalf of the transferor. Proxies are explicitly permitted by CRULLCA (*see ¶ 6:274 ff.*), but the enforceability of this contractual "work around" the restrictions on transferees' membership and voting rights is open to question. [See Corps.C. § 17704.07(o); *see also ¶ 5:491.1 ff.*]

(3) [6:377] **Perfection of security interest:** The method by which a creditor may perfect its security interest, thereby giving the security interest priority over a conflicting *unperfected* security interest, depends on whether the transferable interest qualifies as a "security" under Division 8 of the Commercial Code (sometimes referred to as "UCC Article 8").

(Whether an LLC interest qualifies as a "security" under Division 8 is not determinative of whether the LLC interest qualifies as a "security" under applicable securities laws. The inquiries are separate.)

(a) [6:378] **Transferable interest as "general intangible":** A transferable interest that is not a "security" under the Commercial Code (*see ¶ 6:379 ff.*) is considered a general intangible, and a security interest therein is perfected by filing a UCC-1 financing statement. [Comm'l C. §§ 9310(a), 9322(a)(2)]

(b) [6:379] **Transferable interest as "security":** An LLC interest that qualifies as a "security" under Division 8 of the Commercial Code (*see ¶ 6:380*) can likewise be perfected by filing a UCC-1. But customary practice is to perfect a security interest in *certificated* securities (i) by taking *possession* of the securities and noting the security interest on the certificate, or (ii) where the securities are held by a broker (or other securities intermediary), by control pursuant to a *securities account control agreement* with the broker. [Comm'l C. §§ 8102(a)(15), 8106, 8301(a), 9312(a), 9313(a), 9314(a), 9106]

1) [6:380] **"Security" defined:** To qualify as a security for Commercial Code purposes, an LLC interest must meet the following conditions:

- It is represented by a security certificate in bearer or registered form, or the transfer of it may be registered on books maintained for that purpose by or on behalf of the LLC;
- It is one of a class or series of interests or by its terms is divisible into a class or a series of shares, participations, interests or obligations; *and*
- It is *either* of the following:
  - — It is, or is of a type, dealt in or traded on securities exchanges or securities markets; *or*
  - — It is a medium for investment and by its terms expressly provides that it is a security governed by Division 8. [Comm'l C. § 8102(a)(15)]

For nontraded LLC interests, this third condition is typically satisfied by including an express statement in the operating agreement that the outstanding LLC membership interests are intended to qualify as securities under Division 8 of the California Commercial Code.

2) [6:381] **"Transferable interest" vs. "membership interest":** It is probably sufficient to conclude that the LLC interests referred to in Comm'l C. § 8102(a)(15) refer to "transferable interests," although most LLCs do not, when issuing certificates to their members, distinguish between transferable and membership interests on the face of the certificate. I.e., the certificate will typically acknowledge the holder as the record owner of "membership interests" in the LLC, or "units" or "shares" of the LLC.

➪ [6:382] ***PRACTICE POINTER:*** Institutional lenders that make loans to LLC members will often insist that the LLC elect to treat its outstanding interests as Commercial Code securities. This way, they can obtain the "super priority" granted to lenders that perfect their security interest in LLC interests by possession or control. Alternatively, perfection by control can be obtained in *uncertificated* LLC interests not qualifying as securities pursuant to an uncertificated securities control agreement entered into among the borrower, the LLC and the lender. [Comm'l Code §§ 9314(a), 9106(a), 8106(c)(2)]

Even if a lender does not secure the written consent of the LLC itself to the member's grant of a security interest in the member's LLC interest (such as through an uncertificated securities control agreement), it is sound practice for lenders to secure the LLC's acknowledgement (through its manager or a member authorized to do so) to the grant of a security interest, and an agreement by the LLC to recognize the lender as a transferee upon receipt of a notice of default from the lender. [See *Feresi v. The Livery, LLC* (2015) 232 CA4th 419, 425, 182 CR3d 169, 173-174, *discussed further at ¶ 6:522*]

[6:383 - 6:385] ***Reserved.***

g. [6:386] **Judgment creditor's charge on transferable interest:** A judgment creditor of a member (or transferee) may apply to a court to obtain a charging order against the member's transferable interest. The charging order constitutes a lien on the transferable interest and requires the LLC to pay over to the creditor any distributions that are payable on the member's interest. [Corps.C. § 17705.03(a), (b)]

(1) [6:387] **Foreclosure upon transferable interest:** If the distributions under the charging order will not pay the judgment within a reasonable time, the court may foreclose upon the lien and order the sale of the transferable interest. The purchaser at the foreclosure sale obtains only the transferable interest and does not become a member. [Corps.C. § 17705.03(b)(3)]

(2) [6:388] **Redemption by member:** Any time before foreclosure, the member (or transferee) whose transferrable interest is subject to the charging order may extinguish the charging order by satisfying the judgment and filing a certified copy of the satisfaction with the court that issued the charging order. [Corps.C. § 17705.03(c)]

(3) [6:389] **Satisfaction of judgment by LLC or other members:** Any time before foreclosure, the LLC itself or one or more other members may pay off the judgment creditor and succeed to the creditor's rights under the charging order. [Corps.C. § 17705.03(d)]

h. [6:390] **Member's death:** Upon a member's death, the personal representative (or other legal representative) may exercise the rights of a transferee. For the limited purpose of *settling the estate*, the personal representative may exercise the member's rights to obtain information about the LLC and to inspect LLC records. [Corps.C. § 17705.04]

[6:391 - 6:399] ***Reserved.***

10. [6:400] **Dissociation:** "Dissociation" is the termination of an LLC member's status as a member. This may occur, e.g., by a member's death, voluntary withdrawal from the LLC, or expulsion from the LLC.

a. [6:401] **Voluntary dissociation (withdrawal):** A member may dissociate at any time by express will to withdraw as a member. The dissociation is effective at the time the LLC has notice of the dissociation unless the member specifies a later withdrawal date. (But the member may be liable to the LLC and other members if the withdrawal is "wrongful"; *see ¶ 6:414*.) [Corps.C. §§ 17706.01(a), 17706.02(a)]

b. [6:402] **"Involuntary" dissociation:** Dissociation may also occur by events other than the member's voluntary withdrawal:

(1) [6:403] **Event set forth in operating agreement:** A member may become dissociated upon the occurrence of an event stated in the operating agreement. [Corps.C. § 17706.02(b)]

(2) [6:404] **Expulsion:** Dissociation may occur where a member is expelled pursuant to the operating agreement. [Corps.C. § 17706.02(c)]

A member may also be expelled by the unanimous consent of the other members where:

- It is unlawful to carry on the LLC's activities with the person as member;
- There has been a transfer of all of the member's transferable interest (other than a transfer for security purposes or that is subject to a charging order that has not been foreclosed, ¶ 6:371 ff., 6:386);
- The member is a corporation that filed a certificate of dissolution (or the equivalent), or its charter has been revoked, or its right to conduct business has been suspended (but the LLC must give the corporation 90 days' notice of its intent to expel the corporation in order to afford the corporation an opportunity to avert expulsion); or
- The member is an LLC or general or limited partnership that has been dissolved and is being wound up. [Corps.C. § 17706.02(d)]

(a) [6:405] **Expulsion upon court order:** The *LLC* may seek a court order expelling a member where the member:

- Engaged in *wrongful conduct* that *adversely and materially affected*, or *will adversely and materially affect*, the LLC's activities;
- Willfully or persistently committed a *material breach of the operating agreement* or the member's *fiduciary duties* (Corps.C. § 17704.09, ¶ 6:500 ff.); or
- Engaged in conduct relating to the LLC's activities that make it "not reasonably practicable" to carry on the activities with the member. [Corps.C. § 17706.02(e)]

(3) [6:406] **Death or incapacity:** A member is automatically dissociated upon death. [Corps.C. § 17706.02(f)(1)]

A member is dissociated from a *member-managed* LLC if a guardian or general conservator is appointed for the member, or there is a judicial order that the member has otherwise become incapable of performing duties as a member. [Corps.C. § 17706.02(f)(2)]

(a) [6:407] **Legal representative's exercise of member's rights:** Upon a member's death, or upon appointment of a guardian or conservator for the member, the legal representative of the member or the member's estate (e.g., guardian, conservator, executor or administrator) may exercise all of the member's rights *for the purpose of settling the member's estate or administering the member's property,* including any power the member had under the articles or operating agreement to give a transferee the right to become a member. [Corps.C. § 17706.03(c)]

1) [6:408] **Includes attorney-in-fact:** An attorney-in-fact under a valid power of attorney is also considered a legal representative, with concomitant power to exercise the member's rights. However, this reference to an attorney-in-fact would not appear to give a member an unfettered right in any circumstance to grant a power of attorney over their membership interest. Rather, the intent here would appear restricted to situations where a power of attorney is granted in connection with, e.g., a member's partial or temporary incapacity. [Corps.C. § 17706.03(c)]

(4) [6:409] **Bankruptcy:** A member is dissociated from a *member-managed* LLC upon becoming a debtor in bankruptcy. [Corps.C. § 17706.02(g)]

(5) [6:410] **Trust or trustee as member—distribution of trust:** Where the member is a trust or trustee, the member is dissociated upon distribution of the trust's entire transferable interest. (But there is no dissociation where distribution occurs solely by reason of the substitution of a successor trustee.) [Corps.C. § 17706.02(h)]

(6) [6:411] **Estate as member—distribution of estate:** Similarly, where the member is an estate or a personal representative of an estate, the member is dissociated upon distribution of the estate's entire transferable interest. (But here again, there is no dissociation where distribution occurs solely by reason of the appointment of a successor personal representative.) [Corps.C. § 17706.02(i)]

(7) [6:412] **Termination of certain business entity members:** A member that is not an individual, general or limited partnership, LLC, corporation, trust or estate dissociates upon termination. [Corps.C. § 17706.02(j)]

(8) [6:413] **Merger or termination of LLC:** All members automatically dissociate when the LLC terminates or when the LLC is a disappearing entity in a merger. [Corps.C. § 17706.02(k), (*l*)]

A member also dissociates upon a merger if the merger otherwise causes the member to cease to be a member (e.g., by express terms of the merger agreement). [Corps.C. § 17706.02(k)(2)]

c. [6:414] **Liability for wrongful dissociation:** A member who wrongfully dissociates is liable to the LLC and the other members for any damages caused by the dissociation. [Corps.C. § 17706.01(c)]

Dissociation is wrongful if it breaches an express provision of the *operating agreement*. It is also wrongful when occurring *before termination* of the LLC *and:*

- The member withdraws by express will;
- The member is expelled by judicial order (*see* ¶ *6:405*);
- The member is dissociated by becoming a debtor in bankruptcy (*see* ¶ *6:409*); *or*
- In the case of a member that is not a trust (other than a business trust), an estate or an individual, the person is expelled or otherwise dissociated because it dissolved or terminated. [Corps.C. § 17706.01(b)]

d. [6:415] **Effect of dissociation:** Dissociation as a member does not itself discharge or alter the terms of any pre-dissociation debt, obligation or other liability that the member incurred to the LLC or the other members. The effects of dissociation are generally limited to events occurring *after* dissociation, as set forth below at ¶ 6:416 ff. (unless the operating agreement provides otherwise). [Corps.C. § 17706.03(b)]

(1) [6:416] **Ordinarily, no voting rights or participation in LLC management:** Upon dissociation, the person's right to vote and to participate as a *member* in the management and conduct of the LLC's activities terminates. [Corps.C. § 17706.03(a)(1)]

But the person may continue to participate in the management or operation of the LLC in some other capacity, such as an *employee*. Moreover, a person who is expressly designated as a *manager* may continue as a manager despite dissociation as a member (unless the operating agreement provides that managers must be members).

(2) [6:417] **Member-managed LLC—termination of fiduciary duties:** Where the LLC is member-managed, dissociation terminates a member's fiduciary duties with regard to matters arising and events occurring after dissociation. [Corps.C. § 17706.03(a)(2)]

(a) [6:418] **Caution:** The termination of fiduciary duties upon dissociation does not necessarily terminate other obligations that the member may have to the LLC or the other members. For example, the dissociated member may be free to compete with the LLC, but may be constrained from doing so by obligations of confidentiality to the LLC.

(3) [6:419] **Continued right to distributions:** Upon dissociation, a member becomes a transferee with respect to the member's transferable interest. Thus, the dissociated member continues to have a right to any distributions that may be made by the LLC. [Corps.C. § 17706.03(a)(3)]

➪ [6:420] ***PRACTICE POINTER:*** Dissociation does not trigger a statutory buyout, redemption or forfeiture of the member's interest (*but see* ¶ 6:421). Thus, it may be important for the operating agreement to set forth a buyout of a dissociated member's interest by the LLC and/or the other members.

(a) [6:421] **Potential laches:** A dissociated member may forfeit any right to distributions if they unreasonably delay in asserting their rights. [See *Fitzgerald v. Fitzgerald Home Farm, LLC* (Del. Ch. 2021) 2021 WL 1514385, *4-5 (unpub.opn.)—dissociated member who did not assert claim for 9 years after withdrawing from LLC was barred by laches from seeking reinstatement and share of LLC income]

[6:422 - 6:449] ***Reserved.***

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Chapter 6. Limited Liability Company

D. Management

[6:450] An LLC is member-managed unless the articles of organization contain a statement that the LLC will be managed by one or more managers. [Corps.C. §§ 17704.07(a), 17702.01(b)(5), (6)]

1. [6:451] **Member-Managed LLC:** In a member-managed LLC, the management and conduct of the LLC are vested in all the members. [Corps.C. § 17704.07(b)(1)]

a. [6:452] **Authority of members to bind LLC:** Every member is an agent of the LLC for the purpose of its business or affairs. The act of *any* member done for the *apparent* purpose of carrying on the LLC's business or affairs in the usual way binds the LLC … *unless* the member has, in fact, *no authority* to act for the LLC in the particular matter and the person with whom the member is dealing has *actual knowledge* of the member's lack of authority. [Corps.C. § 17703.01(a), (c)]

(1) [6:453] **Operating agreement may vary members' authority:** The operating agreement may not vary the applicability of *California law* to the authority of LLC members (and agents); *see* ¶ *6:106*. However, a *written* operating agreement may vary a member's authority to bind the LLC. [Corps.C. § 17701.10(d)]

(a) [6:454] **Comment:** The reach of this power to vary a member's authority is unclear. For example, a limitation on the agency power of one or more members set forth in a written operating agreement would be binding on a third party only if that third party "has actual knowledge of the fact that the member has no such [agency] authority." [Corps.C. § 17703.01(a), (c)]

The flexibility accorded the members to vary the rules regarding a member's authority may come into play where the members grant to one or more of them, in a member-managed LLC, special powers not shared generally by the other members; *see* ¶ *6:131*.

b. [6:455] **Ordinarily, equal management and voting rights:** Unless the operating agreement provides otherwise, all members have equal rights in the management and conduct of the LLC's business, including equal voting rights. A difference arising among members as to a matter *in the ordinary course* of the LLC's activities is decided by a *majority* of the *members voting in accordance with their interests in current profits* (unless the operating agreement provides otherwise). [Corps.C. § 17704.07(b)(2), (3); see Corps.C. § 17701.02(m), (r)]

(1) [6:456] **Exceptions requiring unanimous vote:** Unless the operating agreement provides otherwise, the consent of *all* members is required for:

- An act *outside the ordinary course* of the LLC's activities (other than a merger or conversion), and
- Any *amendment to the operating agreement*. [Corps.C. § 17704.07(b)(4), (5)]

c. [6:457] **No entitlement to remuneration:** Unless the operating agreement provides otherwise, a member in a member-managed LLC is not entitled to remuneration for services as a member (except for reasonable compensation for services rendered in winding up the LLC's activities). [Corps.C. § 17704.07(e)]

d. [6:458] **No delegation of management to nonmember:** A member in a member-managed LLC may not delegate management to a nonmember. To do so would improperly transform the LLC into a manager-managed LLC. [*SB Liberty, LLC v. Isla Verde Ass'n, Inc.* (2013) 217 CA4th 272, 283, 158 CR3d 105, 113-114 (decided under prior law)]

[6:459 - 6:469] ***Reserved.***

2. [6:470] **Manager-Managed LLC:** In a manager-managed LLC, any matter relating to the LLC's activities is decided *exclusively by the managers* (except for major events for which CRULLCA grants members the authority to approve or disapprove, such as conversions and mergers). [Corps.C. § 17704.07(c)(1), (4); see *Swart Enterprises, Inc. v. Franchise Tax Bd.* (2017) 7 CA5th 497, 510, 212 CR3d 670, 679]

a. [6:471] **Manager need not be member:** A manager need not be a member of the LLC. However, the dissociation of a member who is also a manager *removes* the person as a manager. [Corps.C. § 17704.07(c)(6)]

Where a manager who is also a member ceases to be a manager, the termination of the manager's status does not itself cause dissociation of the person as member. [Corps.C. § 17704.07(c)(6)]

b. [6:472] **Election/removal by majority of membership interests:** Unless the operating agreement provides otherwise, managers are chosen by the consent of a *majority* of the *members according to their interests in current profits.* A manager remains as manager until a successor has been chosen, unless the manager resigns, is removed or dies or, in the case of a member that is not an individual, terminates. [Corps.C. § 17704.07(c)(5); see Corps.C. § 17701.02(m)]

Unless the operating agreement provides otherwise, a manager may be removed at any time, without cause (but subject to any rights the manager may have under any service contract with the LLC), by the consent of a majority of the *membership interests in current profits*. [Corps.C. § 17704.07(c)(5); see Corps.C. § 17701.02(m)]

c. [6:473] **Authority to bind LLC:** In a manager-managed LLC, no member acting solely in the capacity of a member can bind the LLC or execute any instrument on behalf of the LLC. These powers are reserved to the managers, *each* of whom is an *agent* of the LLC for the purpose of its business or affairs. The act of any manager for apparently carrying on in the usual way the business or affairs of the LLC binds the LLC, *unless* the manager has no authority in fact to act for the LLC in the particular matter *and* the person with whom the manager is dealing has *actual knowledge* of the lack of authority. [Corps.C. § 17703.01(b), (c)]

(1) [6:474] **Authority varied by operating agreement:** A written operating agreement may vary the powers of a manager of a manager-managed LLC. However, the reach of this right is not clear, since restrictions on the authority of a manager do not bind third persons who have no knowledge of the restriction. [Corps.C. §§ 17701.10(d), 17703.01(b)(2)]

One example of where the members may exercise this right is by expanding the power of the manager or managers to take action without the consent of the members even for approving extraordinary actions, such as the sale of all or substantially all of the assets of the LLC.

d. [6:475] **Equal management rights:** Each manager in a manager-managed LLC has equal rights in the management and conduct of the LLC's activities. [Corps.C. § 17704.07(c)(2)]

e. [6:476] **Majority vote re management decisions:** A difference arising among managers as to a matter in the *ordinary course* of the LLC's activities may be decided by a majority of the managers. (Here, any membership interests held by the managers as members are clearly irrelevant, unless the operating agreement provides otherwise.) [Corps.C. § 17704.07(c)(3); see Corps.C. § 17701.02(*l*)]

f. [6:477] **Actions requiring unanimous *member vote:*** Notwithstanding the authority of managers to operate the LLC, the following acts require the consent of *all members* unless the operating agreement (written *or oral*) provides otherwise:

- The sale, lease, exchange or other disposition of all or substantially all of the LLC's property, with or without goodwill, outside the ordinary course of the LLC's activities; or

• Any other act outside the ordinary course of the LLC's activities (other than a merger or conversion). [Corps.C. § 17704.07(c)(4)]

g. [6:478] **Cessation as manager—no discharge of liability to LLC or members:** A person's ceasing as a manager does not discharge any debt, obligation or other liability of the manager *incurred to the LLC or to the members* while the person was a manager. [Corps.C. § 17704.07(c)(7)]

h. [6:479] **Wrongful dissolution—no participation in management:** A person who wrongfully causes dissolution of the LLC loses the right to participate in the management of the LLC as a member or a manager. [Corps.C. § 17704.07(d)]

i. [6:480] **Liability to third parties:** A manager is not liable for LLC debts, obligations or liabilities solely by reason of being a manager. [Corps.C. § 17703.04(a)(2)]

However, a manager may be liable for the manager's own personal wrongful conduct, including participation in tortious or illegal conduct, when performing duties as a manager. This includes situations where the manager has actual authority over, or significant responsibility for, the wrong. [Corps.C. § 17703.04(c); *People v. Pacific Landmark* (2005) 129 CA4th 1203, 1213-1216, 29 CR3d 193, 199-202]

j. [6:481] **Designation of "board of managers":** Some LLC operating agreements provide for a "board of managers." In doing so, the LLC mimics corporate law, with the consequence that a court may by analogy look to relevant *corporate* law when addressing the powers and duties of the LLC board … *unless* the members include specific provisions modifying those duties (to the extent permitted by CRULLCA) in the operating agreement. [See *ITV Gurney Holding Inc. v. Gurney* (2017) 18 CA5th 22, 32, 226 CR3d 496, 503-504—"Although the Company was established as a limited liability company rather than as a corporation, we interpret the establishment of a formal board as a choice by the Company to organize itself according to the ordinary rules of a board of directors"]

(1) [6:482] **Designation of "board of directors?":** Some operating agreements create a "board of directors." CRULLCA provides only for managers and makes no mention of directors. Attorneys cannot assume that the statutory and/or common law relating to *corporate* directors will automatically apply to LLC directors. The operating agreement should either spell out the duties and responsibilities of the LLC "directors" or state explicitly that their duties and responsibilities are those of directors of a California corporation. If the attorney wishes to spell out the LLC directors' duties and responsibilities, then the operating agreement should state *all* the board's responsibilities and authority, including its role in governance vis-à-vis the manager(s); how the directors are elected or appointed and their terms; how directors may be removed; the procedures for board meetings and actions; and the directors' duties and to whom the duties are owed. [See *Obeid v. Hogan* (Del.Ch. 2016) 2016 WL 3356851, *6-8 (applying Del. law) (unpublished opinion)]

[6:483 - 6:489] ***Reserved.***

3. [6:490] **Binding Effect of Instrument Signed by Sole Manager or at Least Two Managers:** Any note, mortgage, evidence of indebtedness, contract, certificate, statement, conveyance or other written instrument, and any assignment or endorsement thereof, is binding on the LLC when signed by at least *two managers* (or by *one manager* in the case of an LLC whose *articles* state that it is managed by only one manager). I.e., the LLC may not invalidate the instrument on the ground of the signers' (or signer's) lack of authority unless the other party had *actual knowledge* of the lack of authority. [Corps.C. § 17703.01(d)]

(This should be so whether the LLC is member-managed or manager-managed, even though § 17703.01(d) refers only to managers.)

a. [6:491] **Application:** The signature block need not specify that the signer is a manager (or member in a member-managed LLC).

An individual was the managing member of LLC1, which was in turn the sole manager of LLC2. The individual signed an indemnity agreement on behalf of LLC2, but the signature block incorrectly set forth the *individual*—rather than LLC1—as the "Managing Member" of LLC2. (The indemnitee was unaware that neither the individual nor LLC1 had actual authority to sign the agreement on behalf of LLC2.) LLC2 was bound by the agreement: Although LLC1 was the actual manager, it was an artificial entity that could act only through the individual, who was also the only individual who could—and did—sign on behalf of LLC2. [*Western Sur. Co. v. La Cumbre Office Partners, LLC* (2017) 8 CA5th 125, 127-128, 213 CR3d 460, 461, 466-467 (decided under prior statute identical to § 17703.01(d))]

[6:492 - 6:499] ***Reserved.***

4. [6:500] **Members' and Managers' Fiduciary Duties:** In a *member-managed* LLC, each *member* owes a duty of loyalty and a duty of care to the LLC and to the other members. [Corps.C. § 17704.09(a); see *Sandy v. McClure* (ND CA 2009) 676 F.Supp.2d 866, 883 (applying Calif. law); see also *American Master Lease LLC v. Idanta Partners, Ltd.* (2014) 225 CA4th 1451, 1480, 171 CR3d 548, 571 & fns. 18 & 19 (decided under prior law)]

In a *manager-managed* LLC, each *manager* owes a duty of loyalty and a duty of care to the LLC and the members. Members who are not managers are relieved of the duties of loyalty and care. [Corps.C. § 17704.09(f)(1), (3); see *Feresi v. The Livery, LLC* (2015) 232 CA4th 419, 425-426, 182 CR3d 169, 174 (decided under prior law)]

a. [6:501] **Ability of operating agreement to vary fiduciary duties:** The operating agreement may not eliminate the duties of loyalty or care, nor may the agreement "unreasonably reduce" the duty of care. However, in the situation of a *member-managed* LLC, an operating agreement that shifts a member's responsibilities to one or more other members may also *limit* or even *eliminate* any fiduciary duty that would have pertained to any such responsibility (*see ¶ 6:110*). Conversely, the operating agreement certainly may *expand* a member's fiduciary duties. [See Corps.C. § 17701.10(c)(4), (14), (15), (e), (f); see also Corps.C. § 17704.09; *and ¶ 6:108 ff.*]

(1) [6:502] **Nonmember managers as parties to operating agreement:** As stated above (¶ 6:471), a manager need not be a member. Although the operating agreement is entered into by all of the "*members*" (see Corps.C. § 17701.02(s) (emphasis added)), managers who are *not members* customarily will be parties to and will sign the operating agreement, since the agreement typically will delineate the managers' duties, responsibilities and compensation.

Alternatively, the LLC can enter into a separate agreement with nonmember managers, such as the LLC would do with independent management agents, setting forth the parties' rights and obligations, including the LLC's right to terminate the manager's engagement.

b. [6:503] **Applicability of fiduciary duties to nonmember managers:** Even in the unusual case, as discussed above (¶ 6:502), where the manager or managers are not LLC members, if the LLC makes clear in its articles of organization and operating agreement that it is manager-managed, then persons identified as managers assume the fiduciary duties of managers, both by virtue of their agency authority and the terms of CRULLCA. [Corps.C. § 17704.09(f)(1)]

c. [6:504] **Duty of loyalty:** Unless the operating agreement provides otherwise, the duty of loyalty "is limited to" (*see ¶ 6:508*) the three following types of conduct (Corps.C. § 17704.09(b)):

(1) [6:505] **Accounting for LLC funds and property:** An LLC member in a member-managed LLC, or a manager in a manager-managed LLC, must account to the LLC and hold as trustee any property, profit or benefit that the manager or member derives in the conduct or winding up of the LLC's activities or from the use of LLC property, including the appropriation of an LLC opportunity. [Corps.C. § 17704.09(b)(1), (f)(1)]

(2) [6:506] **No adverse interest:** Each member in a member-managed LLC, and each manager in a manager-managed LLC, must refrain from dealing with the LLC as, or on behalf of a person having, an interest adverse to the LLC. [Corps.C. § 17704.09(b)(2), (f)(1)]

(3) [6:507] **No competing with LLC:** Each member in a member-managed LLC, and each manager in a manager-managed LLC, must refrain from competing with the LLC in the conduct or winding up of the LLC's activities. [Corps.C. § 17704.09(b)(3), (f)(1)]

(4) [6:508] **Compare—partners' duty of loyalty:** In stating that the duty of loyalty "is limited to" the conduct set forth above (¶ 6:505 ff.), CRULLCA attempts to restrict the duty of loyalty that a manager (in a manager-managed LLC) or member (in a member-managed LLC) owes to the LLC and to the other members. In contrast, the duty of loyalty that a partner of a general partnership owes to a partnership and to the other partners "includes" conduct identical to the conduct set forth above (¶ 6:505 ff.). The reason for the difference in language is not clear. Moreover, the three types of conduct set forth above (¶ 6:505 ff.) appear quite broad and would invite *expansive* interpretations of a manager's (or member's) duty of loyalty.

[6:509 - 6:519] ***Reserved.***

d. [6:520] **Duty of care:** The duty of care in the conduct or winding up of the LLC's activities is limited to refraining from *grossly negligent* or *reckless* conduct, *intentional misconduct* or a *knowing violation of law*. [Corps.C. § 17704.09(c), (f)(1)]

Thus, ordinary or simple negligence does not violate the duty of care (unless the operating agreement provides otherwise). In effect, the LLC—and by extension, the other members—bear the risk of ordinary negligence in the management of the LLC.

e. [6:521] **Good faith and fair dealing:** Members and managers must discharge their duties to the LLC and the members, and exercise any rights, consistent with the obligation of good faith and fair dealing. This is so whether the LLC is *member-managed or manager-managed*, and whether the duties or rights arise under CRULLCA or the operating agreement. [Corps.C. § 17704.09(d), (f)(2); see *Feresi v. The Livery, LLC* (2015) 232 CA4th 419, 425, 182 CR3d 169, 174—managing member "may not obtain any advantage over [plaintiff] (or any other member of the LLC) by even the slightest misrepresentation or concealment" (decided under prior law)]

(1) [6:522] **Example:** A husband and wife who together owned a 25% interest in an LLC divorced, with the wife obtaining a 12.5% interest in the LLC as well as a security interest on her husband's remaining 12.5% interest to secure other obligations of the husband toward the wife arising out of the divorce. The wife never filed a UCC-1 financing statement to perfect her security interest but, instead, notified the other members of the security interest. The president and managing member later loaned money to the husband and obtained a security interest in his membership interest, and then filed a UCC-1 financing statement. The managing member breached his fiduciary duty to the member/wife by knowingly attempting to destroy the value of her security interest to advance his own, and hence his security interest was properly subordinated to the wife's security interest. [*Feresi v. The Livery, LLC* (2015) 232 CA4th 419, 425-426, 182 CR3d 169, 174-175]

[6:523 - 6:525] ***Reserved.***

(2) [6:526] **Comment:** The intended reach of the obligation of good faith and fair dealing of the *members* of a *manager-managed* LLC *to the other members* of the LLC is not clear. Such members have no fiduciary duty of care or loyalty to the LLC, nor do they have agency power to act for and on behalf of the LLC. [Corps.C. §§ 17704.07(c)(1), 17704.09(f)(1), (3)]

The rights of members in a manager-managed LLC are largely limited to voting and information rights, and it is difficult to see how the obligation of good faith and fair dealing would apply. Perhaps the drafters intended to capture situations where a member owns a business competing with the LLC and exercises their information rights to further the member-competitor's own interests.

[6:527 - 6:529] ***Reserved.***

f. [6:530] **Self-interest permitted:** Where the LLC is member-managed, the fact that a member's conduct furthers the member's own interest does not by itself violate any duty owed to the LLC or the other members. Similarly, where the LLC is manager-managed, the fact that a manager's conduct furthers the manager's own interest does not by itself violate any duty owed to the LLC or the other members. [Corps.C. § 17704.09(e), (f)(1)]

(1) [6:531] **Limitation:** The reach of this provision is not as broad as it may first appear because it remains subservient to the duties of loyalty, care, and good faith and fair dealing. The purpose of this provision is to excuse LLC members or managers from accounting for *incidental* benefits obtained in the course of LLC activities *without detriment to the LLC or its other members*. [*Feresi v. The Livery, LLC* (2015) 232 CA4th 419, 426, 182 CR3d 169, 174-175]

[6:532 - 6:540] ***Reserved.***

5. Indemnification of Members, Managers and Agents

a. [6:541] **Indemnification of Members/Managers:** An LLC *must* reimburse and indemnify a member in a member-managed LLC, and a manager in a manager-managed LLC, for any debt, obligation or other liability incurred in the course of the member's or manager's activities on behalf of the LLC. But this is true only if the member or manager complied with their fiduciary duties to the LLC when making the payment or incurring the liability on behalf of the LLC. [Corps.C. §

17704.08(a)] Also, absent language to the contrary in the operating agreement, indemnity may be limited based on equitable principles. [See *Starr v. Mayhew* (2022) 83 CA5th 842, 859, 299 CR3d 99, 115]

b. [6:542] **Indemnification of "agents":** An LLC *may* (permissive) reimburse any officer, employee, or agent of the LLC for any payment or *may* indemnify any such person for any debt, obligation or other liability incurred or made in the course of that person's activities on behalf of the LLC. [Corps.C. § 17704.08(b)]

(1) [6:543] **Exception:** The LLC's authorization to reimburse/indemnify officers, employees and agents is expressly made subject to Corps.C. § 17701.10(g). This is puzzling, because § 17701.10(g) allows the operating agreement to alter or eliminate the indemnification of a *member or manager*. Presumably, this exception should be interpreted to mean that the operating agreement may likewise alter or eliminate the LLC's obligation to indemnify officers, employees and agents. [Corps.C. § 17704.08(b)]

(2) [6:544] **"Agent" defined:** An "agent" is any person who is or was a member of a member-managed LLC, manager of a manager-managed LLC, or officer, employee or other agent of the LLC. "Agent" includes any person who is or was serving at the LLC's request as a manager, director, officer, employee or agent of another foreign or domestic enterprise (e.g., corporation, LLC, or foreign LLC, partnership, joint venture or trust), as well as any person who was a manager, director, officer, employee, or agent of a foreign or domestic enterprise that was a *predecessor* of the LLC or of another enterprise and who served at the request of the predecessor entity or other enterprise. [Corps.C. § 17704.08(d)(2)(A)]

(3) [6:545] **Compare—mandatory indemnification:** To the extent an LLC agent has been successful on the merits in defense "or settlement" of any claim, issue, or matter in any "proceeding" (*see ¶ 6:547)* in which the agent was or is a party or is threatened to be made a party by reason of the fact that the person is or was an LLC agent, and if the agent acted in good faith and in a manner that the agent reasonably believed to be in the best interests of the LLC and its members, then the agent shall be indemnified against expenses actually and reasonably incurred in connection therewith. Such indemnification is not discretionary with the LLC: The agent is entitled as a manner of statutory right to indemnification. [Corps.C. § 17704.08(d)(1)]

(a) [6:546] **Expenses include attorney fees:** Indemnifiable expenses include attorney's fees, as well as any expenses of establishing an indemnified person's right to indemnification under CRULLCA ("fees on fees"). [Corps.C. § 17704.08(d)(2)(B)]

(b) [6:547] **"Proceeding":** "Proceeding" means any threatened, pending, or completed action or proceeding, whether civil, criminal, administrative or investigative. [Corps.C. § 17704.08(d)(2)(C); see *In re SDR Capital Mgmt., Inc.* (BC ND CA 2008) 2008 WL 8188356—indemnifiable expenses include attorneys' fees paid to fend off threatened SEC administrative proceeding]

(c) [6:548] **"Settlement":** It is not clear how an agent can be successful on the merits in the "settlement" of a claim or lawsuit. Presumably, this is intended to provide for indemnification so long as the agent acted in good faith and in a manner that the agent reasonably believed to be in the best interest of the LLC and its members.

(Although the agent indemnification provisions of Corps.C. § 17704.08 were adapted from Corps.C. § 317(d) applicable to corporations, the concept of indemnification for "settlement" does not appear in § 317(d).)

(4) [6:549] **Distinguish—other statutes requiring indemnification:** Other statutory provisions may require the LLC to indemnify certain persons who may qualify as "agents." For example, an LLC must indemnify its *employees* for necessary expenses incurred in the discharge of their duties. [See Lab.C. § 2802]

c. [6:550] **Insurance:** Whether the LLC is member-managed or manager-managed, the LLC may maintain insurance on behalf of any person against liabilities incurred by that person. This applies even to liabilities to the LLC that the operating agreement cannot alter or eliminate (per Corps.C. § 17701.10(g)). [Corps.C. § 17704.08(c)]

[6:551 - 6:559] ***Reserved.***

6. [6:560] **Officers:** A *written* operating agreement may provide for officers, such as a chairperson, president, secretary or chief financial officer. An officer need not be a member or manager. The officers have the titles, powers and duties set forth in the articles of organization or the operating agreement. Any number of offices may be held by the same person. [Corps.C. § 17704.07(u)]

Comment: Many LLC operating agreements provide that officers have the power and authority commonly delegated to officers in corporations with similar titles.

a. [6:561] **Appointment:** A *written* operating agreement may set forth the officers' manner of appointment. Where the operating agreement does not do so, the *managers* may appoint officers, and may discharge the officers at any time (subject to any rights an officer may have under any employment contract). An officer may resign at any time upon written notice to the LLC (but the LLC may pursue any rights it may have under any employment contract with the officer). [Corps.C. § 17704.07(v)]

b. [6:562] **Execution of LLC instruments:** Unless the *articles of organization* provide otherwise, any note, mortgage, evidence of indebtedness, contract, certificate, statement, conveyance or other written instrument, and any assignment or endorsement thereof, is binding on the LLC when signed by the chairperson, the president or any vice president, and also by the secretary, any assistant secretary, the chief financial officer, or any assistant treasurer. I.e., the LLC may not invalidate the instrument on the ground that the signers' lacked authority *unless* the other party had *actual knowledge* of the lack of authority. [Corps.C. § 17704.07(w)]

(1) [6:563] **Comment:** The obvious source of Corps.C. § 17704.07(w) is Corps.C. § 313, applicable to corporations. While many LLCs elect to appoint officers to conduct the LLC's day-to-day business, this provision is odd in its omission of any reference to documents or instruments signed by a "manager" or "member" (in a member-managed LLC). One would have thought that this section, granting presumptive authority for documents or instruments signed by two LLC officers, would also extend to documents and instruments signed by managers or members. The absence of any reference in this section to managers and members implies that its reach does *not* extend to documents and instruments executed by managers or members. Even if the section were construed to extend to managers and members (in a member-managed LLC), it is not clear what the relationship is of this provision to other Corps.C. § 17704.07 subdivisions denying authority to managers or members (in member-managed LLCS) to authorize acts outside of the ordinary course of the activities of the LLC without the consent of all members (unless otherwise provided in the operating agreement). [See Corps.C. § 17704.07(b)(4), (c)(4)(B)]

[6:564 - 6:599] ***Reserved.***

Cal. Prac. Guide Pass--Through Entities Ch. 6-E

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Chapter 6. Limited Liability Company

E. Ongoing Operating Matters

1. [6:600] **California Office Required:** An LLC formed in California must designate and continuously maintain an office in California, which need not be a place of its activity in California. (A foreign LLC registered in California (*see ¶ 6:1200 ff.*) need not maintain a California office.) [Corps.C. § 17701.13(a)(1)]

The designated office must be set forth in the articles and the LLC's initial statement of information. The LLC may change its principal office by delivering to the Secretary of State a new statement of information. (The articles cannot not be amended or restated merely to designate a new principal office.) [Corps.C. §§ 17701.14(a), 17702.01(b)(3), 17702.02(f); *see ¶ 6:660 ff., 6:696*]

2. [6:601] **Preorganization Contracts Valid:** A contract or agreement entered into in the name of the LLC by a promoter before the LLC is organized is nonetheless valid, and may be enforced by or against the LLC after it files its articles of organization so long as it ratifies or adopts the contract. Adoption or ratification may be express or implied; indeed, one means of adopting a preorganization contract is to bring an action to enforce it. [See Corps.C. §§ 17701.11(c), 17701.02(s); *02 Develop., LLC v. 607 South Park, LLC* (2008) 159 CA4th 609, 612, 71 CR3d 608, 610 (noting LLCs and corporations are treated the same with respect to preorganization agreements)]

Cross-refer: For a discussion of pre*incorporation* transactions by promoters, see Friedman, Soza & Jann, *Cal. Prac. Guide: Corporations* (TRG), Ch. 3.

3. [6:602] **LLC Records:** Member and managers have rights of access to LLC records as a matter of law under the circumstances set forth below (¶ 6:603 ff.).

a. [6:603] **Records required by statute:** All LLCs are required to keep and maintain certain records at their office in California. These records must be in written form or in any other form capable of being converted into clearly legible tangible form. [Corps.C. § 17701.13(d)]

(1) [6:604] **Member list:** The LCC must maintain a current list of the full name and last known business or residence address of each member and each transferee. The list must be kept in alphabetical order, and must also show the contribution and share in profits and losses of each member and holder of a transferable interest. [Corps.C. § 17701.13(d)(1)]

(2) [6:605] **Manager list:** If the LLC is manager-managed, it must keep a current list of each manager's full name and business or residence address. [Corps.C. § 17701.13(d)(2)]

(3) [6:606] **Articles and operating agreement:** The LLC is also required to maintain a copy of its articles of organization and any written operating agreement, including all amendments, and any powers of attorney pursuant to which the articles, the operating agreement and any amendments were executed. [Corps.C. § 17701.13(d)(3), (5)]

(4) [6:607] **Income tax records:** The LLC must keep copies of its federal, state and local income tax or information returns and any reports for the *six most recent* fiscal years. [Corps.C. § 17701.13(d)(4)]

(5) [6:608] **Financial statements:** The records must include copies of the LLC's financial statements, if any, for the six most recent fiscal years. [Corps.C. § 17701.13(d)(6)]

(6) [6:609] **Internal books and records:** The LLC must also maintain "books and records … as they relate to the internal affairs" of the LLC for at least the *current* fiscal year and the *past four* fiscal years. [Corps.C. § 17701.13(d)(7)]

(7) [6:610] **Property records for county assessor:** Upon request of a county assessor, the LLC must keep a copy of the business records relevant to the amount, cost and value of all property that the LLC owns, claims, possesses or controls within that county. The records must be made available to the assessor at the LLC's principal office in California or the office it maintains in California or at a place mutually acceptable to the assessor and the LLC. [Corps.C. § 17701.13(e)]

b. [6:611] **Penalty for failure to maintain information:** Failure to maintain the required records subjects the LLC to a penalty of $25 per day, beginning 30 days after receipt of written request by any member that the LLC maintain the records, up to a maximum penalty of $1,500. Where more than one member makes the request, the maximum *daily* penalty is $250. [Corps.C. § 17713.07(a)]

(1) [6:612] **Payable to member:** The penalty must be paid to the member or members who *requested* the LLC to maintain the records *and* who were *damaged* by the failure to maintain the records. Suit to enforce the penalty must be brought within 90 days after the request was made. The penalty is in addition to any other damages and remedies, including the award of attorneys' fees. [Corps.C. §§ 17713.07(a), 17713.08, 17704.10(g)]

(a) [6:613] **Court discretion to reduce penalty:** Where the LLC's failure to maintain the records was "inadvertent or excusable," the court may reduce or suspend the penalty on any terms and conditions it deems reasonable. [Corps.C. § 17713.08]

[6:614] ***Reserved.***

c. Member's right to records

(1) [6:615] **Inspection right:** A member or transferee has the right, upon reasonable request, to inspect and copy during normal business hours any of the above records (¶ 6:602 ff.) that the LLC is required to maintain. However, the LLC may require the member or transferee to show a purpose reasonably related to their interest as a member or transferee. [Corps.C. § 17704.10(b)(1); see *Burkle v. Burkle* (2006) 141 CA4th 1029, 1039, 46 CR3d 562, 570, fn. 8]

(2) [6:616] **Right to information:** Upon request of a member or transferee (or the person's agent or attorney), the LLC must "promptly" deliver, without charge, a written copy of its *member list* (*see ¶ 6:604*), *manager list* (*see ¶ 6:605*), *income tax records* (*see ¶ 6:607*) and any *written operating agreement*. The member or transferee also has the right to a written copy of the LLC's federal, state and local income tax returns for each year promptly after becoming available. However, the LLC may require the member or transferee to show a *purpose reasonably related to their interest* as a member or transferee. [Corps.C. § 17704.10(a), (b)(2), (i)]

(a) [6:617] **Comment:** Effective January 1, 2016, Corps.C. § 17704.10(a) and (b) were amended to change "holder of a transferable interest" to "transferee." The failure to make the same change in Corps.C. § 17704.10(e) and (i) appears to be an oversight. [See Stats. 2015, Ch. 775, § 10]

(3) [6:618] **Amendment of articles or operating agreement by manager via power of attorney:** A manager must promptly furnish to a member a copy of any amendment to the articles of organization or operating agreement executed by a manager pursuant to a power of attorney from the member. [Corps.C. § 17704.10(d)]

(4) [6:619] **Annual report (LLCs with more than 35 members):** *See* ¶ 6:671 ff.
(5) [6:620] **Annual tax information:** *See* ¶ 6:680 ff.
(6) [6:621] ***Caution re operating agreement restrictions:*** The operating agreement may not vary the members' inspection/information rights. [Corps.C. §§ 17701.10(d)(2), 17704.10(h); *see* ¶ *6:116*]

[6:622 - 6:630] ***Reserved.***

d. Manager's rights to records

(1) [6:631] **Inspection right:** A manager has the right, upon reasonable request, to inspect and copy during normal business hours any of the records that the LLC is required to maintain. However, the LLC may require the manager to show a purpose reasonably related to the manager's interest. [Corps.C. § 17704.10(b)(1)]
(2) [6:632] **Right to tax returns:** Each manager may obtain a written copy of the LLC's federal, state and income tax returns for each year promptly after becoming available. However, the LLC may require the manager to show a purpose reasonably related to the manager's interest. [Corps.C. § 17704.10(b)(2)]
(3) [6:633] **Right may be restricted by operating agreement?** CRULLCA bars the operating agreement from varying "a *member's* rights" to LLC records under Corps.C. § 17704.10. This might be read as permitting an operating agreement to vary a *manager's* rights to LLC records under § 17704.10. But any such reading would fly in the face of Corps.C. § 17704.10(h), which makes any waiver of the rights set out in § 17704.10 unenforceable. Such a reading would also be fanciful, since managers, who by definition control an LLC, are unlikely to restrict their own information rights. The omission of a reference to "managers" in Corps.C. § 17701.10(d)(2) is undoubtedly inadvertent. [Corps.C. §§ 17701.10(d)(2) (emphasis added), 17704.10(h); *see* ¶ *6:116*]

[6:634 - 6:639] ***Reserved.***

e. [6:640] **Enforcement by court order; time extensions:** If necessary, the members and managers can enforce their right to information by court action. But the court may also extend the time for compliance by the LLC "for good cause shown." [Corps.C. § 17704.10(f)]
(1) [6:641] **Attorney fees award:** The court may award a party bringing an action to enforce the LLC's obligation to provide information the party's reasonable expenses, including attorney's fees, if it finds that the LLC's failure to comply was without justification. [Corps.C. § 17704.10(g)]
(2) [6:642] ***Caution re operating agreement restrictions:*** The operating agreement may not vary a member's right to pursue a court action. [Corps.C. §§ 17701.10(d)(2), 17704.10(h); *see* ¶ *6:116*]
(a) [6:642.1] **Comment:** The reference in Corps.C. § 17701.10(d)(2) to a *member's* right to pursue a court action might be read to imply that an operating agreement may restrict a *manager's* right to pursue a court action. However, this is undoubtedly just a drafting oversight and not the intent of CRULLCA: It makes little sense to deny a manager the right to enforce his or her right to information. (*See* ¶ *6:633*.)
f. [6:643] **Enforcement by Attorney General:** If the California Attorney General receives a complaint that an LLC is not furnishing the members or managers with information or inspection rights provided by law, the articles of organization or the operating agreement, the Attorney General may send the LLC notice of the complaint. If the LLC fails to respond within 30 days, or if the response is unsatisfactory, the Attorney General may bring an action in cases where private enforcement "would be so burdensome or expensive as to be impractical." The Attorney General may seek injunctive relief, dissolution of the LLC, appointment of a receiver or any appropriate other remedies. [Corps.C. § 17704.10(j), (k)]
g. [6:644] **No waiver of inspection or information rights:** Any waiver of a member's or manager's statutory right to information or to inspect LLC records is unenforceable. [Corps.C. § 17704.10(h)]

[6:645 - 6:649] ***Reserved.***

4. [6:650] **Agent for Service of Process:** An LLC (including a foreign LLC registered in California; *see* ¶ *6:1200 ff.*) must continually maintain an agent for service of process in California. The agent must be either an individual who is a California

resident or a corporation that has filed the requisite certificate with the Secretary of State in compliance with the requirements for acting as an agent for service of process (Corps.C. § 1505). [Corps.C. §§ 17701.13(a)(2), (b), (c), 17701.14]

a. [6:651] **Change of agent:** If an individual agent dies, resigns or no longer resides in California, or if a corporate agent resigns, dissolves or for any other reason can no longer act as agent, the LLC must designate a new agent and "promptly" file an amended statement of information (¶ 6:667). [Corps.C. §§ 17701.13(a)(2), 17701.14, 17701.15(e)]

(1) [6:652] **Agent's resignation or disclaimer of appointment:** The agent may *resign* by filing a duly signed and acknowledged statement of resignation with the Secretary of State. This effectively terminates the agent's authority; and the Secretary of State must immediately advise the LLC of the resignation by written notice directed to LLC's principal office. [Corps.C. § 17701.15(a)-(c)]

The agent may also *disclaim* having been properly appointed as agent for service of process by filing a disclaimer with the Secretary of State. [Corps.C. § 17701.15(d); 2 CCR § 21906]

The resignation or disclaimer must be on a form prescribed by the Secretary of State. [Corps.C. § 17701.15(a), (d); 2 CCR § 21906]

• ***FORM:*** The Secretary of State's standard form Resignation of Agent Upon Whom Process May Be Served (RA-100) is available online at the Secretary of State's website (*www.sos.ca.gov*).

➪ [6:653] ***PRACTICE POINTERS RE AGENT FOR SERVICE OF PROCESS*: *See ¶ 3:111*.**

[6:654 - 6:659] *Reserved.*

5. [6:660] **Biennial Statement of Information (or Statement of No Change):** Every LLC must file a statement of information with the Secretary of State within *90 days after filing its original articles of organization* (or in the case of a foreign LLC registered in California, within *90 days after registering*; *see ¶ 6:1200*). Thereafter, the LLC must file *biennially* a statement of information or, if there is no change to its most recently filed statement of information, a statement of no change (*see ¶ 6:663*). The purpose of the biennial statement is to ensure that basic information about the LLC, such as its address, agent for service of process, and the names and addresses of its manager or managers (or members if it is member-managed), is kept current. [Corps.C. § 17702.09(a), (b); see Corps.C. § 17713.11(a)—biennial statement requirement applies to foreign LLCs registered in California]

a. [6:661] **Compare—*annual statement required for corporations:*** Attorneys advising both corporations and LLCs should not be confused by the fact that corporations must file a statement of information annually. [Corps.C. § 1502(a)]

b. [6:661.1] **Online filing permitted:** An LLC may file its statement of information online at *https://llcbizfile.sos.ca.gov.* In addition, when the statement is filed online, the LLC can request to receive a "pdf" copy of the filed statement by email.

c. [6:662] **Form and fee:** Several months before the statement's due date (*see ¶ 6:663*), the Secretary of State will send the LLC a blank form by mail or, if the LLC indicated a preference to receive the statement by email, by email (but failure to receive the form does *not* excuse compliance). The statement must be completed and returned (or filed online, ¶ 6:661.1), along with a $20 fee. [Corps.C. § 17702.09(b), (c); Gov.C. § 12190(k)]

FORMS

• The Secretary of State's standard form Statement of Information (Form LLC-12) is available online at the Secretary of State's website (*www.sos.ca.gov*).

• The Secretary of State's standard form Statement of No Change (Form LLC-12NC) is available online at the Secretary of State's website (*www.sos.ca.gov*).

d. [6:663] **Due date for subsequent statements:** After filing the initial statement of information (¶ *6:660*), subsequent statements of information must be filed:

• In the case of a *California* LLC, in the calendar month in which its original articles were filed;

• In the case of a *foreign* LLC registered in California, in a six-month period beginning five months before the month in which its application for registration was filed. [Corps.C. § 17702.09(c)]

e. Enforcement provisions

(1) [6:664] **Statutory penalty:** Failure to file the statement when due will result in assessment of a statutory penalty of $250 unless the LLC can show "reasonable cause or unusual circumstances" justifying such failure. [Corps.C. §§ 17713.07(b), 17713.09; Rev. & Tax.C. § 19141; see Corps.C. § 17713.11(a) re foreign LLCs]

(2) [6:665] **Suspension:** If an LLC fails to file a statement, has not filed a statement during the preceding 24 months, and has been certified for a penalty by the Secretary of State (¶ 6:664), the LLC is subject to suspension of its powers, rights and privileges. [Corps.C. § 17713.10(a); see *Palm Valley Homeowners Ass'n, Inc. v. Design MTC* (2000) 85 CA4th 553, 559, 102 CR2d 350, 354 (involving parallel corporate statutory provision); see also Corps.C. § 17713.11 re suspension of foreign LLC's powers]

(a) [6:666] **Reinstatement:** Notwithstanding its suspension, the LLC is empowered to file the overdue biennial statement. Upon filing the statement and paying any fees or taxes that may be due, the suspension is lifted. [Corps.C. § 17713.10(d); see *Palm Valley Homeowners Ass'n, Inc. v. Design MTC* (2000) 85 CA4th 553, 559-560, 102 CR2d 350, 354]

f. [6:667] **New statement required when change in agent for service of process; optional for other changes:** If the LLC's agent for service of process changes, the LLC must file a new statement of information. The LLC may, but need not, file a new statement when any of the other information on its existing statement of information changes. No fee is required to file a new statement. [Corps.C. § 17702.09(d); see Corps.C. § 17702.02(f)]

[6:668 - 6:670] ***Reserved.***

6. LLCs With More Than 35 Members—Special Provisions re Financial Reports

a. [6:671] **Annual Report Requirement:** An LLC having more than 35 members must send an annual report to each member not later than 120 days after the close of the LLC's fiscal year. [Corps.C. § 17704.10(c)]

(1) [6:672] **Contents:** The report must contain at least:

- A *balance sheet* as of the end of the fiscal year;
- An *income statement* for the fiscal year; and
- A *statement of cash flows* for the fiscal year. [Corps.C. § 17704.10(c)(1)]

(2) [6:673] **Certification:** Any report prepared by the LLC's independent accountants must accompany the financial statements. (But this does not mean a certified audit. The "report" may simply state the sources from which the information was obtained, that no audit was done, and that no opinion is expressed as to the accuracy of the original entries.) [Corps.C. § 17704.10(c)(3)]

If there is no such report, the financial statements must be accompanied by a certificate of the LLC manager stating that the financial statements were prepared without audit from the LLC's books and records. [Corps.C. § 17704.10(c)(3)]

b. [6:674] **Quarterly reports upon request:** Where the LLC has more than 35 members, any *three or more* members, or members representing at least *5%* of the "voting interests" (*see ¶ 6:675*), are entitled to obtain *interim* (quarterly) financial statements. [Corps.C. § 17704.10(c)(2)]

Upon written request, such members are entitled to an income statement and balance sheet for the initial three-month, six-month or nine-month period (accompanied by the same sort of accountant's report or manager's certification as required for the annual report, ¶ 6:673). These interim reports are to be delivered or mailed to the requesting members within 30 days after the request. (The request may also be made by members' agents or attorneys.) [Corps.C. § 17704.10(c)(2), (3), (i)]

(1) [6:675] **"Voting interests":** The term "voting interests" is not defined by CRULLCA. If not defined by the operating agreement, it would presumably refer to the members' interests in the LLC's *current profits*. [See Corps.C. § 17704.07(r)(1)]

c. [6:676] **Operating agreement may not dispense with annual report; enforcement:** The operating agreement may not dispense with or vary the requirements for the annual report or quarterly reports (*see ¶ 6:116*). Nor is any waiver of the

right to the annual report or quarterly reports enforceable. Members may enforce the right to receive annual or quarterly reports by court action in the same manner as other rights to LLC records and information (*see ¶ 6:640 ff.*). [See Corps.C. §§ 17701.10(d)(2), 17704.10(f)-(k)]

[6:677 - 6:679] ***Reserved.***

7. [6:680] **Annual Tax Information to Members:** The LLC must send to each member (or holder of a transferable interest) the information necessary to complete the member's federal and state income tax (or information) returns. The information must be sent within 90 days after the end of the *taxable* year. If the LLC has 35 or fewer members, the information must include a copy of the LLC's federal, state and local tax or information returns for the year. [Corps.C. § 17704.10(e)]

a. [6:681] **Operating agreement may not dispense with annual tax information; enforcement:** The operating agreement may not dispense with or vary the requirements for the annual tax information that the LLC must furnish to members (*see ¶ 6:116*). Nor is any waiver of this right valid. Here again, members may enforce the right to receive annual tax information by court action in the same manner as other rights to LLC records and information (*see ¶ 6:640 ff.*). [See Corps.C. §§ 17701.10(d)(2), 17704.10(f)-(k)]

b. [6:681.1] **Federal (IRS) requirement:** *See ¶ 8:240 ff.*

c. [6:681.2] **Franchise Tax Board requirement:** *See ¶ 8:215*.

➪ [6:682] ***PRACTICE POINTER:*** When the LLC's fiscal year is the calendar year, the LLC will have until approximately March 31 to provide its members with the required tax information. This does not leave members with much time to meet the usual April 15 deadline for filing individual income tax returns. The members may wish to include a provision in the operating agreement giving the LLC fewer than 90 days (say, 60 to 75 days) to furnish the tax information.

[6:683 - 6:689] ***Reserved.***

8. [6:690] **Amendment/Restatement of Articles:** An LLC may amend or restate its articles of organization at any time. [Corps.C. § 17702.02(a)]

a. [6:691] **Required member vote:** Unless the articles or operating agreement provide otherwise, the articles may be amended only by the unanimous vote of all members. The articles or operating agreement may not permit the articles to be amended by a vote of less than a *majority* of the members (i.e., those members owning not less than a majority of the interests of the LLC's *current profits*). [Corps.C. §§ 17701.10(d)(4), 17704.07(r)(2), (s); see Corps.C. § 17701.02(m)]

(1) [6:692] **Comment:** The intent of this provision is clear: Any amendment to the LLC's articles of organization must be approved by not less than a "majority of the members," which CRULLCA defines as those members holding not less than a majority of the interests in the LLC's current profits. However, the CRULLCA definition further states that this threshold —majority of interests in current profits—applies "*unless otherwise provided in the operating agreement*." [Corps.C. § 17701.02(m) (emphasis added)]

Thus, for example, if the operating agreement defined "majority of the members" to refer simply to a majority of the members by *number of members* (e.g., in an LLC of ten members, approval by six members regardless of their holdings of the interests in the LLC's profits) then the approval of an amendment to the articles of organization could be approved by the vote of members holding less than a majority of the interests in the LLC's profits.

b. [6:693] **Certificate of amendment:** To amend its articles, the LLC must deliver to the Secretary of State a certificate of amendment on the form prescribed by the Secretary of State. The certificate must state the LLC's name, the Secretary of State's file number for the LLC, and the changes the amendment makes to the articles. [Corps.C. § 17702.02(b)]

• ***FORM:*** The Secretary of State's standard form Certificate of Amendment (Form LLC-2) is available online at the Secretary of State's website (*www.sos.ca.gov*).

(1) [6:694] **When mandatory:** With certain exceptions (*see ¶ 6:696*), the articles must be amended if a member in a member-managed LLC, or a manager in a manager-managed LLC, knows that any information in the existing articles is inaccurate. [Corps.C. § 17702.02(e)]

c. [6:695] **Restated articles of organization:** To restate its articles of organization, the LLC must deliver to the Secretary of State a restatement on the form prescribed by the Secretary of State. The restatement must state the LLC's name, the Secretary of State's file number for the LLC and the entire text of the restated articles (except that no information regarding the agent for service of process may be set forth if the LLC has filed a statement of information per Corps.C. § 17702.09, ¶ 6:660 ff.). [Corps.C. § 17702.02(c)]

• ***FORM:*** The Secretary of State's standard form Restated Articles of Organization of a Limited Liability Company (LLC) (Form LLC-10) is available online at the Secretary of State's website (*www.sos.ca.gov*).

d. [6:696] **Restrictions on certain amendments/restatements:** The articles may not be amended or restated merely to change the LLC's principal office, its mailing address, its agent for service of process, or the agent's address. To change that information, the LLC must complete a new statement of information (*see ¶ 6:660*). [Corps.C. § 17702.02(f)]

e. [6:697] **Execution:** An amendment or restatement must be executed by at least *one manager* of a *manager-managed* LLC or at least *one member* of a *member-managed* LLC unless a greater number is required by the *articles of organization*. [Corps.C. § 17702.02(d)]

f. [6:698] **Filing fee:** The fee for filing an amendment or restatement is $30 (plus a $15 special handling fee if the document is delivered in person to the Secretary of State's office). [Gov.C. §§ 12182(a), 12190(d), (e); 2 CCR § 21903(c)]

[6:699] ***Reserved.***

9. [6:700] **Correction of Document Filed With Secretary of State:** An LLC that discovers that a document filed with the Secretary of State contains inaccurate information or was defectively signed may file a certificate of correction on a form prescribed by the Secretary of State. [Corps.C. § 17702.06(a)]

• ***FORM:*** The Secretary of State's standard form Certificate of Correction (Form LLC-11) is available online at the Secretary of State's website (*www.sos.ca.gov*).

a. [6:701] **Contents:** The certificate of correction must:

• State the LLC's name and the Secretary of State's file number;

• Describe the title of the document to be corrected, including its file date;

• Set forth the name of each party to the document;

• Specify the inaccurate information and the reason it is inaccurate or the manner in which the signing was defective; and

• Correct the defective signature or inaccurate information. [Corps.C. § 17702.06(b)]

b. [6:702] **Execution:** The certificate of correction must be executed in the same manner as the record being corrected was required to be executed. [Corps.C. § 17702.06(c); see Corps.C. § 17702.03(b)—"any record filed under this title may be signed by an agent" (except as otherwise expressly provided)]

c. [6:703] **Retroactive effect:** The filed certificate of correction is effective retroactively as of the date of the document the certificate corrects. (But the certificate of correction is effective when *filed* as to persons who previously relied on the uncorrected document and would be adversely affected by the retroactive effect.) [Corps.C. § 17702.06(d)]

d. [6:704] **Potential liability for failure to correct:** A person who relies on "inaccurate" information contained in a record filed with the Secretary of State may recover damages for any resulting loss. [Corps.C. § 17702.07(a)]

[6:705] ***Reserved.***

(1) Who may be liable

(a) [6:706] **Signer:** Liability may be imposed on the person who signed the record (or caused another person to sign it on their behalf) if the person *knew* the information was inaccurate at the time the record was signed. [Corps.C. § 17702.07(a)(1)]

1) [6:707] **Comment:** It should be noted that an individual who signs a record authorized or required to be filed under CRULLCA affirms "under penalty of perjury" that the information stated in the record is accurate. [Corps.C. § 17702.07(c)]

(b) [6:708] **Member or manager:** A *member* of a *member-managed* LLC, or a *manager* of a *manager-managed* LLC, may be liable where the member or manager had notice of the inaccuracy for a *reasonably sufficient time* before the information was relied upon so that, before the reliance, the member or manager could have corrected the inaccuracy by (i) causing the articles to be amended, (ii) delivering a statement of correction (or a new statement of information, if appropriate; *see ¶ 6:660 ff.*) to the Secretary of State, or (iii) filing a petition for a court order compelling execution of the appropriate corrective document or compelling the Secretary of State to accept the document unsigned (Corps.C. § 17702.04). [Corps.C. § 17702.07(a)(2)]

1) [6:709] **Exception where member relieved of responsibility by operating agreement:** A member of a member-managed LLC is not liable to the extent the operating agreement expressly relieves the member of responsibility for maintaining the accuracy of information contained in records filed with the Secretary of State and imposes that responsibility on one or more other members. [Corps.C. § 17702.07(b)]

10. [6:710] **Members' Class Action Against LLC:** Any LLC member may bring a class action on behalf of all or a class of members to enforce any *claim common to those members*. The class action is governed by the law governing class actions generally, except there is no requirement that the class be so numerous that joinder of all members of the class is impracticable. [Corps.C. § 17709.01]

(*Caution:* The operating agreement may not "unreasonably restrict" a member's right to bring a class action; *see ¶ 6:119*.)

11. [6:711] **Derivative Actions:** A derivative action is an action by a member to enforce a right of the *LLC*—i.e., to redress actual or threatened harm to the *LLC*. Any recovery received in the action belongs to the *LLC* and not to the derivative plaintiff. [See Corps.C. § 17709.02(a) (action "in right of" LLC); *Sprengel v. Zbylut* (2019) 40 CA5th 1028, 1040-1041, 253 CR3d 561, 569-570; *PacLink Communications Int'l, Inc. v. Sup.Ct. (Yeung)* (2001) 90 CA4th 958, 963-966, 109 CR2d 436, 439-441; see also *Hilliard v. Harbour* (2017) 12 CA5th 1006, 1015, 219 CR3d 613, 619]

(*Caution:* The operating agreement may not "unreasonably restrict" a member's right to bring a derivative action; *see ¶ 6:119*.)

a. [6:711.1] **Principles governing corporate derivative actions apply:** The principles governing derivative actions involving corporations also apply to limited liability companies and limited partnerships. [*Schrage v. Schrage* (2021) 69 CA5th 126, 150, 284 CR3d 279, 300; *Sprengel v. Zbylut* (2019) 40 CA5th 1028, 1040, 253 CR3d 561, 570; *PacLink Communications Int'l, Inc. v. Sup.Ct. (Yeung)* (2001) 90 CA4th 958, 963, 109 CR2d 436, 439]

Cross-refer: For a discussion of shareholder derivative actions in the corporations context, see Friedman, Soza & Jann, *Cal. Prac. Guide: Corporations* (TRG), Ch. 6. For a discussion of derivative actions involving limited partnerships, *see* ¶ 5:374 ff.

b. [6:712] **Requirements for plaintiff—membership at time of complained transaction:** To bring a derivative action, the plaintiff must have been a member (of record or beneficially) at the time of the transaction, or any part of the transaction, that gave rise to the action. (But this requirement may be satisfied where plaintiff's status as a member devolved upon plaintiff by operation of law from a member who was a member at the time of the transaction or any part of the transaction—e.g., plaintiff may be the legal representative of a deceased person who was a member at the time of the transaction.) [Corps.C. § 17709.02(a)(1)]

(1) [6:713] **Exception upon court determination:** But a plaintiff who does *not* meet the foregoing requirements may nevertheless bring a derivative action where:

- There is a *strong prima facie case* in favor of the claim;
- No other similar action has been or is likely to be instituted;
- Plaintiff acquired the membership interest before the wrongdoing was *disclosed* to plaintiff *or* to the public;
- Defendant may retain a gain derived from *willful breach of a fiduciary duty* unless the action can be maintained; *and*

• The requested relief will not *unjustly enrich* the LLC or any member. [Corps.C. § 17709.02(a)(1)(A)-(E)]

(2) [6:714] **Plaintiff must be member when action brought:** In addition to the "contemporaneous" membership requirement (¶ 6:712), a plaintiff bringing a derivative action under Corps.C. § 17709.02 must also satisfy a "continuous" membership requirement. This means that the plaintiff was a member of the LLC throughout the litigation of the derivative action. [*Sirott v. Sup.Ct. (Patel)* (2022) 78 CA5th 371, 380-385, 293 CR3d 408, 412-416—plaintiff lost standing to pursue derivative action against LLC when it relinquished its interest in LLC]

c. [6:715] **"Demand" prerequisite:** Before bringing a derivative action, plaintiff must make a reasonable effort to induce the managers to commence the action themselves or otherwise redress the wrong, unless that effort would be useless or futile ("demand futility"). Plaintiff must inform the LLC or the managers in writing of the "ultimate facts of each cause of action against each defendant"; or, alternatively, plaintiff must give the LLC or the managers a copy of the proposed complaint. [Corps.C. § 17709.02(a)(2)]

The complaint filed by a derivative plaintiff must allege "with particularity" plaintiff's efforts "to secure from the managers the action that plaintiff desires or the reasons for not making that effort …" [Corps.C. § 17709.02(a)(2)]

➪ [6:715.1] ***PRACTICE POINTER:*** To avoid disputes concerning whether plaintiff has adequately informed the LLC of the ultimate facts of each cause of action against each defendant, the customary practice is for derivative plaintiffs to provide the LLC with a draft of the complaint they intend to file.

d. [6:716] **Posting of security—noticed motion required:** The LLC or the *defendant* may bring a motion for an order requiring the derivative plaintiff to furnish security to cover the *LLC's and the defendant's* anticipated costs, including attorney fees, in defending the action. [Corps.C. § 17709.02(b)]

(1) [6:717] **When to bring motion:** The motion (which requires notice on all other parties) must be brought within *30 days* after service of process upon the LLC or any defendant who is a manager or was a manager at the time of the alleged wrongdoing (but the court, for good cause shown, may grant an application to bring the motion up to 60 days beyond the original due date of the motion). [Corps.C. § 17709.02(b) & (b)(2)]

(2) [6:718] **Action stayed during pendency of motion:** The motion automatically stays prosecution of the entire action until 10 days after the motion has been disposed of. During that time, no discovery may be conducted, and no further pleadings need be filed by the LLC or any other defendant. [Corps.C. § 17709.02(e)]

(3) [6:719] **Grounds for motion:** The motion must show that there is *no reasonable possibility* that prosecution of the claim alleged in the complaint will benefit the LLC or its members. [Corps.C. § 17709.02(b)(1)]

Alternatively (or additionally), a moving party that is not the LLC must show that the manager did not participate in the transaction complained of in any capacity. [Corps.C. § 17709.02(b)(2)]

(4) [6:720] **Hearing on motion:** A hearing on the motion is required, at which time the court shall consider evidence material to (i) the ground on which the motion is based and (ii) a determination of the probable reasonable expenses, including attorney fees, that the LLC and the defendant will likely incur in defense of the action. [Corps.C. § 17709.02(c)(1)]

(5) [6:721] **Determination of motion:** If the court determines that the moving party has established "a *probability*" (*see ¶ 6:722.1*) in support of its ground for bringing the motion, the court must fix the nature and amount of the security to be furnished by plaintiff to cover reasonable attorney fees and other expenses that the moving party and the LLC may incur in connection with the action. The maximum amount of the security is *$50,000* and must be furnished within a reasonable time as the court fixes. Failure to furnish the security by that time results in *dismissal* of the action. [Corps.C. § 17709.02(c)(2) (emphasis added)]

(6) [6:722] **Motion thwarted by posting of $50,000 bond:** Plaintiff may preclude the motion by furnishing a $50,000 bond before the motion is brought. The furnishing of the bond after the motion is brought results in dismissal of the motion. [Corps.C. § 17709.02(d)]

(7) [6:722.1] **Comment:** Corps.C. § 17709.02 is taken from former Corps.C. § 17501 (Beverly-Killea LLC Act). These sections are in turn derived from Corps.C. § 800, including the provision that the moving party must establish "a probability" in support of the grounds for its motion (¶ 6:721). Although none of these Code sections nor any reported California case describes what is meant by "a probability" in this context, the most sensible reading is that "a probability" means *more likely than not*—i.e., a *more-than-50%* chance.

Where the motion is based upon Corps.C. § 17709.02(b)(1) (¶ 6:719), the moving party must show "a probability" that "there is no reasonable possibility" that the claim will benefit the LLC or its members. A sensible reading of these two provisions together is that the court must find that it is *more likely than not* that *the claim will not benefit* the LLC or its members.

e. [6:723] **Compare—direct action:** Although CRULLCA does not expressly so state, a member may bring a direct action (including a class action, per Corps.C. § 17709.01, ¶ 6:710) for injury to the member's interest as a *member*. In the event a member has both direct and derivative claims, the member may maintain both a direct action and a derivative action. [*Denevi v. LGCC* (2004) 121 CA4th 1211, 1221-1222, 18 CR3d 276, 284; see *Holistic Supplements, L.L.C. v. Stark* (2021) 61 CA5th 530, 541-544, 275 CR3d 791, 797-800—LLC membership interest is personal property, thus plaintiff has standing to bring individual claims based on defendant secretly converting LLC to corporation and then mutual benefit corporation (defendant also subject to personal liability) (*see* ¶ 6:938.1); *Sprengel v. Zbylut* (2019) 40 CA5th 1028, 1040-1041, 253 CR3d 561, 569-570—action to recover LLC funds alleged to have been wrongfully paid to LLC's counsel is derivative action rather than direct action; *PacLink Communications Int'l, Inc. v. Sup.Ct. (Yeung)* (2001) 90 CA4th 958, 963-966, 109 CR2d 436, 439-441—LLC members could not bring direct action for harm resulting from fraudulent sale of LLC assets because harm was to LLC and not to members directly (harm was derivative in nature); compare *Hilliard v. Harbour* (2017) 12 CA5th 1006, 1015, 219 CR3d 613, 619—78-year-old controlling member of LLC could not maintain direct action under guise of Elder Abuse and Dependent Adult Civil Protection Act (Welf. & Inst.C. § 15600 et seq.) where harm was directly to LLC and his injury arose solely by reason of being member]

12. [6:724] **Suspension of LLC Powers:** A California LLC's powers, rights and privileges may be suspended for:

• Failure to timely pay the $800 annual franchise tax (Rev. & Tax.C. § 17941, ¶ 8:203) or the LLC income fee (Rev. & Tax.C. § 17942, ¶ 8:204 ff.). [Rev. & Tax.C. §§ 23301, 23305.5(a)(2)]

• Failure to file the biennial information statement required by Corps.C. § 17702.09(a) (¶ 6:660 ff.). [Corps.C. § 17713.10(a), ¶ 6:665]

• Failure to file a franchise tax return, even if no tax is due. [Rev. & Tax.C. §§ 23301.5, 23305.5(a)(2)]

[6:724.1] ***Application of Cited Authorities to LLCs:*** Cases cited in the following discussion arose in the context of corporations. However, the suspension statutes cited in the following discussion apply equally to corporations and LLCs, and hence the cases should apply to LLCs. [See Rev. & Tax.C. § 23305.5(a)(2), (b)(1) & (2)—"taxpayer" includes LLC, "articles of incorporation" include "articles of organization" and "tax" includes fees imposed by Rev. & Tax.C. §§ 17941 & 17942]

a. [6:724.2] **Effect of suspension:** During the period of such suspension, the only permissible LLC action is filing an application for tax-exempt status or amending the articles to perfect that application or to set forth a new LLC name. Otherwise, the LLC is disqualified from exercising any right, power or privilege. [Rev. & Tax.C. §§ 23301, 23301.5, 23305.5(a)(2); see *Cal-Western Business Services, Inc. v. Corning Capital Group* (2013) 221 CA4th 304, 310, 163 CR3d 911, 915; *Timberline, Inc. v. Jaisinghani* (1997) 54 CA4th 1361, 1367, 64 CR2d 4, 7]

(1) [6:724.3] **Incapacity to sue or defend in court:** Suspension of an LLC provides an opposing party with an affirmative defense that, when timely raised (*see ¶ 6:724.4 ff.*), prevents the LLC from prosecuting or defending an action in a California court. [See *Bourhis v. Lord* (2013) 56 C4th 320, 324, 153 CR3d 510, 512; *City of San Diego v. San Diegans for Open Gov.* (2016) 3 CA5th 568, 577, 207 CR3d 703, 709; *Cal-Western Business Services, Inc. v. Corning Capital Group* (2013) 221 CA4th 304, 310-312, 163 CR3d 911, 915-917—corporate assignee of claim acquired from suspended corporation likewise barred from bringing action to enforce claim during assignor's suspension]

Likewise, a suspended LLC may be prevented from:

— appealing an adverse judgment (see *Tabarrejo v. Sup.Ct. (Princess Retirement Homes, Inc.)* (2014) 232 CA4th 849, 861-862, 182 CR3d 30, 42 (appeal of Labor Commissioner's order to superior court per Lab.C. § 98.2); *Kaufman & Broad Communities, Inc. v. Performance Plastering, Inc.* (2006) 136 CA4th 212, 222, 39 CR3d 33, 39; see *Bourhis v. Lord* (2013) 56 C4th 320, 323, 153 CR3d 510, 511—notice of appeal invalid when filed during corporation's suspension (but validated upon corporation's revivor, ¶ *6:727.4*));

— petitioning for a writ of mandate (see *Brown v. Sup.Ct. (Stewart)* (1996) 242 CA2d 519, 522, 51 CR 633, 635); or

— renewing a judgment obtained prior to suspension (see *Timberline, Inc. v. Jaisinghani* (1997) 54 CA4th 1361, 1367, 64 CR2d 4, 7).

The LLC's incapacity to sue or defend in state courts may also preclude it from suing or defending in federal courts. [See *Matter of Christian & Porter Aluminum Co.* (9th Cir. 1978) 584 F2d 326, 331]

(a) [6:724.4] **Waiver of incapacity defense by failure to timely assert:** An LLC's incapacity to sue or defend due to suspension must be raised by the opposing party at the earliest opportunity. Failure to do so waives the defense. [See *V & P Trading Co., Inc. v. United Charter, LLC* (2012) 212 CA4th 126, 133, 151 CR3d 146, 151; *Color-Vue, Inc. v. Abrams* (1996) 44 CA4th 1599, 1603-1606, 52 CR2d 443, 446-447]

Thus, where plaintiff LLC's suspension existed at the time it filed suit, defendant must raise the incapacity defense in the answer (or by way of demurrer where the incapacity appears on the face of the complaint or is subject to judicial notice). [See *V & P Trading Co., Inc. v. United Charter, LLC*, supra, 212 CA4th at 133-134, 151 CR3d at 150-151; see also *Rossdale Group, LLC v. Walton* (2017) 12 CA5th 936, 943, 219 CR3d 605, 609-610; *and* ¶ *6:724.7*]

Compare: Defendant's failure to timely raise plaintiff LLC's incapacity does not waive any statute of limitations defense that may subsequently arise from the incapacity; *see* ¶ *6:725.2*.

1) [6:724.5] **Untimely assertion of defense in response to discovery motion:** Defendant's failure to timely assert the incapacity defense bars subsequent assertion of the defense in response to a motion by plaintiff LLC to compel discovery. A court's denial of the motion on incapacity grounds is thus *improper* and subject to reversal … as is any resulting *sanctions* award for *bringing* the motion. [See *V & P Trading Co., Inc. v. United Charter, LLC* (2012) 212 CA4th 126, 136-137, 151 CR3d 146, 153-154]

2) [6:724.6] **Exception where LLC refuses to pay delinquent taxes:** Where an LLC's suspension arises out of its failure to pay franchise taxes (*see* ¶ *6:724*), the LLC's continued refusal to pay those taxes allows the trial court to grant the opposing party relief from its failure to timely raise the incapacity defense. To hold otherwise would permit the suspended LLC to evade its state tax obligations while benefitting from the state court system. [See *Cal-Western Business Services, Inc. v. Corning Capital Group* (2013) 221 CA4th 304, 312-313, 163 CR3d 911, 917-918 (corporation had been suspended more than 10 years and represented to court it had no intention of seeking revivor)]

3) [6:724.7] **Standing to sue distinguished:** *Capacity* to sue, which is the right to *come into court*, should not be confused with *standing* to sue, which is the right to *relief* in court. An LLC's suspension does not affect its *standing* to sue. [See *Rossdale Group, LLC v. Walton* (2017) 12 CA5th 936, 944-945, 219 CR3d 605, 611]

➪ [6:724.8] ***PRACTICE POINTER:*** Where plaintiff LLC's suspension existed at the time it filed suit but defendant failed to assert the incapacity defense in its answer, defendant may seek leave to amend the answer. But to succeed on the motion, defendant must make some showing justifying relief from the effect of the original waiver (e.g., defendant learned of the suspension only after filing the answer and promptly moved for leave to amend). [See *V & P Trading Co., Inc. v. United Charter, LLC* (2012) 212 CA4th 126, 134, 151 CR3d 146, 151, fn. 2]

(b) [6:725] **Counsel's duty to notify court of suspension:** Notwithstanding counsel's duties (of confidentiality, etc.) to the client, an attorney who discovers that an LLC client is suspended and thus barred from prosecuting or defending a pending litigation matter has a duty to so advise the court. (The attorney's obligation to the *client* is to advise the client to seek reinstatement.) Failure to advise the court of the suspension is *unethical*, and evidence of *bad faith* that may support an award of *sanctions* against the client and/or the *attorney* for maintaining an unwarranted action (CCP § 128.5) and/or abusing the discovery process (CCP § 2023.010). [See *City of San Diego v. San Diegans for Open Gov.* (2016) 3 CA5th 568, 578-580, 207 CR3d 703, 709-711; *Palm Valley Homeowners Ass'n, Inc. v. Design MTC* (2000) 85 CA4th 553, 562, 102 CR2d 350, 356]

(c) [6:725.1] **Service of process unaffected by suspension:** Service of process upon a suspended LLC is effected in the same manner as service upon an LLC that has not been suspended. I.e., a copy of the summons and complaint is delivered to the LLC's designated agent for service of process (¶ 6:31, 6:650) or, in certain circumstances described by statute, the Secretary of State. [Corps.C. § 17701.16; see *Gibble v. Car-Lene Research, Inc.* (1998) 67 CA4th 295, 301-313, 78 CR2d 892, 895-903]

(d) [6:725.2] **Statute of limitations runs during suspension:** A plaintiff with a claim against a suspended LLC must still file suit within the applicable statute of limitations. There is no statutory authority for "tolling" (extending) the limitations period during defendant's suspension. And because suspension does not impair plaintiff's ability to sue or serve an LLC with process (¶ 6:725.1), there is *no equitable reason* to toll the limitations period. [See *Grell v. Laci Le Beau Corp.* (1999) 73 CA4th 1300, 1305-1306, 87 CR2d 358, 362-363]

[6:725.3] Conversely, a suspended LLC with a claim against defendant must likewise file suit within the applicable statute of limitations. However, where a suspended LLC timely files suit but the limitations period expires during the course of the litigation, the LLC's subsequent revivor does *not* "reinstate" the claim. This is so even where defendant *waived* the incapacity defense by failure to timely assert it (¶ 6:724.4) … because the incapacity defense is *distinct* from the statute of limitations defense. [See *V & P Trading Co., Inc. v. United Charter, LLC* (2012) 212 CA4th 126, 135-136, 151 CR3d 146, 152-153; *Casiopea Bovet, LLC v. Chiang* (2017) 12 CA5th 656, 664, 219 CR3d 157, 163; *City of San Diego v. San Diegans for Open Gov.* (2016) 3 CA5th 568, 579, 207 CR3d 703, 710; *and ¶ 6:727 ff.*]

(e) [6:725.4] **Court's jurisdiction to grant relief to adverse party not affected by LLC's suspension:** A suspended LLC's lack of capacity to sue or defend does not affect the court's jurisdiction to proceed in the matter and to grant relief to the adverse party. To hold otherwise would allow the LLC to benefit from the acts that led to its suspension. [See *Tabarrejo v. Sup.Ct. (Princess Retirement Homes, Inc.)* (2014) 232 CA4th 849, 868, 182 CR3d 30, 47]

• [6:725.5] As stated above (¶ 6:724.3), a suspended LLC may be prevented from prosecuting an appeal, including appeal of a Labor Commissioner order to the superior court (Lab.C. § 98.2). Although the suspended LLC's filing of the notice of appeal is invalid, the court nevertheless has jurisdiction to accept the appeal and the mandatory bond (or cash deposit) posted in connection therewith (Lab.C. § 98.2(b)). Where the LLC chooses not to seek reinstatement (¶ 6:727) and thus is prevented from prosecuting the appeal, the court may dismiss the appeal and order the bond forfeited to the adverse party (employee) as required by statute. [See *Tabarrejo v. Sup.Ct.* (*Princess Retirement Homes, Inc.*) (2014) 232 CA4th 849, 863-868, 182 CR3d 30, 43-48]

(f) [6:725.6] **Limitation—intervention by insurer:** Where the LLC is unable to defend itself in court against a claim for which it is insured, the insurer may nevertheless *intervene* and defend against the claim. [See *Reliance Ins. Co. v. Sup.Ct. (Wells)* (2000) 84 CA4th 383, 386-388, 100 CR2d 807, 809-811; see also *Truck Ins. Exchange v. Sup.Ct. (Transco Syndicate #1)* (1997) 60 CA4th 342, 347-350, 70 CR2d 255, 258-260; and *El Escorial Owners' Ass'n v. DLC Plastering, Inc.* (2007) 154 CA4th 1337, 1349-1350, 65 CR3d 524, 534-535]

1) [6:725.7] **Reason:** If the LLC is barred from conducting a defense and the insurer is not permitted to intervene, the plaintiff will be able to obtain an unopposed default judgment, which it may then enforce (up to the amount of the policy limits) in a direct action against the insurer. [Ins.C. § 11580(b)(2)] This would punish the *insurer* for something it did not do and had no control over—i.e., the LLC's failure to pay taxes (or file an information statement or tax return, ¶ 6:724). [See *Reliance Ins. Co. v. Sup.Ct.* (*Wells*) (2000) 84 CA4th 383, 386-388, 100 CR2d 807, 809-811; see *Truck Ins. Exchange v. Sup.Ct.* (*Transco Syndicate #1*) (1997) 60 CA4th 342, 347-348, 70 CR2d 255, 258—insurer could intervene in co-insurers' action against suspended corporation seeking to rescind co-insurers' policies (rescission would eliminate intervenor insurer's contribution rights)]

2) [6:725.7a] **Distinguish—no subrogation by insurer:** An insurer may not assert a subrogation claim on behalf of a suspended LLC. A subrogated insurer "stands in the shoes of its insured"; it has no greater rights than the insured and is subject to the same defenses assertable against the insured. Hence, an insurer cannot do via subrogation what the suspended insured LLC cannot do on its own. [See *Travelers Property Cas. Co. of America v. Engel Insulation, Inc.* (2018) 29 CA5th 830, 835-838, 240 CR3d 623, 626-629; see also *Kaufman & Broad Communities, Inc. v. Performance Plastering, Inc.* (2006) 136 CA4th 212, 217-224, 39 CR3d 33, 35-42; *Truck Ins. Exchange v. Sup.Ct.* (*Transco Syndicate #1*) (1997) 60 CA4th 342, 349-350, 70 CR2d 255, 259]

(g) [6:725.8] **Compare—derivative suit against persons preventing reinstatement:** Although a suspended LLC cannot sue, one of its members may maintain a derivative suit on its behalf against its members, managers or officers who control the books, records or other *information needed to cure the suspension*. In such a case, it would be inequitable to allow the defendant to assert the suspension as a shield against the derivative suit. [See *Reed v. Norman* (1957) 48 C2d 338, 344, 309 P2d 809, 813]

(h) [6:726] **Compare—suit by third-party beneficiary of LLC contract:** A third-party beneficiary of a contract entered into by an LLC may bring suit to enforce the contract notwithstanding the LLC's suspended status at the time of suit. This is so even where the plaintiff beneficiary was also a member and/or manager of the now suspended LLC and thus arguably bore some responsibility for the nonpayment of taxes or other events that led to the suspension. [See *Bozzio v. EMI Group Ltd.* (9th Cir. 2016) 811 F3d 1144, 1149-1152—member of band whose corporation entered into Loan-Out Agreement with record company could bring suit against record company to enforce Agreement notwithstanding corporation's suspension at time of suit]

(i) [6:726.1] **Continuance to effect reinstatement:** Moreover, a suspended LLC is entitled to a "short continuance" so that it may effect reinstatement (e.g., by paying back taxes, ¶ 6:727) and then resume prosecution or defense of the action. [See *Cadle Co. v. World Wide Hospitality Furniture, Inc.* (2006) 144 CA4th 504, 511-513, 50 CR3d 480, 485-487; *Color-Vue, Inc. v. Abrams* (1996) 44 CA4th 1599, 1606, 52 CR2d 443, 447; *United States v. 2.61 Acres of Land* (9th Cir. 1986) 791 F2d 666, 668-670]

(2) [6:726.2] **Cannot engage in real estate transactions:** A suspended LLC may not "sell, transfer or exchange" real property within California. [Rev. & Tax.C. §§ 23302(d), 23305.5(a)(2)]

(3) [6:726.3] **Contracts voidable:** Further, contracts entered into by the LLC during suspension are voidable at the option of the other party—but *not* at the option of the LLC. [Rev. & Tax.C. §§ 23304.1(a), 23305.5(a)(2); see *Performance Plastering v. Richmond American Homes of Calif., Inc.* (2007) 153 CA4th 659, 669, 63 CR3d 537, 545]

(a) [6:726.4] **Limitation—court-ordered rescission required:** The right to declare a contract voidable is exercisable only in a lawsuit brought by either party with respect to the contract. [Rev. & Tax.C. §§ 23304.5, 23305.5(a)(2)]

Upon finding the contract voidable, the court must order its rescission, *provided* the LLC (i) receives full restitution of any benefits it conferred under the contract, and (ii) was allowed a reasonable opportunity to "cure the voidability" (*see ¶ 6:727.6*). Absent a rescission order, the contract is enforceable. [Rev. & Tax.C. §§ 23304.5, 23305.5(a)(2)]

(b) [6:726.5] **Relief from voidability:** *See* ¶ 6:727.6 ff.

(4) [6:726.6] **Cannot claim escheated property:** A suspended LLC cannot obtain from the California Controller property of the LLC that escheated under the Unclaimed Property Law (CCP § 1500 et seq.). Nor can an *assignee or judgment creditor* of the LLC obtain the escheated property. This is so even where the judgment creditor acquired a judicial assignment (per CCP § 708.510) of the LLC's property or rights. An assignee who acquires a claim from a suspended LLC takes the claim *subject to any defenses that could be asserted against the LLC*, including *lack of capacity*. [See *Casiopea Bovet, LLC v. Chiang* (2017) 12 CA5th 656, 663, 219 CR3d 157, 162]

(5) [6:726.7] **Potential loss of LLC name:** Among the rights lost by a suspended LLC is the right to hold its name and prevent another LLC from adopting that name. Thus, another LLC may, by filing articles of organization (or a name reservation or amendment to its articles), effectively take away a suspended LLC's name and require it to adopt a new name prior to revivor. [See *Boyer v. Jones* (2001) 88 CA4th 220, 224-225, 105 CR2d 824, 827]

(6) [6:726.8] **Potential administrative cancellation (dissolution) by Secretary of State where LLC suspended at least 60 months:** *See ¶ 6:871 ff.*

b. [6:727] **Reinstatement (revivor):** An LLC that has been suspended for failure to pay franchise taxes or to file a franchise tax return may be reinstated by applying to the Franchise Tax Board, filing the necessary returns, and paying the overdue taxes plus any additions to tax, interest, penalties, and any other amounts due. When all payments due are made, the Franchise Tax Board issues a "certificate of revivor." [Rev. & Tax.C. §§ 23305, 23305.5(a)(2)]

If the suspension was for failure to file a biennial information statement, the LLC can be reinstated simply by filing the statement. [Corps.C. § 17713.10(d)]

• ***FORM:*** The Franchise Tax Board's standard form Application for Certificate of Revivor—Limited Liability Company (FTB 3557 LLC) is available on the Franchise Tax Board's website (*www.ftb.ca.gov*).

(1) [6:727.1] **"Substantial compliance" rule:** *Substantial compliance* with the revivor requirements permits LLCs suspended for failure to pay franchise taxes or file returns (Rev. & Tax.C. §§ 23301, 23301.5, 23305.5(a)(2), (b)(2)) to nonetheless prosecute or defend actions prior to any official revivor. However, "substantial compliance" requires *payment in full* of all taxes, interest or penalties due the state. [See *Sade Shoe Co., Inc. v. Oschin & Snyder* (1990) 217 CA3d 1509, 1516, 266 CR 619, 624—corporation's payment of past-due tax only ($200), without payment of interest and penalties thereon ($90.85), not "substantial compliance" with Rev. & Tax.C. § 23305 revivor provisions]

(2) [6:727.2] **Who may reinstate:** Application for reinstatement of the "taxpayer" may be made by "any stockholder or creditor, by a majority of the surviving trustees or directors thereof, by an officer, or by any other person who has interest in the relief from suspension or forfeiture." This encompasses an LLC's members and managers, and in fact the Franchise Tax Board's Application for Certificate of Revivor—Limited Liability Company (*see ¶ 6:727*) states that persons who can sign the Application include a member. [Rev. & Tax.C. § 23305; see Rev. & Tax.C. § 23305.5(a)(2)—"taxpayer" includes LLC]

Thus, for example, where some right or title is in the LLC's name (or it is the plaintiff in pending litigation), any member, manager or creditor, or purchaser of the claim, title, or cause of action, can arrange for its reinstatement to protect the LLC's rights therein. [See *Bozzio v. EMI Group Ltd.* (9th Cir. 2016) 811 F3d 1144, 1151, 1154]

(3) [6:727.3] **Clearance of LLC name:** Before a certificate of revivor is issued by the Franchise Tax Board, it must obtain from the Secretary of State an endorsement upon the revivor application that the LLC's name is still available (*see ¶ 6:727*). [Rev. & Tax.C. §§ 23305a, 23305.5(a)(2)]

(4) [6:727.4] **Effect of reinstatement:** A revivor has the effect of restoring all powers, rights and privileges to the suspended LLC.

It also *validates* all acts and transactions that occurred while the LLC was suspended … *unless* a substantive defense (e.g., statute of limitations, ¶ 6:725.2) accrued prior to the revivor. In other words, a revivor validates any *procedural* step taken on behalf of an LLC while under suspension (such as obtaining a judgment or attachment, bringing an appeal, undertaking discovery, or getting an extension of a land use permit). [Rev. & Tax.C. §§ 23305a, 23305.5(a)(2); see *Bourhis v. Lord* (2013) 56 C4th 320, 323, 153 CR3d 510, 511—notice of appeal filed during corporation's suspension validated by corporation's revivor even though revivor occurred after deadline for filing appeal; see *Longview Int'l, Inc. v. Stirling* (2019) 35 CA5th 985, 989-991, 247 CR3d 793, 795-797—recording of abstract of judgment during judgment creditor corporation's suspension validated by revivor and hence enforceable against real property owner; *Center for Self-Improvement & Comm. Develop. v. Lennar Corp.* (2009) 173 CA4th 1543, 1557, 94 CR3d 75, 84—Prop. 65 "toxic exposure" notice (Health & Saf.C. § 25249.6) given by suspended corporation validated by subsequent revivor; *Sea Breeze Salt, Inc. v. Mitsubishi Corp.* (9th Cir. 2018) 899 F3d 1064, 1075—dismissal of appeal "not required when a delinquent corporation pays its back taxes and the state restores its corporate powers while its appeal is pending"]

(a) [6:727.5] **Rationale:** The suspension provisions are designed to put pressure on delinquent LLCs to file their annual information statements and pay their taxes. That purpose is satisfied when the statement is filed and the taxes are paid. But the revivor does not "roll back the clock" and, thus, any rights that become barred during the suspension remain barred. [See *Peacock Hill Ass'n v. Peacock Lagoon Const. Co.* (1972) 8 C3d 369, 371, 105 CR 29, 30; *Benton v. County of Napa* (1991) 226 CA3d 1485, 1490-1491, 277 CR 541, 544-545; *ABA Recovery Services, Inc. v. Konold* (1988) 198 CA3d 720, 724-725, 244 CR 27, 30]

(b) [6:727.6] **Voidable contracts subject to "validation":** Suspended LLCs may seek relief from the voidability of their contracts by:

- Filing an application for relief from contract voidability with the Franchise Tax Board (on a form provided by the Board);

- Designating the period for which relief is requested on the application (i.e., the period beginning on the same date as the LLC's income year and ending on the date the application is made);

- Filing any required tax returns, including returns for the relief period;

- Paying any tax, additions to tax, penalties, interest, and any other amounts owing, including any amounts attributable to the relief period; and

- Paying any daily penalty (¶ 6:727.8). [Rev. & Tax.C. §§ 23305.1(a), 23305.5(a)(2)]

  Assuming these conditions are satisfied, all contracts entered into during the relief period that have not been rescinded by final court order (¶ 6:726.4) are enforceable. [Rev. & Tax.C. §§ 23305.1(c), 23305.5(a)(2)]

- ***FORM:*** The Franchise Tax Board's standard form Application for Relief from Contract Voidability is available on the Franchise Tax Board's website (*www.ftb.ca.gov)*.

1) [6:727.7] **Relief from voidability need not be sought simultaneously with revivor:** LLCs that previously received revivor certificates (but did not simultaneously seek relief from voidability) have a second chance to correct their contractual voidability problems … so long as the contracts are ones for which relief from voidability *could have been granted* had the relief been sought simultaneously with restoring good standing. But relief from voidability must be sought for the *entire* period during which the LLC was suspended (and any applicable penalties must be paid; *see ¶ 6:727.8*). [Rev. & Tax.C. § 23305.1(b)(2)]

2) [6:727.8] **Penalties:** LLCs are assessed a $100 penalty for each day for which relief from voidability is granted, but not exceeding *in total* the tax for the requested relief period. The penalty is due and payable on demand by the Franchise Tax Board. [Rev. & Tax.C. §§ 23305.1(b)(1)(B), 23305.5(a)(2)]

13. [6:728] **Equity Incentive Compensation Plans and Options:** LLCs sometimes wish to offer ownership interests or units as incentives to prospective or current employees. LLC ownership options and plans may be granted pursuant to a *single* written plan available on a company-wide basis to *all* employees (or class of employees), or may be granted on an *individual* basis with a customized agreement negotiated with each recipient.

Stock options and plans are well known to corporations, but equity options and plans tend to be more inchoate when applied to LLCs.

a. [6:728.1] **Types of options/plans:** LLCs use various types of compensation plans and options:

(1) [6:729] **Membership performance units**, also known as restricted units, are analogous to restricted stock in a corporation. The units usually carry full membership rights, benefits and privileges, including voting rights, rights to inspect LLC records, information rights, and participation in distributions. Alternatively, the units may represent membership interests in a separate class from that of the original equity owners (*see ¶ 6:208*). The recipient usually becomes an LLC member upon execution of the operating agreement (or an addendum or amendment thereto).

(a) [6:729.1] **Vesting:** The units may vest ratably over a fixed period—e.g., 20% per year over five years. Sometimes there is no vesting in the first year of service with the LLC. Vesting might also be accelerated upon certain events, such as a sale of the company. If the employee quits before expiration of the vesting period, unvested units would usually be forfeited. If the employee is terminated for cause or breaches post-employment covenants, and the LLC would be granted the right to offset distributions payable with respect to vested units for damages caused by the employee's actions or breaches.

(b) [6:729.2] **Federal tax consequences:** Awards of membership units are generally taxed in the same manner as corporate restricted stock.

1) [6:729.3] **Income to employee:** The award is included in the recipient's income as of either (i) the *award date* if the award is substantially vested on that date or if the recipient makes a timely election under IRC § 83(b) or (ii) in all other situations, such later date on which the units become *substantially vested*. [IRC § 83; Treas.Reg. §§ 1.83-1(a), 1.83-3(b); see *Crescent Holdings, LLC v. Commr.* (2013) 141 TC 477, 494-505—IRC § 83 applies to grants of LLC membership interests]

The amount included in the recipient's income is the excess of the value of the units over the amount paid, and this excess is taxed as ordinary income. Where the amount paid for the units consists exclusively of the employee's services, the *entire value* of the units is thus included in income. [See IRC § 83]

2) [6:729.4] **Deduction by LLC:** The LLC can claim a deduction equal to the amount included in the recipient's income in the taxable year in which the recipient's taxable year *ended*. LLCs with a calendar tax year (which is almost always the case) will thus claim the deduction in the same year as the recipient reported income from the award. [See IRC § 83(h); *see ¶ 8:48*]

a) [6:729.5] **LLC bound by amount included in recipient's income?** The IRS interprets IRC § 83 as requiring the LLC's deduction to mirror the amount (and timing) of what is *actually included* in the recipient's income—even though the LLC has no control over the recipient's tax return. (However, the LLC may invoke a "safe harbor," *¶ 6:729.6*.) [Treas.Reg. § 1.83-6(a); see *Venture Funding, Ltd. v. Commr.* (1998) 110 TC 236, 240-248, aff'd without opn. (6th Cir. 1999) 198 F3d 248 (upholding IRS interpretation)]

But the Federal Circuit disagrees: The amount deductible by the LLC under IRC § 83 would be the amount *includible* (i.e., *properly included by law*) in the recipient's income. Thus, the LLC's deduction is not affected by

the recipient's failure to report the stock (or its proper value) on the recipient's return. [*Robinson v. United States* (Fed. Cir. 2003) 335 F3d 1365, 1369-1373 (invalidating Treas.Reg. § 1.83-6(a))]

1/ [6:729.6] **"Safe harbor" for LLC deduction:** To alleviate the potential problem of the "nonreporting employee," the Regulations allow the LLC to claim the deduction in the proper year—regardless of what the recipient does—so long as the LLC timely files a proper Form W-2 or 1099 with respect to the equity award. [Treas.Reg. § 1.83-6(a)(2); see *Venture Funding, Ltd. v. Commr*. (1998) 110 TC 236, 245-247]

b) [6:729.7] **Potential recognition of gain:** At one time, there was some uncertainty whether the LLC should recognize gain on the recipient's share of the LLC's assets as if the LLC had transferred an undivided interest in the assets to the recipient as compensation, and the recipient had then contributed those assets back to the LLC. But the IRS rejected this position. [REG-105346-03, 70 Fed.Reg. 29675, 29679 (2005)]

However, the issuance of equity units can trigger taxable income to other LLC members to the extent the LLC has *debt*. [IRC § 752]

(2) [6:730] **Profits interests** typically give the holder a percentage interest in the LLC's *annual profits* plus a *capital appreciation right* measured from the date of issuance of the interest to a specified liquidity date. Here again, vesting or performance requirements may also be imposed.

(a) [6:730.1] **Tax consequences:** A profits interest is dependent upon the LLC's future profits and, unlike the grant of restricted LLC units, does not result in the recognition of taxable income to the recipient upon grant or provide any deduction to the LLC upon grant. *See ¶ 8:52 ff.*

(3) [6:731] **Phantom unit rights** entitle the holder only to a *payment* (not an equity interest in the LLC) upon a specified liquidity event, such as the sale of the business. Phantom unit rights usually do not confer any membership rights in the LLC. They may thus resemble capital interests. They are described as "phantom" because they come into existence only upon the specified event and disappear thereafter.

Where the employee pays nothing for the interests (i.e., consideration for the interests consists solely of the services rendered by the employee), phantom unit rights tend to resemble a cash *bonus* that has specific method of calculation. Phantom unit rights are often attractive to the LLC and its existing members because they confer no true ownership rights on the recipients and do not interfere with LLC management.

(a) [6:731.1] **Tax consequences:** The receipt of phantom unit rights is not taxable to the recipient. *Payments* to the recipient on account of the phantom unit rights upon the specified liquidity date are taxed in the year of *receipt* as *ordinary* income.

But phantom units may, depending upon the terms of the plan providing for their grant, be subject to inclusion in income for purposes of the *self-employment tax* (FICA—i.e., Federal Insurance Contributions Act; *see ¶ 8:330 ff.*) when the phantom units are no longer subject to a substantial risk of forfeiture. [See Treas.Reg. § 31.3121(v)(2)-1]

1) [6:731.2] **Caution—IRC § 409A:** A phantom equity plan ordinarily will be subject to the deferred compensation rules of IRC § 409A, which specifies, e.g., permissible payment events, restrictions on funding, and requirements for deferral elections. Failure to comply with § 409A can subject recipients to acceleration of income and penalties. Nevertheless, careful drafting can generally avoid these pitfalls without undue interference with the LLC's compensation objectives. [See R. Olshan and E. Schohn, *Section 409A Handbook*, Ch. 19.III.A.3 (Bloomberg BNA, 3rd ed. 2021)]

2) [6:731.3] **Caution—ERISA:** Phantom units may also be subject to certain requirements under the Employee Retirement Income Security Act of 1974. [See D. Hogans, *Phantom Stock Plan*, Practical Law Document W-001-4007 (Thomson Reuters)]

(4) [6:732] **Phantom unit appreciation rights** entitle the holder only to a payment, upon a specified liquidity event, equal to the *increase in the LLC's value* measured from the *date of the award* to the *date of the liquidity event*. Here again, they typically confer no other benefits, rights and privileges of LLC membership. Phantom unit appreciation rights are frequently more desirable from a management point of view than phantom unit rights because they are based only on the *future* value of the LLC.

Once again, where the only consideration for the phantom unit appreciation rights are the services rendered by the employee, they may be the functional equivalent of a cash *bonus* that is based on a specific method of calculation.

Phantom unit appreciation rights, like phantom unit rights, are often attractive to the LLC and its existing members because they confer no true ownership rights on the recipients and do not interfere with LLC management.

A drawback is that phantom unit appreciation rights require a reliable valuation of the company as of the date of the *award*.

(a) [6:732.1] **Tax consequences:** The tax consequences are the same as with phantom unit rights; *see ¶ 6:731.1 ff.*

(5) [6:733] **Equity options:** The LLC may also grant its employees (or other persons, for that matter) *options* to acquire its equity upon payment of a specified strike price. Options, like other forms of incentive compensation, may vest over a period of time and contain conditions and restrictions (e.g., option to acquire 100 units at rate of 20 units per year, subject to forfeiture upon termination of employment).

(a) [6:733.1] **Tax consequences:** The IRS has not issued definitive guidance on the tax consequences of LLC equity options. At present, the tax rules for LLC equity options are generally assumed to be same as for corporate stock options: There are no tax consequences upon the *grant* of an equity option. Upon *exercise*, the employee recognizes *ordinary* income, and the LLC receives a *deduction*, equal to the difference between the exercise price and the value of the underlying equity on the exercise date. [See IRC § 83; Treas.Reg. § 1.83-7]

Care should be taken in drafting equity option plans for LLCs so that they comply with or are exempt from IRC § 409A (*see ¶ 7:731.2*) in order to avoid the acceleration of income (as well as penalties). [See R. Olshan and E. Schohn, *Section 409A Handbook*, pp. 19-5 & 19-6 (2d ed. 2016)]

• ***FORMS***

— LLC Equity Incentive Plan, *see Form 6:D.1*.

— Equity Incentive Award Agreement, *see Form 6:D.2*.

— Operating Agreement Provisions Re Treatment of Incentive Units, *see Form 6:D.3*.

b. [6:734] **Exemption from bonding statutes for membership interest issued to employee, officer or manager:** Labor Code § 407 prohibits investments and the sale of an interest in a business in connection with securing a position with the business.

Labor Code § 406 provides that any *property* put up by an employee or applicant as a part of a contract of employment must be treated as a *bond*. (Bonds are generally used where an employee is entrusted with the employer's property or where the employer regularly advances goods or merchandise to be delivered or sold by the employee. The bond must be held in trust and used only for liquidating accounts between the employer and employee or otherwise returned to the employee. See Lab.C. §§ 402, 403, 404, 405.)

However, Labor Code §§ 406 and 407 do *not* apply to LLC membership interests issued to an *employee* of the LLC or any of its parents or subsidiaries pursuant to a membership interest *purchase or option plan or agreement*. Nor do Lab.C. §§ 406 and 407 apply where membership interests are issued to a person in connection with securing a position as an *officer or manager* of the LLC or any parent or subsidiary. [Corps.C. § 17704.01(e)]

c. [6:735] **Securities law requirements:** Corporate stock is clearly a security, and hence the law governing *corporate stock* options is well defined. However, LLC membership interests or units may or may not constitute securities; *see ¶ 7:81 ff.*

If counsel determines that the underlying LLC units or membership interests would constitute a security, federal and state securities laws must be complied with when the LLC's membership interests, or a right or option to acquire membership interests, are offered as compensation.

Caveat: Much of the law regarding LLC equity interests is taken by analogy to corporate stock options.

(1) Compliance with federal securities laws

(a) [6:735.1] **Employee equity options:** The *grant* of an employee *stock* option—and by analogy, the grant to an employee of an *LLC equity* option—is not considered an "offer to sell" a security "for value" under the 1933 Act. Thus, registration is not required. Reason: Although the employee's services typically constitute consideration for the option grant, the prevailing view is that acceptance of the grant is an *employment*—not an "investment"—decision. [See Overman, "Registration and Exemption from Registration of Employee Compensation Plans Under the Federal

Securities Law," 28 Vand.L.Rev. 455, 460-461 (1974); and *Dayton Steel Foundry Co.* (1971) Fed.Sec.L.Rep. (CCH) ¶ 78,443]

But the *exercise* of an outstanding equity option *does* involve a "sale" of the security. Registration will be required unless an exemption applies (¶ *6:735.3*). (Form S-8 should be used for 1934 Act reporting companies; Form S-1 for all other companies.)

(b) [6:735.2] **Employee equity purchase plans:** Employee equity purchase plans generally involve an "offer to sell" the company's securities. Thus, registration is required unless an exemption is available (¶ *6:735.3*).

(c) [6:735.3] **Exemptions from registration:** SEC Rule 701 (¶ *7:450 ff.*) expressly exempts offers and sales of securities issued by a *nonreporting* company pursuant to employee benefit or compensation plans or agreements. The maximum amount that may be *sold annually* is the *greatest* of (i) $1 million, (ii) 15% of the issuer's total assets, or (iii) 15% of the outstanding securities of that class. (Securities sold under Rule 701 are "restricted securities" and cannot be resold absent registration or an exemption from registration.) [SEC Rule 701]

Additionally, employee equity option or equity purchase plans may be exempt from registration under the *intrastate* exemption (SA § 11, Rules 147 and 147A; *see* ¶ *7:207 ff.*) or the exemptions for *nonpublic offerings* under Regulation D and SA § 4(a)(2) (*see* ¶ *7:300 ff.*).

(2) [6:735.4] **Compliance with California securities laws:** Where no exemption is available (¶ *6:735.5 ff.*), the grant of an option to acquire LLC equity must be qualified. Under established practice, qualification is obtained for both the issuance (grant) of the option and the future issuance of the underlying units or membership interests upon exercise of the option. (*See* ¶ *7:1022 ff.* for qualification standards.)

(a) Exemptions from qualification

1) [6:735.5] **Rule 701 exempt securities:** The offer or sale of a security issued pursuant to an LLC equity purchase plan or agreement is exempt from the California qualification requirements if the transaction is exempt from federal registration under SEC Rule 701 (¶ *6:735.3*) and if certain other requirements are met. [Corps.C. § 25102(o); *see* ¶ *7:920 ff.*]

2) [6:735.6] **"Limited offering" exemption:** The "limited offering" exemption (Corps.C. § 25102(f), ¶ *7:800 ff.*) is available for LLC equity options and LLC equity purchase rights, but it is limited to no more than 35 "counted" employees having the requisite personal qualifications (*see* ¶ *7:805*).

[6:736 - 6:739] ***Reserved.***

14. [6:740] **Financial Penalties for Manipulation of Market Value of Membership Interests (SEC Reporting Companies):** Under CRULLCA, an LLC that is a 1934 Act reporting company or that has a registration statement pending before the SEC may be liable for a civil penalty of up to $1 million for making material misrepresentations (falsehoods or omissions) to manipulate the market value of its membership interests. [Corps.C. § 17713.12(a)(1), (f); see 15 USC § 7201(7) ("issuer" defined)]

a. [6:741] **Vicarious liability for acts of members, officers and certain managers and agents:** The penalty applies where the LLC has "actual knowledge" that a misrepresentation was made by a member, an officer, a manager with authority over the LLC's financial operations, or an agent authorized by the LLC to make public representations about its financial condition. [Corps.C. § 17713.12(a)(1), (e)(1) & (2)]

b. [6:742] **Penalty averted by disclosure to members and regulatory authorities:** No penalty may be assessed where the LLC gives written notification to the appropriate government agency (Attorney General, Department of Financial Protection and Innovation, Department of Insurance, Department of Managed Health Care, or SEC) and its members and investors within 30 days after it acquires actual knowledge of the misrepresentation. But the notification need not be given (and no penalty may be assessed) if the members and investors, or the government agency, as the case may be, have already been notified. (I.e., the intention is to penalize an LLC only for willfully suppressing the truth.) [Corps.C. § 17713.12(a)(2), (e)(5)]

c. [6:743] **Penalty averted by "abatement":** The penalty may also be avoided where the LLC "abates" the misstatement within the 30 day period. [Corps.C. § 17713.12(b)]

d. [6:744] **Enforcement by Attorney General or district or city attorney:** An action to enforce the penalty may be brought by the Attorney General, or a district attorney or city attorney, in the name of the people of the State of California. [Corps.C. § 17713.12(g)]

[6:745 - 6:779] ***Reserved.***

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Chapter 6. Limited Liability Company

F. Dissolution

[6:780] The term "dissolution" can be somewhat confusing. Dissolution is the event that *begins* the *winding up* of the LLC in anticipation of its ultimate termination. A dissolved LLC remains in existence for the purpose of winding up. When the winding up is completed, all creditors are paid and the remaining assets are distributed to the members, the LLC may then formally *terminate* by filing a *certificate of cancellation* of its articles of organization. [See *Boschetti v. Pacific Bay Investments Inc.* (2019) 32 CA5th 1059, 1066-1069, 244 CR3d 480, 485-487—internal affairs doctrine mandates that dissolution of foreign LLC doing business in California be governed by foreign LLC's jurisdiction of organization (¶ *6:1236*)]

1. Commencing Dissolution

a. [6:781] **LLC that never conducted business—cancellation of articles within 12 months of filing:** In the unusual event that the LLC has not conducted any business, the LLC may be dissolved by the streamlined procedure of filing a *short form* certificate of cancellation within 12 months of filing the articles of organization. If the LLC received payments for membership interests from investors, the LLC must return those payments before filing the certificate. [Corps.C. § 17707.02(a), (b)]

• ***FORM:*** The Secretary of State's standard form Short Form Certificate of Cancellation (Form LLC-4/8) is available online at the Secretary of State's website (*www.sos.ca.gov*).

(1) [6:782] **Execution:** If the LLC has members, the short form certificate of cancellation must be signed by members holding 50% or more of the "voting interests" (*see* ¶ *6:303 ff.*). [Corps.C. § 17707.02(a); see Corps.C. § 17701.02(m)]

If there are no members, the certificate must be signed by managers (if any) holding 50% or more of the voting interests of the managers. [Corps.C. § 17707.02(a)]

If there are no members or managers, the certificate must be signed by the person, or 50% or more of the persons, who signed the articles of organization. [Corps.C. § 17707.02(a); see Corps.C. § 17702.03(a)(4)—personal representative of deceased or incompetent organizer may sign certificate of cancellation in place of decedent or incompetent]

(2) [6:783] **Filing fee:** There is no fee for filing the certificate. (However, there is the usual $15 special handling fee if the certificate is delivered personally to the Secretary of State's office.) [Gov.C. §§ 12182(a), 12190(m); 2 CCR § 21903(c)]

(3) [6:784] **Final tax return:** Even though the LLC conducted no business, it must still file a final franchise tax return or final annual tax return. [Corps.C. § 17707.02(a)(4)]

b. [6:785] **Dissolution pursuant to articles or operating agreement provision:** An LLC is dissolved upon the happening of a triggering event as set forth in the articles or a *written* operating agreement. [Corps.C. § 17707.01(a)]

c. [6:786] **Dissolution by vote of members:** The LLC may also be dissolved upon the vote of members holding 50% or more of the voting interests of the members or that *greater percentage* of the *voting interests* of the members as may be specified in the articles or a *written* operating agreement. [Corps.C. § 17707.01(b); *see* ¶ *6:303 ff.*]

Neither the articles nor the operating agreement may deny the members the right to vote on dissolution nor reduce the required vote to less than 50% of the members' voting interests. [Corps.C. §§ 17701.10(d)(4), 17704.07(t)]

d. [6:787] **Dissolution when no members:** An LLC is dissolved when it has had no members for *90 consecutive days*. [Corps.C. § 17707.01(c)]

(1) [6:788] **Exception for single-member LLC:** Upon the death of the sole member of an LLC, the member's status as a member may pass to the member's heirs, successors and assigns by will or applicable law. The heir, successor or

assign automatically becomes a member (or if more than one, they become members). However, the membership interest is subject to administration of the deceased member's estate. [Corps.C. § 17707.01(c)]

e. [6:789] **Dissolution by judicial decree:** The LLC may also be dissolved by a decree of judicial dissolution pursuant to an action filed by *any member or manager*. The plaintiff (or plaintiffs) must show:

• It is "not reasonably practicable" to carry on the business in conformity with the articles or operating agreement; *OR*

• Dissolution is reasonably necessary for the protection of plaintiff's rights or interests; *OR*

• The LLC's business has been abandoned; *OR*

• Management is deadlocked or subject to internal dissension; *OR*

• Those in control of the LLC have been guilty of, or have knowingly countenanced, persistent and pervasive fraud, mismanagement or abuse of authority. [Corps.C. §§ 17707.01(d), 17707.03(a), (b)]

(1) [6:790] **Avoiding judicial dissolution by purchasing membership interests:** One or more of the nonplaintiff members may avoid judicial dissolution by purchasing the plaintiffs' membership interests for *cash* at *fair market value*. [Corps.C. § 17707.03(c)(1); see *Boschetti v. Pacific Bay Investments Inc.* (2019) 32 CA5th 1059, 1066-1069, 244 CR3d 480, 485-487—§ 17707.03(c) buyout right not applicable to foreign LLC doing business in California]

(a) [6:790a] **"Fair market value" defined:** For purposes of valuating LLC membership interests under Corps.C. § 17707.03, the "commonly accepted definition" of "fair market value" applies—i.e., "the price at which the property would change hands between a willing buyer and a willing seller when the former is not under any compulsion to buy and the latter is not under any compulsion to sell, and both parties have reasonable knowledge of the relevant facts." Fair market value includes "discounts reflected in the market." [*Cheng v. Coastal L.B. Assocs., LLC* (2021) 69 CA5th 112, 123-124, 284 CR3d 270, 277-278—lack of control discount may be applied to valuation of LLC membership interests]

(b) [6:790.1] **Compare—corporations:** The parallel provision for corporations provides for a buyout at "fair value," and goes on to specify that "fair value shall be determined on the basis of the liquidation value … but taking into account the possibility, if any, of sale of the entire business as a going concern in a liquidation." [Corps.C. § 2000(a); see Friedman, Soza & Jann, *Cal. Prac. Guide: Corporations* (TRG), Ch. 8]

Caution: Courts look to cases applying Corps.C. § 2000 when there is no relevant case law interpreting and applying the buyout procedures under Corps.C. § 17707.03. However, § 2000's "fair value" standard is different from § 17707.03's "fair market value" standard (¶ 6:790a), and § 2000's valuation standard does *not* apply to LLC membership buyouts under § 17707.03. [*Cheng v. Coastal L.B. Assocs., LLC* (2021) 69 CA5th 112, 120, 123-124, 284 CR3d 270, 275, 277-278—lack of control discount may be applied under Corps.C. § 17707.03, even though Corps.C. § 2000 does not permit such discounts]

(c) [6:791] **Determination of purchase price:** Where the parties cannot agree on fair market value, the purchasers may apply to the court to ascertain value. Dissolution and winding up is *stayed* pending the court's decision. [Corps.C. § 17707.03(c)(2)]

1) [6:792] **Bond required:** The purchasing members must post a bond in an amount sufficient to pay the plaintiffs' estimated reasonable expenses, including attorney fees, in the event the purchasers do not complete the purchase (*see ¶ 6:798*). [Corps.C. § 17707.03(c)(2)]

2) [6:793] **Appraisal procedure:** The court must appoint three disinterested appraisers to determine fair market value. If evidence is required, the court must prescribe the time and manner of producing evidence. [Corps.C. § 17707.03(c)(3)]

a) [6:793.1] **Summary proceeding:** Unless the court orders otherwise, the appraisal proceedings are summary in nature. The parties do *not* have the right to depose the appraisers or examine witnesses interviewed by them in arriving at their valuation. [See *Abrams v. Abrams-Rubaloff & Assocs., Inc.* (1980) 114 CA3d 240, 248, 170 CR 656, 659 (decided under parallel provision governing corporations)]

b) [6:793.2] **Valuation date:** Fair market value is determined as of the date when plaintiffs' action was commenced. However, any party may bring a motion to designate some other date, which the court may grant upon hearing and for good cause shown. [Corps.C. § 17707.03(c)(5)]

[6:793.3] ***Reserved.***

c) [6:793.4] **Appraisers' determination:** "The award of the appraisers or a majority of them, when confirmed by the court, shall be final and conclusive upon all parties." [Corps.C. § 17707.03(c)(3)]

1/ [6:793.5] **Court may order appraisers to confer:** If a majority of the appraisers fail to agree on valuation, the court does not have to make a de novo value determination (¶ 6:794 ff.). The court may order the appraisers to confer with each other to determine whether a consensus can be reached. [*Cheng v. Coastal L.B. Assocs., LLC* (2021) 69 CA5th 112, 120, 284 CR3d 270, 275]

d) [6:794] **Court discretion re award:** It is the *court* that fixes fair market value. Consequently, the appraisers' award does not bind the trial court. The court is free to select among conflicting appraiser opinions, decide the matter de novo, or order the appraisers to confer (¶ 6:793.5). Additionally, the appellate court may adjust the amount of the award. [See *Cheng v. Coastal L.B. Assocs., LLC* (2021) 69 CA5th 112, 120-121, 284 CR3d 270, 275-276; *Dickson v. Rehmke* (2008) 164 CA4th 469, 475, 78 CR3d 874, 878 & fn. 4; *Brown v. Allied Corrugated Box Co.* (1979) 91 CA3d 477, 491, 154 CR 170, 179 (decided under parallel provision governing corporations)]

1/ [6:794a] **When court must make de novo value determination:** The trial court must make a de novo value determination if it concludes that the appraisers' award is erroneous or incorrect. Otherwise, the court *may* make a de novo value determination, but it is not *required* to do so. [*Cheng v. Coastal L.B. Assocs., LLC* (2021) 69 CA5th 112, 120-121, 284 CR3d 270, 275-276]

e) [6:794.1] **Court order:** The court cannot directly order the purchasing parties to pay the price set by the appraisers. But it can (and usually will) decree that *unless* the purchasing parties pay that price by a specified date, the LLC shall be wound up and dissolved. In addition, the court can order judgment against the purchasing parties and the sureties on their bond (*see ¶ 6:792*) for the *expenses* incurred in connection with the appraisal by the member whose membership interest was to be purchased. [Corps.C. § 17707.03(c)(3); see *Go v. Pacific Health Services, Inc.* (2009) 179 CA4th 522, 529-532, 101 CR3d 736, 741-743 (decided under parallel provision governing corporations)]

1/ [6:794.2] **Order not automatically stayed by appeal:** The filing of a notice of appeal from the trial court's order does *not* automatically stay the order. A party wishing to stay the order while pursuing an appeal must first seek a stay from the trial court. If the trial court refuses, the party may then petition the appellate court for a writ of supersedeas suspending the trial court's power to compel execution of the order pending appellate review. [*Dickson v. Rehmke* (2008) 164 CA4th 469, 475-478, 78 CR3d 874, 877-880—order is appealable and service of order triggers CRC 8.104(a) 60-day appeal deadline; see *Veyna v. Orange County Nursery, Inc.* (2009) 170 CA4th 146, 154-158, 87 CR3d 658, 665-668 (decided under parallel provision governing corporations); and Eisenberg, *Cal. Prac. Guide: Civil Appeals & Writs* (TRG), Ch. 7]

3) [6:795] **Offset for breach of contract:** Where the initiation of the dissolution constitutes a breach of the operating agreement or other agreement with the purchasing parties, any resulting damages may be deducted from the purchase price. [Corps.C. § 17707.03(c)(1)]

a) [6:796] **Limitation:** Plaintiffs are *not* liable for damages where the ground for judicial dissolution is abandonment of the LLC's business, deadlocked management or internal dissension, or pervasive fraud, mismanagement or abuse of authority (*see ¶ 6:789*). [Corps.C. § 17707.03(c)(1)]

[6:797] ***Reserved.***

(d) [6:798] **Effecting or rejecting purchase:** The purchasers may avoid dissolution by paying plaintiffs the value of their membership interests within the time specified by the court in return for the plaintiffs' membership interests. [Corps.C. § 17707.03(c)(4)]

Alternatively, they can back out of the purchase if they feel the price fixed by the court is too high. But they no longer have the ability to contest the grounds for involuntary dissolution (¶ 6:789)—i.e., the dissolution *must* proceed. And they will have to pay all reasonable expenses (including attorney fees) incurred by the other parties in the appraisal process—even if those costs exceed the posted bond (¶ 6:792). [Corps.C. § 17707.03(c)(3); see *Go v. Pacific Health Services, Inc.* (2009) 179 CA4th 522, 529-532, 101 CR3d 736, 741-743; *Trahan v. Trahan* (2002) 99 CA4th 62, 75,

120 CR2d 814, 824 (decided under parallel provision governing corporations); *In re Orange County Nursery, Inc.* (CD CA 2010) 439 BR 144, 152-154 (same)]

(2) [6:798.1] **Buyout may proceed despite dismissal by plaintiff:** Once the buyout procedure is commenced, plaintiff cannot prevent the buyout from going forward by dismissing the action. The purchaser still has the right to pursue the buyout. [Corps.C. § 17707.03(c)(6); see *Kennedy v. Kennedy* (2015) 235 CA4th 1474, 1487, 186 CR3d 198, 208 (but holding plaintiff's dismissal terminated defendant's buyout right in suit brought before CRULLCA's 1/1/14 effective date, *see* ¶ *6:3*); see also *Ontiveros v. Constable* (2018) 27 CA5th 259, 272-274, 237 CR3d 892, 901-902 (contrasting LLC and corporate statutory buyout provisions)]

(3) [6:799] **Other remedies permitted:** The court may impose other available remedies in connection with the dissolution. [Corps.C. § 17707.03(d)]

(4) [6:800] **Caution re operating agreement restrictions:** The operating agreement may not vary a court's power to decree dissolution or the members' rights to avoid dissolution by purchase of the plaintiffs' membership interests. [Corps.C. § 17701.10(c)(7)]

(5) [6:800.1] **Jurisdiction to dissolve foreign LLC?** Under the internal affairs doctrine (¶ 6:1236), dissolution of a foreign LLC is governed by the law of the state under which the LLC is organized. Left unanswered is whether a California court has jurisdiction to dissolve a foreign LLC. [*Boschetti v. Pacific Bay Investments Inc.* (2019) 32 CA5th 1059, 1066-1067, 244 CR3d 480, 485 (declining to decide issue because, even if court has jurisdiction to dissolve foreign LLC, "the internal affairs doctrine would require it to apply to a dissolution claim the law of the state under which the entity was organized"); *see* ¶ 6:780]

In other states, courts lack subject matter jurisdiction to dissolve a foreign LLC. [*In re Coinmint, LLC* (Del. Ch. 2021) 261 A3d 867, 906-907; *Raharney Capital, LLC v. Capital Stack LLC* (NY App.Div. 2016) 138 AD3d 83, 86-87, 25 NYS3d 217, 219—"We agree with near-universal law that the courts of one state do not have the power to dissolve a business entity formed under another state's laws"]

(6) [6:800.2] **Voluntary dissolution vote:** A vote by the members to voluntarily dissolve an LLC will terminate any buyout action. Plaintiff, owner of a one percent interest in an LLC, filed an action seeking judicial dissolution of the LLC under Corps.C. § 17707.03. Defendants, other LLC members who together held 50% of the membership interest, filed a motion to avoid dissolution by purchasing the plaintiff's one percent interest. During the pendency of the action, plaintiff, along with the owners of an additional 49% of the entity, voted to dissolve the LLC. The dissolution vote by 50% of the members immediately dissolved the LLC pursuant to Corps.C. § 17707.01(b) and extinguished the defendants' right to purchase plaintiff's one percent ownership interest. [*Friend of Camden, Inc. v. Brandt* (2022) 81 CA5th 1054, 1058, 1066-1067, 197 CR3d 732, 734, 740-741 (directing trial court to dismiss buyout proceeding as moot and parties to wind up LLC's activities]

f. [6:801] **Filing of certificate of dissolution:** Unless dissolution is by the members' unanimous vote (*see* ¶ *6:802*), the LLC must file a certificate of dissolution with the Secretary of State on the form prescribed by the Secretary of State. [Corps.C. § 17707.08(a)(1), (3)]

(1) [6:802] **When not required—members' unanimous vote to dissolve:** Where the LLC is dissolved pursuant to the vote of *all* members, a statement to that effect may be added to the *certificate of cancellation of articles of organization* (*see* ¶ *6:856*), and a separate certificate of dissolution is not required. (The Secretary of State's standard form certificate of cancellation contains a box that must be checked to indicate whether the dissolution was by unanimous member vote; *see* ¶ *6:855*). [Corps.C. § 17707.08(a)(3)]

(2) [6:803] **Contents:** The certificate of dissolution must set forth the LLC's name, the Secretary of State's file number, the event causing dissolution (per Corps.C. § 17707.01, ¶ 6:785 ff.) and any other information the LLC desires to include. [Corps.C. § 17707.08(a)(2)]

• ***FORM:*** The Secretary of State's standard form Certificate of Dissolution (Form LLC-3) is available online at the Secretary of State's website (*www.sos.ca.gov*).

[6:804] ***Reserved.***

(3) Execution

(a) [6:805] **By "managers":** Corps.C. § 17707.08(a) states that "The managers shall sign and cause to be filed … a certificate of dissolution …" Although this would seem to imply that *all* managers must sign, the certificate need be signed only by a person authorized by the LLC. (Indeed, the Secretary of State's form permits signature by such a person.) [Corps.C. § 17702.03(a)(1); also see Corps.C. § 17702.03(b)—"any record filed under this title may be signed by an agent" (except as otherwise expressly provided)]

1) [6:806] **Comment:** Technically, the requirement that the managers must cause the certificate to be filed would apply only in a manager-managed LLC, leaving open the question of who is responsible for the certificate of dissolution in a member-managed LLC. Of course, common sense would leave this responsibility to the members. [See Corps.C. § 17701.02(n)—"manager" applies only in manager-managed LLC]

(b) [6:807] **Dissolved LLC with no members:** If the LLC is dissolved because it has had no members for 90 consecutive days (Corps.C. § 17707.01(c), ¶ 6:787)**,** the certificate must be signed by the person winding up the LLC's activities. [Corps.C. §§ 17702.03(a)(3), 17707.08(a)(1); also see Corps.C. § 17702.03(b)—"any record filed under this title may be signed by an agent" (except as otherwise expressly provided)]

(4) [6:808] **Filing fee:** There is no fee for filing the certificate of dissolution (other than a $15 special handling fee if the document is delivered personally to the Secretary of State's office). [Gov.C. §§ 12182(a), 12190(m); 2 CCR § 21903(c)]

(5) [6:809] **Effective date:** The certificate becomes effective on the date the certificate is *filed* (as evidenced by the Secretary of State's endorsement of the date on the certificate) or upon such *later* date as may be *set forth in the certificate* (but not more than *90 days after filing*). [Corps.C. § 17702.05(c)]

g. [6:810] **Compare—de facto dissolution:** Dissolution may take place notwithstanding that the LLC and its members did not follow the statutory formalities. A de facto dissolution may occur where the LLC, because of insolvency or other reason, suspends all its obligations and goes into liquidation without following the statutory dissolution procedures. [*CB Richard Ellis, Inc. v. Terra Nostra Consultants* (2014) 230 CA4th 405, 413-417, 178 CR3d 640, 646-649]

The de facto dissolution doctrine may be invoked to avoid a fraud or injustice, as where members distribute all the LLC's assets to themselves immediately prior to formal dissolution in an effort to thwart potential creditors. In such a circumstance, the dissolution is deemed to occur upon liquidation of the assets, thereby enabling the creditors to subsequently bring suit against the members pursuant to Corps.C. § 17707.07(a)(1)(B) (recovery of distribution paid to members upon *dissolution*, ¶ 6:842 ff.). [*CB Richard Ellis, Inc. v. Terra Nostra Consultants*, supra, 230 CA4th at 413-415, 178 CR3d at 646-647]

(1) [6:811] **Comment:** LLCs may not make a distribution that would render it technically insolvent or unable to pay its debts as they become due in the ordinary course of business. Similar provisions existed under the prior law that applied in *CB Richard Ellis*, supra. [See Corps.C. § 17704.05(a), ¶ 6:332; former Corps.C. §§ 17254, 17355; *CB Richard Ellis, Inc. v. Terra Nostra Consultants* (2014) 230 CA4th 405, 414-415, 178 CR3d 640, 646-647]

It is not clear why these provisions were not invoked in *CB Richard Ellis*, supra.

[6:812 - 6:819] ***Reserved.***

2. [6:820] **Winding Up of Business:** Upon dissolution, the LLC's business must be wound up. The winding up is performed by the managers who did not wrongfully dissolve the LLC. If there are no such managers, the members must wind up the LLC. If there are no members, the person or a majority of the persons signing the articles of organization may wind up the LLC. (Of course, where dissolution is by judicial decree (*see ¶ 6:789*), the winding up must be conducted in accordance with the decree.) [Corps.C. § 17707.04(a)]

a. [6:821] **Limited post-dissolution/post-cancellation activities authorized:** The LLC continues to exist for the purpose of winding up its affairs, prosecuting and defending actions in order to collect and discharge obligations, disposing of its property and collecting its assets. The LLC *cannot* continue business except so far as necessary for its winding up. [Corps.C. § 17707.06(a), (b)]

(1) [6:822] **Post-cancellation activities:** Effective January 1, 2016, Corps.C. § 17707.06 was amended to provide that an LLC continues to exist for the purpose of winding up its affairs not only after the filing of any certificate of dissolution, but also after the filing of a certificate of cancellation. The amendment was requested by the Secretary of State, apparently out

of concern over when a dissolution occurs based upon the decision in *CB Richard Ellis, Inc. v. Terra Nostra Consultants* (2014) 230 CA4th 405, 411-415, 178 CR3d 640, 644-647, which employed the concept of de facto dissolution (¶ 6:810). (The concern was misplaced, since the amendment to § 17707.06 does not clarify when a dissolution occurs (that is governed by Corps.C. § 17707.01) and, even had the amendment been in place, the result in *CB Richard Ellis*, supra, would have been the same.) In any event, at that time, no amendment was made to Corps.C. § 17707.08(b)(2)(C) (*see* ¶ 6:856), which provides that, upon the filing of a certificate of cancellation, an LLC is cancelled "and its powers, rights, and privileges shall cease." [Corps.C. § 17707.08(b)(2)(C); see *DD Hair Lounge, LLC v. State Farm Gen. Ins. Co.* (2018) 20 CA5th 1238, 1243-1246, 230 CR3d 136, 138-141—amendment to § 17707.06 applies retroactively to CRULLCA's 1/1/14 effective date (*see* ¶ *6:2*)]

However, effective January 1, 2023, Corps.C. § 17707.08 was amended to allow for the continuation of the LLC after the filing of the certificate of cancellation for the purpose of winding up the LLC's affairs as provided in Corps.C. § 17707.06. [Corps.C. § 17707.08(b)(2)(C)]

Comment: While the explicit provisions of Corps.C. § 17707.06 should apply so as to authorize managers or members (in a member-managed LLC) to continue winding up the LLC's affairs even after the filing of a certificate of cancellation, prudence would dictate that the certificate of cancellation be filed only after all activities necessary for winding up have been completed.

(2) [6:823] **Authority of persons acting on LLC's behalf:** The members, managers and officers continue to have authority to bind the LLC to the extent appropriate for winding up its activities. In other transactions, the acts of members, managers and officers bind the LLC to the same extent as before dissolution so long as the other party to the transaction did not have *notice of the dissolution*. [Corps.C. § 17707.06(d)]

(3) [6:824] **Omitted assets:** Any assets inadvertently or otherwise omitted from the winding up continue in the cancelled LLC for the benefit of those entitled to the assets upon cancellation. Any person authorized to wind up the affairs of an LLC that has filed a certificate of cancellation may use the assets to discharge the LLC's liabilities and may distribute excess assets to the LLC's former members. [Corps.C. § 17707.06(c)]

[6:825] ***Reserved.***

b. [6:826] **Written notice to creditors:** Written notice of the commencement of the winding up of the LLC must be *mailed* to all known creditors and any other claimants whose addresses appear in the LLC's records. [Corps.C. § 17707.04(a)]

c. [6:827] **Judicial order to wind up:** Upon petition of any member or manager, or of three or more creditors, a court may order the winding up of the LLC if necessary for the protection of any parties in interest. The court must designate the managers or members who are to wind up the LLC's affairs; or upon a showing of good cause, the court may designate another person or persons to wind up the LLC's affairs. [Corps.C. § 17707.04(b)]

d. [6:828] **Actions against dissolved LLC and its members:** *See* ¶ 6:842 ff.

e. [6:829] **Compensation for winding-up services:** Except as otherwise set forth in the articles or a *written* operating agreement, the persons winding up the LLC's affairs are entitled to reasonable compensation. [Corps.C. § 17707.04(c)]

f. [6:830] **Payment of creditors:** All known debts and liabilities of the LLC must be paid, or adequately provided for (*see* ¶ 6:832), before distribution of any remainder to the members (¶ 6:840). [See Corps.C. § 17707.05(a); *and* ¶ *6:832.1*]

(1) [6:831] **Expiration of claim period (court-supervised dissolution):** If the LLC is being wound up pursuant to a judicial proceeding or under judicial supervision, no distribution may be made to the members until the expiration of any court-ordered period for the presentation of claims. [Corps.C. § 17707.05(b)]

(2) [6:832] **"Adequately provided for":** The payment of a debt or liability, whether the whereabouts of the creditor are known or unknown, has been "adequately provided for" where, e.g., payment has been assumed or guaranteed in good faith by one or more *financially responsible* persons in a manner that the members or managers determined *in good faith and with reasonable care* to be adequate. [Corps.C. § 17707.05(c)(1)(A)]

Payment is also adequately provided for if it is assumed or guaranteed by the United States government or any federal agency. [Corps.C. § 17707.05(c)(1)(A)]

If any creditors are unknown, not locatable or refuse to accept their payment, payment is adequately provided for when deposited with the Controller in trust for the creditor ("escheat"). [Corps.C. § 17707.05(c)(1)(B); see Corps.C. § 2008]

None of these means are exclusive, and "adequate provision" may be made by other means. [Corps.C. § 17707.05(c)(2)]

(3) [6:832.1] **Members may not vary creditors' rights:** Corps.C. § 17707.05(a) begins, "Except as otherwise provided in the articles of organization or the written operating agreement," and then goes on to state (a) that all known debts and liabilities must be paid or adequately provided for, and (b) the manner of distribution of the LLC's remaining assets to the members. [Corps.C. § 17707.05(a)]

Neither the articles nor the operating agreement may restrict the rights of third persons.

Thus, the "Except" clause should be interpreted to allow the members to vary only the *allocation of distributions* among the members (*see ¶ 6:841*) *after* payment or provision for payment of third party creditors. [Corps.C. § 17701.10(c)(11)]

g. [6:833] **"Responsible person" liability for unpaid sales taxes:** Upon dissolution, any member, manager or other person who had control or supervision of, or responsibility for, paying the LLC's sales and use taxes may be personally liable for any unpaid taxes (and interest and penalties) that he or she *willfully* (i.e., "intentionally," irrespective of motive) failed to pay during the period he or she had such control, supervision or responsibility. (But personal liability attaches only if the LLC included sales tax reimbursement in the selling price of its products.) [Rev. & Tax.C. § 6829; 18 CCR § 1702.5; see *In re Leal* (9th Cir. BAP 2007) 366 BR 77, 81]

[6:834 - 6:839] ***Reserved.***

3. [6:840] **Distribution of Remaining Assets to Members Following Payment of Creditors:** Once all known debts and liabilities have been paid or adequately provided for (¶ 6:830 ff.), any remaining assets are distributed to the members in accordance with the articles or *written* operating agreement. [Corps.C. § 17707.05(a)]

a. [6:841] **Final distribution where articles and operating agreement silent:** If the articles or operating agreement do not provide for the final distribution, the LLC's remaining assets are distributed to the members in the following order:

- First, to members in satisfaction of any liabilities for distributions that were declared but not paid, or any liabilities arising from unlawful distributions (see Corps.C. §§ 17704.04(d), 17704.05(d), 17704.06);

- Next, to members for the return of their contributions; and

- Last, to members in the proportions in which they share in distributions. [Corps.C. § 17707.05(a)]

(1) [6:841.1] **Comment:** Corps.C. § 17707.05(a)(1) refers to the allocation of final distributions to the members "pursuant to Sections … 17704.05 and 17704.06." The cite to § 17704.06 does not make sense: Corps.C. § 17704.06 governs the members' liability *to* an LLC for distributions made with the members' knowledge that the distribution was impermissible (per Corps.C. § 17704.05(a)). The reference in § 17707.05(a)(1) to previous impermissible distributions should be limited to Corps.C. § 17704.05(d) (LLC's indebtedness to members for impermissible distributions is at parity with LLC's indebtedness to general, unsecured creditors).

4. [6:842] **Actions Against Dissolved LLC or Members:** An action against a dissolved LLC, whether arising before or after dissolution, may be enforced against the dissolved LLC to the extent of its undistributed assets, including any insurance that may be available to satisfy claims. [Corps.C. § 17707.07(a)(1)(A)]

In the event that any assets have been distributed to the members, the action may be enforced against the members *to the extent of the assets distributed to them upon dissolution*. (This does not impose unlimited personal liability upon LLC members. Here, the liability is in effect limited to return of the distributed assets.) Members of a dissolved LLC may be sued in the name of the LLC upon any cause of action against the LLC. [Corps.C. § 17707.07(a)(1)(B); see *CB Richard Ellis, Inc. v. Terra Nostra Consultants* (2014) 230 CA4th 405, 412, 178 CR3d 640, 644-645; *Gottlieb v. Kest* (2006) 141 CA4th 110, 154, 46 CR3d 7, 38]

a. [6:843] **Third party's right to enforce action against members:** Corps.C. § 17707.07(a)(1)(B) does not hold members liable for judgments entered against a dissolved LLC. Instead, it authorizes third parties to *enforce* against members of a dissolved LLC the *causes of action that ordinarily would be brought against the LLC*. [See *CB Richard Ellis, Inc. v. Terra Nostra Consultants* (2014) 230 CA4th 405, 416-417, 178 CR3d 640, 647-648 (decided under substantively identical predecessor statute)]

b. [6:844] **Limitations periods to bring action against member:** All actions against a member of a dissolved LLC must be brought before the *earlier* of the expiration of the applicable statute of limitations or four years after the effective date of the dissolution. [Corps.C. § 17707.07(a)(2)]

(1) [6:845] **Effective date?** It is not clear what the effective date of the dissolution is for statute of limitations purposes. While there are several possibilities, including the date of the event triggering the dissolution under Corps.C. § 17701.01 (¶ 6:785 ff.), the effective date of the LLC's certificate of dissolution (¶ *6:809*), or the effective date of the LLC's certificate of cancellation (¶ *6:862*), the sensible answer is the effective date of the certificate of dissolution, since that is public, easily verifiable and consistent with the use of the word "dissolution" in Corps.C. § 17707.07(a)(2)(B) (¶ 6:801). However, the 2015 amendment to Corps.C. § 17707.06 providing that an LLC continues to exist for the purpose of winding up its affairs after the filing of a certificate of cancellation (*see* ¶ *6:822*) raises the question whether the "effective date" for statute of limitations purposes should be the date the LLC files its certificate of cancellation.

c. [6:846] **Service of process:** In an action against the LLC, process may be served by delivery to a *manager*, *member*, *officer* or *person having charge of its assets* or, if none of these persons can be found, upon "any agent upon whom process might be served at the time of dissolution." If none of these can be found with due diligence as shown in an affidavit, the court may order service upon the *Secretary of State* (or an *assistant* or *Deputy* Secretary of State) on behalf of the LLC. Service is deemed complete on the 10th day after delivery to the Secretary of State (who will then send notice to the LLC's principal office). [Corps.C. § 17707.07(b); see Corps.C. § 17701.16]

d. [6:847] **Indefinite existence for quiet title action:** An LLC survives and continues to exist indefinitely for the purpose of being sued in any quiet title action. Any judgment binds all the LLC members (or other person having an interest in the LLC). [Corps.C. § 17707.07(c)]

e. [6:848] **Member's contribution right from other members:** Any member compelled to return distributed assets in an amount exceeding the member's pro rata share of the claim may seek contribution from the other members. [Corps.C. § 17707.07(a)(1)(B), 2nd para.]

[6:849] ***Reserved.***

5. [6:850] **Cancellation of Dissolution Proceedings:** Any time before the filing of a certificate of cancellation of the articles of organization (¶ 6:855 ff.), the LLC may halt the dissolution proceedings and remain in business. [Corps.C. § 17707.09]

a. [6:851] **Grounds:** Dissolution may be cancelled where:

• *All* members vote to continue the business of the LLC; *OR*

• Dissolution was by a vote of the members and *each member who consented to the dissolution* agrees *in writing* to revoke his or her vote; *OR*

• The LLC was not, in fact, dissolved. [Corps.C. § 17707.09(a)]

(1) [6:852] **Comment:** The first two requirements are severe, and permit a single member, or member who previously consented to the dissolution, to veto a proposed termination of the dissolution proceedings.

Unfortunately, these provisions are among the statutory dissolution provisions that may *not* be varied by the operating agreement (or articles). [See Corps.C. § 17701.10(c)(8); ¶ 6:118]

b. [6:853] **Filing of certificate of continuation:** To halt dissolution, the LLC may file a certificate of continuation with the Secretary of State on the form prescribed by the Secretary of State. Upon filing of the certificate of continuation, any filed certificate of dissolution is of no effect *ab initio*. [Corps.C. § 17707.09(a), (b), (c)]

• ***FORM:*** The Secretary of State's standard form Certificate of Continuation (Form LLC-8) is available online at the Secretary of State's website (*www.sos.ca.gov*).

(1) [6:854] **Filing fee:** The fee for filing the certificate of continuation is $30 (plus a $15 special handling fee if the certificate is delivered in person to the Secretary of State). [Gov.C. §§ 12182(a), 12190(h); 2 CCR § 21903(c)]

6. [6:855] **Completion of Dissolution—Filing of Certificate of Cancellation of Articles:** Once the winding up of the LLC's affairs has been completed, the LLC must file with the Secretary of State a certificate of cancellation of articles of organization on the form prescribed by the Secretary of State. Filing of the certificate terminates the existence of the LLC, and its powers, rights and privileges cease, except as provided in Corps.C. § 17707.06 (cancelled LLC continues to exist for purpose of winding up affairs, prosecuting and defending certain actions, disposing of and conveying property, and collecting and dividing assets). [Corps.C. § 17707.08(b)(1), (c); *see ¶ 6:821 ff.*]

• ***FORM:*** The Secretary of State's standard form Certificate of Cancellation (Form LLC-4/7) is available online at the Secretary of State's website (*www.sos.ca.gov*).

a. [6:856] **Contents:** The certificate of cancellation of articles of organization must set forth:

• The LLC's name and the Secretary of State's file number;

• That a final franchise tax return or a final annual tax return has been or will be filed with the Franchise Tax Board;

• That upon the filing of the certificate of cancellation, except as provided in Corps.C. § 17707.06 (¶ 6:821 ff., 6:855*)*, the LLC shall be canceled and its powers, rights and privileges shall cease; and

• Any other information that is desired. [Corps.C. § 17707.08(b)(2)]

(1) [6:857] **Caution—continuation of LLC powers:** Although the certificate states that the LLC's powers cease upon filing of the certificate, in fact the LLC's power to wind up its business continues. [Corps.C. § 17707.06(a); *see ¶ 6:821 ff.*]

(2) [6:858] **Statement re member vote:** The Secretary of State's form contains a box that must be checked to indicate whether the dissolution was made by the vote of *all* members. If the vote was by all members, a separate certificate of dissolution is not required. *See ¶ 6:802*.

b. [6:859] **Execution:** The certificate of cancellation must be signed by the *managers*. (But if the LLC is dissolved because it has had no members for 90 consecutive days (Corps.C. § 17707.01(c), ¶ 6:787), the certificate must be signed by the person who wound up the LLC's activities.) [Corps.C. §§ 17702.03(a)(5), 17707.08(b)(1); see also Corps.C. § 17702.03(b)—an "agent" may not execute certificate of cancellation]

(1) [6:860] **Comment:** Technically, execution of the certificate of cancellation by the managers applies only in a manager-managed LLC, leaving open the question of who must execute the certificate in a member-managed LLC. [See Corps.C. § 17701.02(n)—"manager" applies only in manager-managed LLC]

It would seem that the members in a member-managed LLC should execute the certificate of cancellation because such members are also de facto managers.

c. [6:861] **Filing fee:** There is no fee for filing the certificate of cancellation (other than a $15 special handling fee if the document is delivered personally to the Secretary of State's office). [Gov.C. §§ 12182(a), 12190(n); 2 CCR § 21903(c)]

d. [6:862] **Effective date:** The cancellation becomes effective on the date the certificate is *filed* (as evidenced by the Secretary of State's endorsement of the date on the certificate) or upon such *later* date as may be *set forth in the certificate* (but not more than *90 days after filing*). [Corps.C. § 17702.05(c)]

[6:863 - 6:864] ***Reserved.***

7. [6:865] **"Reinstatement" of Terminated LLC Upon Court Order:** As described below (¶ 6:866 ff.), the Government Code contains a procedure to "reinstate" an entity—i.e., to return the entity to "active status" on the Secretary of State's records—after the entity has filed a "termination document." A "termination document" is "the certificate or other document required by the Corporations Code that is the last certificate or document required by the Secretary of State to effect the final dissolution, surrender, or cancellation of the business entity." [Gov.C. §§ 12260, 12261(a)]

a. [6:866] **Application to LLCs:** Prior to 2016, a certificate of cancellation terminated the LLC's existence. However, Corps.C. § 17707.06(a) was amended in 2015 (*see ¶ 6:822*) to provide that an LLC that has filed a certificate of cancellation continues to exist for the limited purpose "of winding up its affairs, prosecuting and defending actions by or against it in order

to collect and discharge obligations, disposing of and conveying its property, and collecting and dividing its assets." [Corps.C. § 17707.06(a); *see ¶ 6:821*]

Thus, reinstatement is no longer required if the LLC seeks only to wind down its affairs. But reinstatement is necessary if the members seek to *revive the LLC as a going concern*. (CRULLCA does not authorize the filing of a "certificate of revocation" or any other procedure by which members or managers can revoke the certificate of cancellation and "*revive*" the LLC.)

b. [6:867] **Procedure:** A court order for reinstatement may be obtained by filing a petition in superior court containing the legal and factual basis for reinstatement. Alternatively, the court order can be made as part of a civil action for damages or equitable relief. (The Secretary of State shall not be made a party to the action.) [Gov.C. § 12261(c); see *Holistic Supplements, L.L.C. v. Stark* (2021) 61 CA5th 530, 556-557, 275 CR3d 791, 809-810—plaintiff did not have to file stand-alone petition for reinstatement because she pled claim for reinstatement in civil action (Corps.C. § 12261 "does not impose any specific pleading requirements") (*see ¶ 6:938.1*)]

(1) [6:868] **Grounds for reinstatement:** The grounds for reinstatement are limited to:

• A member's or manager's factual representations in the certificate of cancellation are materially false; or

• The submission of the certificate of cancellation to the Secretary of State was fraudulent. [Gov.C. §§ 12260, 12261(a)]

(2) [6:869] **Loss of LLC name—amendment of articles to adopt new name:** Once the certificate of cancellation has been filed, the LLC's name (or a similar name) becomes "available" and may be adopted by another LLC. If the Secretary of State determines that the name of the revived LLC would conflict with that of another LLC, reinstatement must be conditioned upon the LLC changing its name (by filing an amendment to its articles of organization) so as to eliminate the conflict. [Gov.C. § 12262]

(3) [6:870] **Effective date:** Reinstatement is effective upon the Secretary of State's filing of a certified copy of the court order reinstating the LLC. (The Secretary will notify the Franchise Tax Board of the reinstatement.) [Gov.C. § 12263]

8. [6:871] **Compare—Administrative Cancellation (Dissolution):** A California LLC's powers, rights and privileges may be suspended for, among other things, failure to file a franchise tax return or failure to pay the $800 annual franchise tax or the LLC income fee (per Rev. & Tax.C. § 23301 et seq., ¶ 6:724 ff.). A California LLC that has been so suspended for at least *60 continuous months* is subject to administrative cancellation (in effect, dissolution). [Corps.C. § 17713.10.1(a)]

a. [6:872] **Purpose:** So long as an LLC has not formally dissolved, state law continues to impose the $800 minimum annual franchise tax even if the LLC has ceased doing business. In many cases, years may pass before the members become aware that taxes, penalties and interest have been accruing; at that point, they may simply "walk away" from the LLC rather than go through the trouble and expense of dissolution. The Franchise Tax Board, however, can extinguish an uncollectible debt only after 20 years. Administrative cancellation is designed to eliminate defunct businesses and relieve the FTB of the burden of pursuing uncollectible accounts. [Senate Floor Analyses of AB 2503 (8/18/18); Senate Governance and Finance Committee Analysis of AB 2503 (6/25/18); Assembly Revenue and Taxation Committee Analysis of AB 2503 (4/20/18)]

Administrative cancellation thus differs from true dissolution in that there are no procedures to pay creditors, liquidate assets or distribute any remainder to the members.

b. [6:873] **Not applicable to foreign LLCs:** Administrative cancellation applies only to a "domestic" LLC—i.e., an LLC organized under California law. Administrative cancellation does not apply to a foreign LLC registered in California (*see ¶ 6:1200 ff.*). [Corps.C. §§ 17701.02(g), 17713.10.1(a)—"A *domestic* limited liability company … may be subject to administrative cancellation …" (emphasis added); see Senate Governance and Finance Committee Analysis of AB 2503, supra, p. 4—"FTB would need considerable resources to verify that a foreign entity had ceased business operations"]

c. Procedure

(1) [6:874] **Notice to LLC:** The FTB will transmit to the Secretary of State the names and Secretary of State file numbers of LLCs subject to administrative cancellation. The Secretary of State must provide 60 days' notice of the pending cancellation on its website (*www.sos.ca.gov*) by listing the LLC's name and file number. The posting must also provide instructions

for the LLC to submit to the FTB a written objection to the cancellation before the 60-day period expires. [Corps.C. § 17713.10.1(c), (d)]

The FTB must also mail written notice to the LLC's "last known address." If the FTB does not have a valid address for the LLC, the posting on the Secretary of State's website will be deemed sufficient notice to the LLC. [Corps.C. § 17713.10.1(b)]

(2) [6:875] **Cancellation where LLC fails to object:** If the FTB receives no written objection within the 60-day notice period (¶ *6:874*), the Secretary of State will administratively cancel the LLC by filing an appropriate certificate. [Corps.C. § 17713.10.1(f)]

(3) [6:876] **Objection by LLC; revivor (reinstatement):** If the FTB receives a written objection to the cancellation within the 60-day notice period (¶ *6:874*), the LLC has an additional 90 days from the date the objection is received to (i) apply for revivor (*see* ¶ *6:727 ff.*), (ii) file returns and pay or otherwise satisfy all accrued taxes, penalties, and interest, and (iii) fulfill any other requirements necessary for revivor. The FTB may extend the 90-day period for up to an additional 90 days. [Corps.C. § 17713.10.1(g)(1), (3); see Rev. & Tax.C. § 23310—FTB may abate taxes, interest and penalties for years in which LLC ceased business and had no assets]

If the LLC fulfills the conditions for revivor, the administrative cancellation will be withdrawn. [Corps.C. § 17713.10.1(g)(2)(A)]

If the LLC does not fulfill the conditions for revivor, the LLC will be administratively cancelled as of the later of (i) 90 days after receipt of its written objection or (ii) the date of any extension granted by the FTB. [Corps.C. § 17713.10.1(g)(2)(B)]

d. [6:877] **Effect of cancellation:** Administrative cancellation terminates the LLC's rights, powers and privileges. [Corps.C. § 17713.10.1(k)]

(1) [6:878] **Abatement of taxes:** Administrative cancellation also terminates (abates) the LLC's liability for taxes, interest and penalties, and the FTB may no longer pursue collection. [Corps.C. § 17713.10.1(h), (i)]

[6:879 - 6:899] ***Reserved.***

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Chapter 6. Limited Liability Company

G. Conversion into Other Entity

[6:900] There are circumstances in which an LLC may wish to convert into another business entity. When a conversion occurs, it is most commonly into a corporation. Institutional investors may prefer the corporate form for making equity investments. Or the business may wish to engage in a public offering of its securities, in which event the corporate form is far more familiar to investors.

A California LLC may have developed business in one or more other states, or may wish to take advantage of more advantageous laws in another state, and thus convert into a *foreign LLC*. (This may also be accomplished by means of a *merger* with a foreign LLC.)

(*Caution:* The operating agreement may not vary any statutory provision governing LLC conversions except as permitted by those statutory provisions; *see ¶ 6:123*. More specifically, the operating agreement may not restrict a member's right to approve a conversion that would result in *personal liability* of the member; *see ¶ 6:120*.)

1. [6:901] **Entities Into Which LLC May Convert:** A California LLC may convert into an "other business entity"—i.e., a California or foreign *corporation, general partnership*, *limited partnership*, *business trust*, *real estate investment trust* or *for-profit unincorporated association*. It may also convert into a *foreign LLC*. [Corps.C. §§ 17710.01(k), 17710.02(a)]

Of course, in the case of conversion into a *foreign* entity (including a foreign LLC), the conversion must be expressly permitted by the law of the foreign entity, and the LLC must comply with both California law and the laws of the foreign entity with respect to conversion. [Corps.C. §§ 17710.02(b), 17710.05(a)]

[6:902] ***Reserved.***

a. Conditions for conversion

(1) [6:903] **Conversion into general partnership, limited partnership or foreign LLC:** Conversion into a general or limited partnership, or a foreign LLC, is permitted only if each member would receive a percentage interest in the profits and capital of the converted (new) entity equal to the member's percentage interest in the converting LLC's profits and capital as of the effective time of conversion. [Corps.C. § 17710.02(a)(1)]

(2) [6:904] **Conversion into other entity:** Conversion into an entity other than a general partnership, limited partnership or foreign LLC is permitted only if:

- Each membership interest of the same class is treated *equally* with respect to any distribution of cash, property, rights, interests or securities of the new entity, unless *all* members of the class consent; *and*
- The nonredeemable membership interests of the converting LLC are converted only into nonredeemable interests or securities of the converted entity, unless all holders of the nonredeemable interests consent. [Corps.C. § 17710.02(a)(2)]

2. [6:905] **Plan of Conversion:** The LLC must prepare a plan of conversion, which must state:

- The terms and conditions of the conversion;
- The place of organization of the converting LLC and the converted entity, and the name of the converted entity after conversion;
- The manner of converting the membership interests of each of the members into interests (shares, securities, etc.) of the converted entity;

• The provisions of the converted entity's governing documents (this requirement will typically be satisfied by attaching the governing documents—e.g., partnership agreement, or articles of incorporation and bylaws, or articles of organization and operating agreement if converting into a foreign LLC—to the plan of conversion);

• Any provisions required by the converted entity's governing laws; and

• Any other provisions that are desired (e.g., an effective date of conversion; *see* ¶ *6:931*). [Corps.C. § 17710.03(a)]

a. [6:906] **Approval by managers and members:** The plan of conversion must be approved by *all managers* (in the case of a manager-managed LLC) and by a *majority* of the members of each class of membership interests of the converting LLC (i.e., the holders of a majority of the interests in the current profits of each class of the LLC), unless a greater approval is required by the operating agreement. But if the members would become personally liable for any obligations of the converted entity, the plan must be approved by *all* members *unless* the plan provides that all members will have dissenters' rights (*see* ¶ *6:1050 ff.*). [Corps.C. § 17710.03(b); see Corps.C. § 17701.02(n)—"manager" applies only in manager-managed LLC]

These approval provisions may not be varied by the operating agreement. [Corps.C. § 17701.10(c)(10), (12)]

b. [6:907] **Amendment of plan:** A plan of conversion that has been approved may nevertheless be amended before the conversion takes effect if the amendment is approved by *all managers* (in the case of a manager-managed LLC) and a majority of the members. If the amendment changes any of the principal terms of the plan of conversion, the amendment must also be approved by the managers and members in the same manner and extent as was required for approval of the original plan. [Corps.C. § 17710.03(d); see Corps.C. § 17701.02(m), (n)—"manager" applies only in manager-managed LLC]

c. [6:908] **Abandonment of plan:** At any time before the conversion is effective, the plan of conversion may be abandoned upon the approval of *all managers* (in the case of a manager-managed LLC) and by a majority of the members. [Corps.C. § 17710.03(e); see Corps.C. § 17701.02(n)—"manager" applies only in manager-managed LLC]

Abandonment is subject to any contractual rights of third parties. [Corps.C. § 17710.03(e)]

d. [6:909] **Retention of plan:** The converted entity must keep the plan of conversion at its principal place of business if it is a California LLC or a foreign other business entity, or at its principal office or registered transfer agent if it is a California corporation. [Corps.C. § 17710.03(f)]

3. [6:910] **Dissenters' Rights:** Members who do not vote in favor of the conversion may be entitled to have the LLC buy out their membership interests at fair market value. Dissenters' rights may also apply where the *operating agreement* specifically provides for statutory dissenters' rights or *all managers* (if the LLC is manager-managed) and those members having a *majority* in interest in current profits agree that statutory dissenters' rights apply. *See further discussion at* ¶ 6:1050 ff.

4. [6:911] **Statement or Certificate of Conversion (Conversion to California General Partnership, Limited Partnership or Corporation):** A *statement* of conversion is a statement setting forth the conversion and is contained in another document, such as a certificate of limited partnership or articles of incorporation. A *certificate* of conversion is a document pertaining only to the conversion and is comprised basically of the statement of conversion.

A *certificate* of conversion must be on a form prescribed by the Secretary of State. [Corps.C. § 17710.06(e)]

a. [6:912] **Contents:** The statement or certificate of conversion must set forth:

• The converting LLC's name and the Secretary of State's file number; and

• A statement that the principal terms of the plan of conversion were approved by a vote of the members that equaled or exceeded the vote required under Section 17710.03 (¶ 6:906), specifying each class entitled to vote and the percentage vote required of each class. [Corps.C. § 17710.06(b)]

(1) [6:913] **Additional contents of certificate of conversion:** In addition to the above information (¶ 6:912), a certificate of conversion must set forth:

• The name, form of organization (general partnership, limited partnership, corporation, etc.), and jurisdiction of organization of the converted entity;

• The name, street address and mailing address of the converted entity's agent for service of process (but no address shall be stated if a corporation qualified under Corps.C. § 1505 (*see ¶ 3:107*) is designated as the agent); and

• The street address of the converted entity's principal office. [Corps.C. § 17710.06(c)]

b. [6:914] **Ordinarily, execution by all members or managers required:** A statement or certificate of conversion must be executed and acknowledged by all members of a member-managed LLC or by all managers of a manager-managed LLC, *unless* a lesser number is provided in the articles or operating agreement. [Corps.C. § 17710.06(b)]

➪ [6:915] ***PRACTICE POINTER:*** As stated, a statement of conversion is contained within another document, such as articles of incorporation. Thus, the document containing the statement of conversion must be signed by the members, who may also sign in the capacity of, e.g., incorporators or general partners.

[6:916] ***Reserved.***

c. When to use statement vs. certificate of conversion

(1) [6:917] **Conversion into California limited partnership:** If the LLC converts into a California limited partnership, a *statement* of conversion must be completed on the certificate of limited partnership to be filed with the Secretary of State. [Corps.C. § 17710.06(a)(1)

• ***FORM:*** The Secretary of State's standard form Certificate of Limited Partnership—Conversion (LP-1A) is available online at the Secretary of State's website (*www.sos.ca.gov*).

(a) [6:918] **Filing fee:** The fee for filing the certificate of limited partnership containing the statement of conversion is $70 (plus a $15 special handling fee if the articles are delivered in person to the Secretary of State's office). [Gov.C. §§ 12182(a), 12188(b); 2 CCR § 21903(c)]

(b) [6:919] **Certificate conclusive evidence of conversion:** A copy of the certificate of limited partnership, duly certified by the Secretary of State, is conclusive evidence of the conversion of the LLC into a limited partnership. [Corps.C. § 17710.04(b)]

(2) [6:920] **Conversion into California general partnership:** If the LLC converts into a California general partnership, a *statement* of conversion must be completed on the general partnership's statement of partnership authority. But if no statement of partnership authority is filed, a separate *certificate* of conversion must be filed with the Secretary of State. [Corps.C. § 17710.06(a)(2)]

FORMS

• The Secretary of State's standard form General Partnership Statement of Authority—Conversion (GP-1A) is available online at the Secretary of State's website (*www.sos.ca.gov*).

• The Secretary of State's standard form Certificate of Conversion (CONV-1A) is available online at the Secretary of State's website (*www.sos.ca.gov*).

[6:921] ***Reserved.***

(a) Filing fee

1) [6:922] **Statement of conversion:** The fee for filing a statement of partnership authority containing a statement of conversion is $70 (plus a $15 special handling fee if delivered in person to the Secretary of State's office). [Gov.C. § 12187(a); 2 CCR § 21903(c)]

2) [6:923] **Certificate of conversion:** The fee for filing a certificate of conversion is $30 (plus a $15 special handling fee if delivered in person to the Secretary of State's office). [Gov.C. §§ 12182(a), 12187(c); 2 CCR § 21903(c)]

(b) [6:924] **Statement of partnership authority conclusive evidence of conversion:** A copy of the statement of partnership authority, duly certified by the Secretary of State, is conclusive evidence of the conversion of the LLC to a general partnership. [Corps.C. § 17710.04(b)]

(3) [6:925] **Conversion into California corporation:** If the LLC converts into a California corporation, a *statement* of conversion must be completed on the corporation's articles of incorporation. [Corps.C. § 17710.06(a)(3)]

• ***FORM:*** Sample Articles of Incorporation with Statement of Conversion may be viewed online at the Secretary of State's website (*www.sos.ca.gov*).

(a) [6:926] **Filing in Sacramento office only:** Ordinarily, articles of incorporation may be filed in either the Sacramento or Los Angeles office of the Secretary of State. However, articles containing a statement of conversion may be filed only in the Sacramento office.

(b) [6:927] **Filing fee:** The fee for filing articles of incorporation containing a statement of conversion is $150 (plus a $15 special handling fee if delivered personally to the Secretary of State's office). [Gov.C. §§ 12182(a), 12184; 2 CCR § 21903(c)]

(4) [6:928] **Conversion into foreign entity:** If the LLC converts into a foreign limited LLC or other foreign business entity, a *certificate* of conversion must be filed with the Secretary of State. [Corps.C. § 17710.06(a)(4)]

• ***FORM:*** The Secretary of State's standard form Certificate of Conversion (CONV-1A) is available online at the Secretary of State's website (*www.sos.ca.gov*).

(a) [6:929] **Filing fee:** The fee for filing a certificate of conversion is $30 (plus a $15 special handling fee if delivered in person to the Secretary of State's office). [Gov.C. §§ 12182(a), 12190(o); 2 CCR § 21903(c)]

d. [6:930] **No certificate of cancellation required:** The filing of a certificate of conversion, certificate of limited partnership, statement of partnership authority, or articles of incorporation containing a statement of conversion has the effect of the filing of a certificate of cancellation by the converting LLC. The converting LLC is not required to take any other action as a result of the conversion under the statutory provisions governing LLC dissolution (Corps.C. § 17707.01 et seq.). [Corps.C. § 17710.06(d)]

5. [6:931] **Effective Date of Conversion:** The conversion into another entity—regardless of the type entity—is effective upon the *earliest* date that all of the following occur:

• The members duly approve the plan of conversion;

• All documents required by law to create the converted entity are filed; and

• Any effective date set forth in the plan of conversion occurs. [Corps.C. § 17710.04(a)]

a. [6:932] **Potential additional requirement when converting into foreign entity:** If the LLC converts into a foreign entity, the laws governing the converted foreign entity may impose additional requirements before the conversion is deemed effective. [Corps.C. § 17710.05(a)]

6. [6:933] **Effect of Conversion:** The converted entity is for all purposes (other than franchise/income taxation) the same entity that existed before the conversion. The conversion is not deemed a transfer of property. Upon conversion, all LLC property and rights vest in the converted entity, and all LLC debts, liabilities and obligations continue as such in the converted entity. Any action or proceeding pending by or against the LLC may be continued against the converted entity as if the conversion had not occurred. [Corps.C. § 17710.09(a), (b)]

a. [6:934] **Nondissenting member deemed party to new entity's governing documents:** All members who did not exercise dissenters' rights (¶ 6:1089), are deemed parties to any agreements constituting the governing documents for the converted entity that were adopted as part of the plan of conversion (regardless of whether the member executed the plan of conversion or such documents). [Corps.C. § 17710.03(c)]

[6:935] ***Reserved.***

b. Member's liability following conversion

(1) [6:936] **Preconversion obligations:** Following conversion, a member remains liable for all *LLC* obligations for which the member was personally liable *before* the conversion. [Corps.C. § 17710.09(c)(1), (d)]

(2) [6:937] **Postconversion obligations:** A member is also liable for all obligations of the *converted entity* incurred *after* the conversion, but those obligations may be satisfied only out of property of the entity where:

- The member becomes a limited partner in a limited partnership;
- The member becomes a shareholder in a corporation;
- The member becomes a holder of equity securities in another type of entity if such a holder is not personally liable for the obligations of that entity under the law under which the entity is organized or under its governing documents. [Corps.C. § 17710.09(c)(2)]

(3) [6:938] **Member's liability for transaction entered into with third party?** CRULLCA provides that where a member entered into a transaction with a third party who reasonably believed that the member was a general partner, the member is liable for a resulting obligation incurred within 90 days after the conversion takes effect. [Corps.C. § 17710.09(e)]

This provision was obviously adapted from the law applicable to limited partnership conversions (see Corps.C. § 15911.09(e)). It should be the rare case indeed when a third party creditor of an LLC "reasonably" believes that one or more of the members of the LLC is a "general partner."

(4) [6:938.1] **Personal liability for unlawful conversion:** A member may be personally liable for tortiously converting an LLC to a corporation. [*Holistic Supplements, L.L.C. v. Stark* (2021) 61 CA5th 530, 544-545, 275 CR3d 791, 799-801—defendant may be personally liable for secretly converting LLC to corporation after transferring ownership of LLC to plaintiff]

c. [6:939] **Recording of statement or certificate of conversion:** The converted entity may file a certified copy of the certificate of conversion, or charter document containing a statement of conversion, in the county recorder's office of any county in which the converting partnership holds real property. Doing so shows record ownership in the converted entity of the converted LLC's interest in the property and is conclusive evidence, in favor of bona fide purchasers or encumbrancers for value, that the conversion was validly completed. [Corps.C. § 17710.07]

7. [6:940] **Tax Treatment:** *See ¶ 8:584 ff.*

8. [6:941] **Securities Law Considerations:** *See* ¶ 7:1500 ff.

[6:942 - 6:949] ***Reserved.***

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Chapter 6. Limited Liability Company

H. Mergers

[6:950] An LLC may merge with one or more other California LLCs. It may also merge with California general partnerships, limited partnerships or corporations. A merger with other California business entities (a business trust, real estate investment trust or for-profit unincorporated association) is permitted so long as the merger is permitted under the laws governing the other entity. [Corps.C. §§ 17710.01(k), 17710.10, 17710.11]

Caution: The operating agreement may not vary any statutory provision governing LLC mergers (other than as specifically provided by any such statutory provision); *see ¶ 6:123*. And more specifically, the operating agreement may not restrict a member's right to approve a merger that would result in the member's personal liability; *see ¶ 6:120*.

1. [6:951] **Merger with Foreign Entity:** An LLC may merge with one or more *foreign* LLCs or other business entities (corporations, general partnerships, limited partnerships, business trusts, real estate investment trusts or a for-profit unincorporated association). If the California LLC is the survivor, the foreign entities must not be prohibited from merging by the laws under which they are organized. If a foreign LLC or foreign other business entity is the survivor, the laws of the jurisdiction under which the survivor is organized must authorize the merger. [Corps.C. §§ 17710.01(j), (k), 17710.11(c), (d), 17710.17(a)]

a. [6:952] **Governing law:** If the survivor is a California business entity, any California disappearing LLC must comply with the merger provisions contained in CRULLCA. [Corps.C. § 17710.17(a)]

If the survivor is a foreign business entity, the merger may be performed in accordance with the laws governing the foreign entity (but the provisions regarding dissenters' rights continue to apply to the LLC). [Corps.C. § 17710.17(a), (e)]

2. [6:953] **No Merger With Limited Liability Partnership:** An LLC may not merge with a limited liability partnership because the law governing limited liability partnerships does not permit a limited liability partnership to merge with another entity. [Corps.C. § 16910(a)(3); *see ¶ 4:270*]

3. [6:954] **Agreement of Merger:** The parties to the merger must approve an agreement of merger. Persons other than the merging entities may be parties to the agreement. [Corps.C. § 17710.12(a)]

[6:955] ***Reserved.***

a. Approval of agreement

(1) [6:956] **By LLC:** The merger *agreement* must be approved by *all* managers (in the case of a manager-managed LLC) and by a *majority* of the members (i.e., those members owning more than 50 percent of the aggregate membership interests of the members in the current profits of the LLC of each class of membership interests, unless the operating agreement requires a *greater* approval). But if the members are to become personally liable for any obligations of a constituent entity, the "principal terms" of the merger agreement must be approved by *all* members unless the merger agreement provides that all members will have dissenters' rights (Corps.C. § 17711.01 et seq., ¶ 6:1050 ff.). [Corps.C. § 17710.12(a); see Corps.C. § 17701.02(n)—"manager" applies only in manager-managed LLC]

Caution: The operating agreement may not reduce the vote required of the members of an LLC to approve a merger below a majority of the members, nor restrict a member's right to approve a merger that would result in *personal liability* of the member; *see ¶ 6:120*.

(a) [6:957] **Comment:** The members' approval of the merger agreement vs. approval of the *principal terms* of the agreement is a drafting inconsistency. [See also Corps.C. § 17710.14(a)(2)—statement in certificate of merger that "principal terms of agreement of merger" were duly approved] To be safe, counsel should have the members approve the agreement itself.

(2) [6:958] **By other entity:** The agreement must be approved by each other constituent entity by those persons required to approve the merger by the laws under which it is organized. [Corps.C. § 17710.12(a)]

b. [6:959] **Contents:** The merger agreement must contain all the following:

(1) [6:960] **Terms and conditions:** The merger agreement must state the terms and conditions of the merger. [Corps.C. § 17710.12(a)(1)]

(2) [6:961] **Name and place of organization:** The merger agreement must state the name and place of organization of all constituent entities, and which is to be the surviving entity. [Corps.C. § 17710.12(a)(2)]

(a) [6:962] **Change of name:** The agreement may change the name of the surviving LLC, which may be the same as or similar to the name of a disappearing LLC. [Corps.C. § 17710.12(a)(2)]

(3) [6:963] **Conversion of membership interests:** The agreement must state the manner of converting the membership interests into interests or other securities of the surviving LLC or other entity. If membership interests are not to be converted solely into interests or other securities of the surviving entity, the agreement must set forth the cash, property, rights, interests or securities that the members are to receive in exchange for their interests. [Corps.C. § 17710.12(a)(3)]

Alternatively, the agreement may state that the members' membership interests are canceled without consideration. (This may occur in a "bail-out" situation where the surviving entity takes over the business of the acquired entity and assumes its debt, but otherwise pays nothing to the equity holders of the acquired entity.) [Corps.C. § 17710.12(a)(3)]

(a) [6:964] **Equal treatment of membership interests:** Each membership interest of the same class must be treated equally with respect to any distribution of cash, property, rights, interests or securities unless all members of the class consent otherwise. [Corps.C. § 17710.12(b)(1)]

1) [6:965] **Exception:** Equal treatment does not apply to a membership interest that is being canceled *and* that is held by a constituent LLC, its parent or "subsidiary." [Corps.C. § 17710.12(b)(1)]

(b) [6:966] **Special provision for more-than-50% owned LLC:** Unless all members of the same class consent otherwise, unredeemable membership interests may be converted only into unredeemable interests or securities of the surviving entity or a parent if a constituent LLC or constituent other business entity owns, directly or indirectly, prior to the merger, interests or securities of a another constituent business entity representing more than 50% of the interests or securities entitled to vote with respect to the merger of the other business entity (or more than 50% of the "general" voting power—i.e., the power to vote on election of directors (see Corps.C. § 194.5)—of a constituent business entity that is a domestic corporation). [Corps.C. § 17710.12(b)(2)]

1) [6:967] **Exception for 90%-owned LLC:** But this provision does not apply in a merger of an LLC with another LLC in which it controls at least 90% of the membership interests entitled to vote with respect to the merger. [Corps.C. § 17710.12(b)(2)]

(c) [6:968] **Applicable to California parent of foreign LLC:** These provisions (Corps.C. § 17710.12(b)) apply to any California LLCs that are being merged as well as to any California LLC that is a *parent* of a *foreign constituent LLC*. [Corps.C. § 17710.17(e)]

(d) [6:969] **Inapplicable if approved by Financial Protection and Innovation Commissioner:** These provisions (Corps.C. § 17710.12(b)) do not apply where the Commissioner of Financial Protection and Innovation has approved the fairness of the terms and conditions of the merger. [Corps.C. §§ 17710.12(b)(3), 17710.13; see Corps.C. § 25142; *¶ 7:1537*]

(4) [6:970] **Amendment of articles:** The merger agreement must state any amendments to the surviving LLC's articles of organization (if applicable) to be effected by the merger. [Corps.C. § 17710.12(a)(4); see Corps.C. § 17710.14(a)(3)]

(a) [6:971] **Comment:** Corps.C. § 17710.12(a)(4) does not address the vote (or consent) needed to amend the surviving LLC's articles where the vote required for amendments is higher than the vote required to approve the merger agreement. Corps.C. § 17710.12(e) does address the similar situation where a merger agreement effects amendments to the *operating agreement* of any constituent LLC (*see ¶ 6:976 ff.*). In light of this silence and the explicit treatment of amendments to *operating agreements*, the prudent conclusion is to require that any amendment to the articles to be effected by the merger agreement be approved by the vote set forth in those articles (or in the surviving LLC's operating agreement) for amendments to the articles.

(5) [6:972] **Other provisions:** The agreement may also contain any other provisions required by the laws under which any other constituent business entity is organized, as well as any other provisions that are desired (including a provision for the treatment of fractional membership interests). [Corps.C. § 17710.12(a)(5), (6)]

c. [6:973] **Amendment of agreement:** A merger agreement that has been approved may be amended before the certificate of merger or the merger agreement is filed with the Secretary of State if the amendment is approved:

• By the managers and members in the same manner and to the same extent as was required for approval of the original merger agreement; and

• By each other constituent business entity. [Corps.C. § 17710.12(c)]

d. [6:974] **Abandonment of merger:** At any time before the merger is effective, the managers and members may abandon the merger "without further approval by the membership interests." Abandonment is subject to any contractual rights of other parties to the merger and third parties. [Corps.C. § 17710.12(d)]

(1) [6:975] **Comment:** Here again, the LLC merger provisions were taken virtually verbatim from the limited partnership merger provisions, which permit the *general* partners to abandon a merger without further approval of the *limited* partners (see Corps.C. § 15911.12(d)).

The LLC abandonment provision presents a problem because it does not specify any requisite vote of the members for the decision to abandon the merger. If, in a manager-managed LLC, the merger agreement itself or the authorization granted by the members to the managers to approve the merger does not set forth the mechanism for abandoning the merger, then abandonment by the same approval as was required to approve the merger would probably suffice (i.e., approval by all managers in a manager-managed partnership and approval of a majority in interest of the members; *see ¶ 6:956*). In fact, under prior law, a merger could be abandoned by the members of a constituent LLC "in the same manner as required for approval of the agreement of merger," and the failure to include a similar provision in CRULLCA was probably a legislative oversight. [See former Corps.C. § 17551(d)]

e. [6:976] **Amendment or adoption of operating agreement:** A merger agreement may effect any *amendment* to the operating agreement. It may also effect the adoption of a *new* operating agreement for the *survivor* LLC. Any such amendment, or adoption of a new operating agreement, is effective at the effective time or date of the merger. [Corps.C. § 17710.12(e)]

(1) [6:977] **Dissenters' rights where greater number of members required to approve amendment or adoption than required to approve merger:** If a greater number of members is required to approve an amendment to the operating agreement than is required to approve the merger agreement, and the number of members who approve the merger agreement is less than the number required to approve an amendment to the operating agreement, then any amendment to the operating agreement or adoption of a new operating agreement made in the merger agreement is effective only if the merger agreement provides that *all* members have dissenters' rights (Corps.C. § 17711.01 et seq., ¶ 6:1050 ff.). [Corps.C. § 17710.12(e)(2)]

f. [6:978] **Retention of merger agreement:** If the survivor is a *California LLC*, the merger agreement must be kept at its designated office in California. [Corps.C. § 17710.12(f); see Corps.C. § 17701.13(a) (LLC must "designate and continuously maintain" an office in California, ¶ 6:600)]

If the survivor is another business entity or a foreign LLC, the merger agreement must be kept at its principal place of business. [Corps.C. § 17710.12(f); see Corps.C. § 17710.14(a)(5)]

(1) [6:979] **Right to copy upon request:** Upon request, a copy of the agreement of merger must be given "promptly" without charge to any member or holder of shares, interests or other securities of a constituent business entity. Any waiver of this requirement is unenforceable. [Corps.C. § 17710.12(f)]

4. [6:980] **Dissenters' Rights:** Members who do not vote in favor of the merger may be entitled to have their interests bought out at fair market value. *See discussion at ¶ 6:1050 ff.*

5. [6:981] **Filings With Secretary of State:** As described below (¶ 6:982 ff.), a certificate of merger is required if the survivor is an entity other than a corporation, while an agreement of merger is filed if the survivor is a California corporation or a foreign corporation in a merger in which a California corporation was a disappearing entity.

a. [6:982] **Certificate of merger:** A *certificate* of merger *must* be filed on the form prescribed by the Secretary of State in a merger involving a California LLC and another business entity in which the LLC or other business entity (other than a corporation) is the *survivor*. [Corps.C. § 17710.14(a); see Corps.C. § 17710.17(b)]

• ***FORM:*** The Secretary of State's standard form Certificate of Merger (OBE MERGER-1) is available online at the Secretary of State's website (*www.sos.ca.gov)*.

(1) [6:983] **Contents:** The certificate of merger must set forth the following information:

(a) [6:984] **Names and any file numbers:** The certificate must contain the names and the Secretary of State's file numbers (if any) of each of the constituent entities, separately identifying the surviving entity and the disappearing entity or entities. [Corps.C. § 17710.14(a)(1)]

(b) [6:985] **Members' approval:** The certificate must contain a statement setting forth the total number of outstanding interests of each class entitled to vote on the merger and that the principal terms of the agreement of merger were approved by a vote of the number of interests of each class, which equaled or exceeded the vote required. The certificate must specify each class entitled to vote and the percentage vote required of each class. [Corps.C. § 17710.14(a)(2)]

(c) [6:986] **Changes to articles of organization:** Where an LLC is the survivor, the certificate of merger must set forth any change required to the information set forth in the survivor's articles of organization (*see ¶ 6:970*) resulting from the merger, including any change in the survivor's name. (The filing of a certificate of merger setting forth any changes to the articles of organization has the effect of filing of a certificate of amendment of the articles of organization, and no separate certificate of amendment need be filed.) [Corps.C. § 17710.14(a)(3)]

(d) [6:987] **Effective date:** Where the certificate is not to be effective upon filing, the certificate must set forth the future effective date or time, which must be a specified date or time *not more than 90 days* after the filing. [Corps.C. § 17710.14(a)(4)]

(e) [6:988] **Survivor's name and other information:** Where the survivor is another business entity or a foreign LLC, the certificate of merger must set forth the survivor's name, type of entity, jurisdiction in which the entity was organized, and the entity's principal place of business. [Corps.C. § 17710.14(a)(5)]

(f) [6:989] **Other information:** The certificate must also contain any other information required by the laws under which each other constituent entity is organized. [Corps.C. § 17710.14(a)(6)]

1) [6:990] **Agreement of merger where corporation merges into foreign limited partnership:** If the survivor is a foreign LLC in a merger in which a California corporation is a disappearing entity, a copy of the agreement of merger (including officers' certificates; see Corps.C. § 1113(g)(1)) must be filed simultaneously with the certificate of merger. [Corps.C. § 17710.14(a)(6); *see ¶ 6:1000*]

➪ [6:991] ***PRACTICE POINTER:*** The agreement of merger that is filed with the Secretary of State typically is an abbreviated form of the full merger agreement, and sets forth only the principal terms of the merger. This document should be filed as an attachment to the certificate of merger. (The Secretary of State's standard form Certificate of Merger treats such attachments as part of the Certificate ("incorporated by reference").)

(2) [6:992] **Execution:** The certificate of merger must be executed and acknowledged by:

- Each California LLC by *all* managers, but "if none" (i.e., the LLC is member-managed), by all members unless a lesser number is provided in the articles of organization or operating agreement;

- Each foreign LLC by *one or more* managers, or if none, *one or more members*; and

- Each other business entity by those persons required to execute the certificate by the laws under which the entity is organized. [Corps.C. § 17710.14(a); see Corps.C. § 17702.03(b)—"any record filed under this title may be signed by an agent" (except as otherwise expressly provided)]

(3) [6:993] **$150 filing fee:** The fee for filing the certificate of merger is $70 if only LLCs are merged and $150 for all other mergers (plus, in either situation, a $15 special handling fee if the certificate is delivered in person to the Secretary of State's office). [Gov.C. §§ 12182(a), 12190(i), (j); 2 CCR § 21903(c)]

[6:994 - 6:999] ***Reserved.***

b. [6:1000] **Agreement of merger:** An agreement of merger must be filed if the survivor is a California corporation, or if the survivor is a foreign corporation in a merger in which a California corporation is a constituent entity. (Here again, the agreement of merger that is filed with the Secretary of state is typically an abbreviated form of the full merger agreement; *see* ¶ *6:991*.) The agreement of merger must include officers' certificates (per Corps.C. § 1113(g)(1)). [Corps.C. § 17710.14(b); see Corps.C. § 17710.17(b)]

(1) [6:1001] **Execution by all managers:** The agreement of merger must be executed and acknowledged by *all* of the *managers* unless a lesser number is provided in the *articles of organization*. (Of course, the agreement must also be appropriately executed and acknowledged by the constituent corporation and any other business entities.) [Corps.C. § 17710.14(b); see Corps.C. § 17702.03(b)—"any record filed under this title may be signed by an agent" (except as otherwise expressly provided)]

(a) [6:1002] **Comment:** Technically, the requirement that the agreement of merger by executed and acknowledged by all "managers" would apply only to a manager-managed LLC. However, for purposes of Corps.C. § 17710.14(b), the requirement that the agreement be executed by all managers should probably be read to apply also to a member-managed LLC (i.e., the agreement should be executed by all members unless a lesser number is provided in the articles of organization or operating agreement of the LLC). [See Corps.C. § 17701.02(n)—"manager" applies only in manager-managed LLC]

The reference in Corps.C. § 17710.14(b) to execution of the "certificate" of merger, rather than the agreement of merger, is a drafting error. Execution of the certificate of merger is set forth in Corps.C. § 17710.14(a), ¶ 6:992.

(2) [6:1003] **Filing fee:** The fee for filing the agreement of merger is $150 (plus a $15 special handling fee if the agreement is delivered in person to the Secretary of State's Office). [Gov.C. §§ 12182(a), 12186(*l*); 2 CCR § 21903(c)]

c. [6:1004] **Foreign entity as survivor—undertaking filed with Secretary of State:** A survivor that is a foreign entity must file the following with the Secretary of State:

- An agreement that it may be served *in California* in a proceeding for the enforcement of an obligation of any constituent entity and in a proceeding to enforce dissenters' rights with regard to a California constituent entity;

- An irrevocable *appointment* of the *Secretary of State* as its *agent for service of process*, and an address to which process may be forwarded; and

- An agreement to *promptly pay the buyout amount to any holder of a dissenting interest* (*see* ¶ *6:1100*). [Corps.C. § 17710.17(f)]

6. [6:1005] **Effective Date of Merger:** The merger is effective upon the filing of the certificate of merger or agreement of merger *unless* the certificate or agreement specifies a later effective date or time (¶ *6:987*). [Corps.C. § 17710.15(a); see Corps.C. § 17710.17(b)]

If the survivor is a foreign entity, the merger becomes effective in accordance with the law governing the foreign entity; but the merger continues to be effective as to the LLC upon the filing of the certificate of merger or agreement of merger. [Corps.C. § 17710.17(c)]

7. [6:1006] **Effect of Merger:** When the merger becomes effective, the separate existence of the disappearing entities ceases and the surviving entity automatically succeeds to all of the disappearing entity's or entities' property, rights, debts and liabilities. [Corps.C. § 17110.16(a), (b)]

a. [6:1007] **Lawsuits or proceedings:** Any action or proceeding pending by or against any disappearing entity may proceed against that entity to judgment, and the judgment is binding upon the survivor. [Corps.C. § 17710.16(c)]

Alternatively, the action or proceeding may be brought against the survivor, or the survivor may be substituted in place of the disappearing entity. [Corps.C. § 17710.16(c)]

b. [6:1008] **Assumption of franchise tax obligations and liabilities:** Upon the effectiveness of a merger, the surviving entity is deemed to assume the disappearing entity's franchise tax obligations and liabilities, including the disappearing entity's obligation to prepare and file tax and information returns otherwise required under the Revenue & Taxation Code and to pay any tax liabilities. If the surviving entity is a domestic LLC, corporation, or foreign LLC or foreign corporation registered or qualified to do business in California, then the Secretary of State is to notify the Franchise Tax Board of the merger. (Corps.C. § 17710.19(b) also refers to foreign LLPs, but they cannot be parties to inter-species mergers in California.) A certificate of satisfaction from the Franchise Tax Board, stating that the disappearing entity's tax liabilities have been paid or secured, is no longer required. [Corps.C. § 17710.19]

c. [6:1009] **Member's liability:** The members of a disappearing LLC continue to have any liability for the debts and obligations of the disappearing LLC that existed before the merger. [Corps.C. § 17710.16(d)]

(1) [6:1010] **Comment:** As stated earlier, the provisions for LLC mergers were taken virtually verbatim from the provisions for limited partnership mergers, which state that general partners continue to be liable for premerger debts and liabilities (Corps.C. § 15911.16(d)). Thus, Corps.C. § 17710.16(d) appears anomalous, although there are circumstances where members have personal liability for LLC obligations (e.g., personal guaranties, wrongful distributions).

d. [6:1011] **Disappearing LLC—no certificate of cancellation required:** The filing of a certificate of merger or agreement of merger has the effect of filing a certificate of cancellation of a disappearing LLC's articles of organization. [Corps.C. § 17710.14(c)]

(1) [6:1012] **Foreign LLC:** The filing of a certificate of merger or agreement of merger also has the effect of a cancellation of registration for any *foreign* LLC, and no separate certificate of cancellation is required. [Corps.C. § 17710.17(d)]

e. [6:1013] **Disappearing foreign corporation—no certificate of surrender required:** By filing the certificate of merger or agreement of merger, a disappearing foreign corporation automatically surrenders its right to transact business in California. The corporation need not file a certificate of surrender of its certificate of qualification. [Corps.C. § 17710.14(d); see Corps.C. §§ 2105(a), 2112, 2113]

f. [6:1014] **Recording of certificate or agreement of merger:** The filing of a certified copy of the certificate of merger or the filed agreement of merger in the county recorder's office of any county in which a disappearing entity holds real property establishes record ownership in the survivor of the disappearing entity's interest in the property. [Corps.C. § 17710.18]

[6:1015 - 6:1049] ***Reserved.***

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Chapter 6. Limited Liability Company

I. Dissenters' Rights

[6:1050] Ordinarily, dissenters' rights apply whenever the approval of members is required for a "reorganization" (*see ¶ 6:1051 ff.*) of an LLC having *more than 35 members* (*see ¶ 6:1075*). In these circumstances, each member who did *not vote in favor* of the reorganization (or, if the outstanding membership interests are publicly traded, each member who voted *against* the reorganization at a *meeting* rather than by written consent) may require the LLC to buy out their membership interest for cash in accordance with the procedure set forth in CRULLCA. [Corps.C. §§ 17711.02(a), (b)(3), 17711.13(b)]

(*Caution:* The operating agreement may not vary any provision governing dissenters' rights; *see ¶ 6:124*.)

1. [6:1051] **"Reorganization":** For dissenters' rights purposes, a "reorganization" means any of the following:

a. [6:1052] **Conversion:** Dissenters' rights apply in conversions (¶ 6:900 ff.). [Corps.C. § 17711.01(a)(1)]

b. [6:1053] **Merger:** Dissenters' rights also apply in a merger (¶ 6:950 ff.). [Corps.C. § 17711.01(a)(2)]

c. [6:1054] **"Exchange reorganization":** Dissenter's rights also apply in what may be called an "exchange reorganization," a term borrowed from the law applicable to corporations.

Such an "exchange reorganization" occurs when an LLC exchanges (in whole or in part) its membership interests for membership interests (or equity securities) of another LLC (or other business entity) if, immediately after the acquisition, the acquiring LLC has *control* of the other LLC (or other business entity). An "exchange reorganization" also occurs when an LLC exchanges, in return for ownership interests of the acquired entity, membership interests or equity securities of an LLC or other business entity that *controls* the acquiring LLC (i.e., a "parent" entity). [Corps.C. § 17711.01(a)(3)]

Thus, the LLC effectively acquires another LLC (or other business entity, such as a corporation) which it operates as a "subsidiary" through ownership of the other LLC's membership interests (or of the other business entity's equity securities, such as a corporation's stock). No merger or consolidation is effected between the LLC and the other entity: Both entities continue to retain their separate identities. The owners of the "subsidiary" receive membership interests (either of the acquiring LLC or its "parent" LLC, or alternatively, equity securities of the acquiring LLC's "parent" entity), and thus become members in the acquiring LLC or parent entity.

(1) [6:1055] **"Control" requirement:** After the exchange reorganization, the LLC must "control" the "subsidiary"—i.e., the LLC must possess, directly or indirectly, the power to direct or cause the direction of the "subsidiary's" management and policies. [Corps.C. § 17711.01(b)]

(a) [6:1056] **Compare—no "reorganization" where no "control":** There are no dissenters' rights where an LLC that issues membership interests in return for ownership interests in another entity does not obtain "control" of the other entity.

It may seem anomalous that dissenters' rights would hinge on "control" rather than on issuance of membership interests (which may dilute the members' investments in the LLC). But this in fact parallels the law applicable to corporations. [See Corps.C. § 160(b)]

One explanation is that, with the change in control, those members who have not accepted interests in the acquiring LLC or parent entity should be offered the opportunity to "bail out" of their investment now that it is under the control of a party they neither selected when they invested in the acquired LLC nor may now approve.

(b) [6:1057] **Compare—law applicable to corporations:** The "control" requirement is much more straightforward with respect to corporations. When a corporation engages in an exchange reorganization with another corporation (effectively acquiring a subsidiary), "control" means, quite simply, direct or indirect ownership of *more than 50%* of the target corporation's voting shares. [Corps.C. § 160(b)]

Determining when an LLC has "control" of another LLC or other business entity can be problematic, as described below (¶ 6:1058 ff.).

(c) [6:1058] **"Control" of another LLC:** An acquiring LLC would acquire control of a "target" LLC only if it could remove and replace the manager or managers in a *manager*-managed LLC, or acquire a majority of the outstanding membership interests in a *member*-managed LLC. (However, for a member-managed LLC with numerous and widely dispersed members, effective control of the LLC may not require acquisition of a majority of the outstanding membership interests.)

(d) [6:1059] **"Control" of limited partnership:** An LLC would appear to have clear "control" of a limited partnership only if the LLC can remove and replace the general partner of the "subsidiary" limited partnership with a person or entity of its choosing, e.g., by the manager or managing member of the "parent" LLC. That, in turn, will depend upon the terms of the limited partnership agreement.

(e) [6:1060] **"Control" of corporation:** An LLC should have "control" of a corporation so long as it owns more than 50% of the corporation's voting stock. But this might not be the situation where a voting trust or shareholder agreement skews power over corporate management.

(2) [6:1061] **"Boot" permitted:** As stated above (¶ 6:1054), the exchange must be in whole or *in part* for membership interests or equity securities. [Corps.C. § 17711.01(a)(3)]

Thus, the owners of the target entity may be offered membership interests or equity securities plus *cash* (or *other property*).

➪ [6:1061.1] ***PRACTICE POINTER:*** The dissenters' rights provisions are the only statutory provisions dealing with LLC exchange reorganizations. As stated above (*¶ 6:1054*), the concept of exchange reorganizations is taken from the laws applicable to corporations, which have specific IRC provisions that allow *nontaxable* reorganizations (see IRC §§ 354(a), 361, 368(a)(1)(B)). These IRC provisions do *not* apply to pass-through entities. (The taxation of LLC exchange reorganizations is governed by the federal tax provisions applicable to pass-through entities generally; *see Ch. 8*.)

d. [6:1062] **"Sale of assets reorganizations":** Dissenters' rights also apply in what may be called a "sale of assets reorganization," another term borrowed from the law applicable to corporations.

Such a "sale of assets reorganization" occurs when an LLC acquires all or substantially all the *assets* of another LLC or other business entity in exchange (in whole or in part) for either its membership interests *or its debt securities* that are not adequately secured and that have a maturity date in excess of *five years* after consummation of the acquisition. [Corps.C. § 17711.01(a)(4)]

A "sale of assets reorganization" also occurs when an LLC exchanges, in return for assets, membership interests, equity securities or debt securities of an LLC or other business entity that *controls* the acquiring LLC (i.e., a "parent" entity). Here again, the debt securities must meet the same requirements (i.e., not adequately secured and have a maturity in excess of five years). And the "parent" is in "control" of the acquiring LLC if it possesses direct or indirect power to direct the LLC's management and polices. [Corps.C. § 17711.01(a)(4), (b)]

Here again, the "sale of assets reorganization" provision parallels the sale of assets reorganization provision applicable to corporations that acquire assets in exchange for stock (or debt securities). [See Corps.C. § 181(c)]

➪ [6:1062.1] ***PRACTICE POINTER:*** The dissenters' rights provisions are the only statutory provisions dealing with LLC "sale of assets reorganizations." As with exchange reorganizations (*¶ 6:1061.1*), *corporate* "sale of assets reorganizations" have specific IRC provisions that allow *nontaxable* reorganizations (see IRC §§ 354(a), 361, 368(a)(1)(C)). These IRC provisions do *not* apply to pass-through entities. (The taxation of LLC "sale of assets reorganizations" is governed by the federal tax provisions applicable to pass-through entities generally; *see Ch. 8*.)

[6:1063 - 6:1069] ***Reserved.***

2. [6:1070] **When Applicable:** As set forth below (¶ 6:1071 ff.), dissenters' rights do not apply in all reorganizations.

a. [6:1071] **Post-2013 LLCs:** Dissenters' rights apply to LLCs formed after 2013. [Corps.C. § 17711.13(a)(1)]

• [6:1071.1] **Comment re pre-2014 LLCs:** Although CRULLCA applies to all LLCs "existing" after 2013, including LLCs organized under the Beverly-Killea Act, dissenters' rights apply only to domestic LLCs *formed* after 2013 (and certain *foreign* LLCs *formed or qualifying to do business in California* after 2013). [Corps.C. §§ 17711.13(a)(1), (2), 17713.04(a)]

Read literally, these provisions eliminate dissenters' rights for the members of an LLC (or foreign LLC otherwise subject to dissenters' rights under CRULLCA) organized (or qualified) prior to 2014. More than 800,000 LLCs were organized in California from 2000 to 2013. [See Calif. Lawyers Ass'n Bus. Law Section, Partnerships and Limited Liability Companies Committee and Opinions Committee, *Third-Party Closing Opinions: Limited Liability Companies and Partnerships*, App. B ("Entity Formation, 2000-2016") (12/9/16)]

b. [6:1072] **Foreign LLCs:** Dissenters' rights apply to foreign LLCs if (1) the LLC was formed or filed an application to qualify to do business in California *after 2013* and (2) members holding more than *50% of the voting power* held by all members reside in California. [Corps.C. § 17711.13(a)(2)]

c. [6:1073] **By agreement of members:** Where dissenters' rights are not available under the above provisions (*¶ 6:1071 ff.*), dissenters' rights will nonetheless apply if the *operating agreement* so provides. Dissenters' rights also apply if so agreed by those members holding more than 50 percent of the aggregate interests of the members in the current profits of the LLC *and*, in the case of a *manager*-managed LLC, agreed to by *all* managers. [Corps.C. § 17711.13(a)(3); see Corps.C. § 17701.02(m)]

d. [6:1074] **LLCs having buyout provisions:** Dissenters' rights do *not* apply if the operating agreement specifically sets forth the amount to be paid in respect for dissenting interests in the event of a reorganization. [Corps.C. § 17711.13(b)]

e. [6:1075] **LLCs with fewer than 35 members:** Most significantly, buyout rights do *not* apply in partnerships having 35 or fewer members if *all members waived statutory dissenters' rights in writing* in the operating agreement or otherwise; but the waiver is ineffective if there are *more than 35 members at the time of the reorganization* (i.e., where the number of members increased to over 35 between the time of the waiver and the subsequent reorganization). [Corps.C. § 17711.13(b)]

[6:1076 - 6:1079] ***Reserved.***

3. [6:1080] **Buyout Price:** The buyout amount is the *fair market value* of the membership interest as determined as of the *day before the first announcement* of the terms of the proposed reorganization, excluding any appreciation or depreciation in consequence of the proposed reorganization. The buyout price is paid in *cash* (or cash equivalent)—i.e., no installment payments, debt instruments or securities. [Corps.C. § 17711.02(a)]

4. [6:1081] **Includes "Assignees":** Dissenters' rights apply to the "recordholder" of a dissenting membership interest, including an "assignee of record" of that interest. [Corps.C. § 17711.02(c)]

a. [6:1082] **Comment:** Corps.C. § 17711.01(c) is taken word-for-word from prior law (former Corps.C. § 17601(c)). However, the term "assignee" is not otherwise used in CRULLCA. CRULLCA uses the term "transferee" instead. [See Corps.C. § 17701.02(ab)]

An assignee (or transferee) of a membership interest does not have voting rights. [Corps.C. § 17705.02(a)(3)(A), (g)] Accordingly, for an assignee to exercise dissenters' rights, the assignee's assignor, if an LLC member, must not have voted in favor of the reorganization (or, if the outstanding interests in the LLC are publicly traded and the vote was conducted by way of meeting rather than by written consent, must have voted against the reorganization). Since most LLCs are not

publicly traded, this should not prove an impediment in most cases because assignor members typically want nothing further to do with the LLC and will not participate in the vote on a reorganization.

5. [6:1083] **Exception for "Listed" Membership Interests:** Special rules apply where membership interests are listed either on a national securities exchange (as certified by the Financial Protection and Innovation Commissioner under Corps.C. § 25100(o)) or on the list of OTC margin stocks issued by the Federal Reserve System Board of Governors. In such circumstances, the LLC must, in the notice requesting the members' approval of the reorganization, provide a summary of the relevant statutory provisions regarding dissenters' rights (i.e., Corps.C. §§ 17711.02-17711.06). Members holding a class of "listed" membership interests have dissenters' rights only if *at least 5%* of outstanding interests of that class demand to be bought out. [Corps.C. § 17711.02(b)(1)]

Additionally, members seeking to be bought out must have voted *against* the reorganization (i.e., failure to vote in favor is not sufficient) *unless* approval of the reorganization was sought by *written consent* rather than by a vote. If the approval was sought by written consent, the member is entitled to dissenters' rights if the member did *not vote in favor* of the reorganization. [Corps.C. § 17711.02(b)(3)]

[6:1084] ***Reserved.***

6. Procedure

a. [6:1085] **LLC's notice to nonapproving members:** Within 10 days after approval of the plan of reorganization by the members, the LLC must send notice of the approval to each member. The notice must include:

- A copy of Corps.C. §§ 17711.01, 17711.02, 17711.04 and 17711.05;
- A statement of the price determined by the LLC to represent the fair market value of its outstanding interests; and
- A "brief description" of the procedure to be followed if the member wishes to be bought out. [Corps.C. § 17711.03(a)]

The statement of price constitutes an *offer* to purchase any dissenting interests. [Corps.C. § 17711.03(a)]

➪ [6:1086] ***PRACTICE POINTER:*** The notice of approval typically includes a transmittal letter by which the member can accept the offer, provide contact information, attest to the ownership of the interests held of record by the member, and provide a social security or tax identification number (or complete an enclosed Form W-9).

(1) [6:1087] **Compare—"listed" membership interests:** As stated, an LLC with "listed" interests must include a summary of the statutory buyout provisions in its notice requesting the members' *approval* of the reorganization. Dissenting members desiring to be bought out must make a written demand not later than the *date of the members' meeting to vote on the reorganization* (*see ¶ 6:1090*). [Corps.C. §§ 17711.02(b)(1)(A), 17711.03(b)(1)]

(2) [6:1088] **Caution—potential attorney and expert witness fees award against LLC:** An LLC that "lowballs" dissenting members may be liable for all court costs, including fees of attorneys, appraisers and expert witnesses, if a court awards the dissenting members a higher price than the LLC offered. *See ¶ 6:1109*.

b. [6:1089] **Dissenting member's purchase demand:** A dissenting member who wishes to be bought out must make a *written* demand on the LLC for the purchase of the dissenting member's interest. The demand must be *received* by the LLC (or its transfer agent) within *30 days* after the date on which the notice of approval was *mailed* to the members. [Corps.C. §§ 17711.02(b)(4), 17711.03(b)]

(1) [6:1090] **Special rule for "listed" membership interests:** In the case of "listed" membership interests (*see ¶ 6:1083*), the written demand to be bought out must be made upon the LLC *not later than the date of the members' meeting to vote upon the reorganization*. [Corps.C. § 17711.03(b)]

(2) [6:1091] **Contents of demand:** The demand must state the number or amount of the member's interest in the LLC and must also contain a statement of what the member claims to be the fair market value of that interest as of the day before

the "announcement" of the proposed reorganization. The statement of fair market value constitutes an *offer* by the member to sell the interest at that price. [Corps.C. § 17711.03(c)]

➪ [6:1092] ***PRACTICE POINTER:*** The member's offer will, for all but listed LLCs, be in response to the LLC's notice of approval of the reorganization. In effect, the member's offer represents a *counteroffer* to the LLC's offer, at which point negotiations between the member and the LLC will commence (unless the LLC accepts the counteroffer, an unlikely possibility.).

(a) [6:1093] **Certificate representing LLC interest:** If the member's interest is represented by a certificate, the certificate must accompany the written demand. [Corps.C. §§ 17711.02(b)(5), 17711.04]

The certificate is to be stamped or endorsed with a statement that the interest is a dissenting interest. [Corps.C. § 17711.04]

1) [6:1094] **Exchange for certificates of "appropriate denominations":** The certificate may also "be exchanged for certificates of appropriate denominations," to be stamped or endorsed with a statement that the interest is a dissenting interest. [Corps.C. § 17711.04]

Section 17711.04 is based upon prior law (former Corps.C. § 17603), which in turn was based on the corporate provision (Corps.C. § 1302). The quoted language may be apposite in the corporate context, but would be highly unusual in the LLC context, because most interests in LLCs are either uncertificated or represented by plain certificates evidencing all of the interests held by a particular member. The language of the statute is more suitable to LLCs whose outstanding interests are publicly traded.

2) [6:1095] **Subsequent transferees bound:** Upon any subsequent transfers of the dissenting interest on the LLC's books, any new certificate (or other written statement issued therefor) must also bear a statement that the interest is a dissenting interest together with the name of the original holder of the dissenting interest. [Corps.C. § 17711.04]

a) [6:1096] **Transferee may exercise buyout right:** As noted (¶ 6:1081), "dissenting members" include "assignees." Although the general thrust of CRULLCA severely limits the rights of "*transferees*" of membership interests, "assignees" of dissenting interests may nevertheless obtain the fair market buyout price for their interests.

(b) [6:1097] **No withdrawal of demand without LLC consent:** A dissenting member may not withdraw a buyout demand unless the LLC consents. [Corps.C. § 17711.10]

[6:1098 - 6:1099] ***Reserved.***

c. [6:1100] **Buyout:** If the LLC and the dissenting member agree on the purchase price, the member is entitled to the agreed price together with interest at the legal rate on judgments (10%, per CCP § 685.010(a)) from the date of *consummation* (i.e., the effective date) of the reorganization. Unless the LLC and the member agree otherwise, payment is due within the latest of:

• 30 days after the date the amount was agreed to;

• 30 days after any statutory or contractual conditions to the reorganization are satisfied; or

• The date any certificates representing the bought out member's interest are surrendered. [Corps.C. § 17711.05(b)]

(1) [6:1101] **Written agreement retained by LLC:** All agreements fixing the fair market value of any dissenting members' interest as between the LLC and the dissenting member must be in *writing* and filed in the LLC's records. [Corps.C. § 17711.05(a)]

(2) [6:1102] **Lawsuit to determine buyout price where parties cannot agree:** If the LLC and a dissenting member fail to agree upon the fair market value of a dissenting interest, or if the LLC denies that a membership interest meets the qualifications for a dissenting interest, then the member or the LLC may bring an action to determine the fair market value and/or whether the member's interest qualifies as a dissenting interest. [Corps.C. § 17711.06(a)]

(a) [6:1103] **Deadline for suit:** The action must be commenced within *six months* after the date that *notice of approval* of the reorganization was *mailed* to the member. [Corps.C. § 17711.06(a)]

(b) [6:1104] **Joinder/intervention of other members:** Two or more dissenting members may join as plaintiffs or be joined as defendants. [Corps.C. § 17711.06(b)]

In lieu of filing an independent action, the LLC or the dissenting member may join or intervene in any existing action between the LLC and a dissenting member. [Corps.C. § 17711.06(a)]

Multiple actions between the LLC and dissenting members may be consolidated. [Corps.C. § 17711.06(b)]

(c) [6:1105] **Stay of litigation re approval of reorganization:** The court action is suspended (stayed) pending any resolution of any litigation brought challenging the sufficiency or regularity of the members' vote or consent in approving the reorganization. [Corps.C. § 17711.12]

(d) [6:1106] **Court determination:** If the status of the member's interest as a dissenting interest is in dispute, the court must first determine that issue. The court may then determine the issue of the fair market value of the dissenting interest, or may appoint one or more impartial appraisers to determine fair market value (¶ 6:1107). [Corps.C. § 17711.06(c)]

1) [6:1107] **Procedure where one appraiser or all appraisers agree:** If the court appoints one or more appraisers, the appraiser, or a majority of the appraisers, must determine fair market value within the time fixed by the court. Upon filing of the appraisal report, either party may make a motion to submit the report to the court together with any additional evidence as the court considers relevant. The court may confirm the report if found "reasonable." [Corps.C. § 17711.07(a)]

If the court does not confirm the report, or if a majority of appraisers fails to file a report within 30 days from the date of their appointment or such later date as the court allows, the court must determine the fair market value of the dissenting interests. [Corps.C. § 17711.07(b)]

2) [6:1108] **Judgment:** The court must enter judgment against the LLC for payment of the buyout price of each dissenting member who is a party, together with interest at the legal rate (10%, per CCP § 685.010(a)) from the date of *consummation* of the reorganization. The judgment is payable "forthwith," subject to endorsement and delivery to the LLC of any certificates representing dissenting interests. [Corps.C. § 17711.07(c), (d)]

3) [6:1109] **Apportionment of costs; potential attorney fees award:** The court may apportion costs, including reasonable compensation for the appraisers, as it considers equitable. [Corps.C. § 17711.07(e)]

However, if the appraisal exceeds the price offered by the LLC, the LLC *must* pay the costs. If the value awarded by the court is more than 125% of the price offered by the LLC, the court has *discretion* to include *attorney fees* and *expert witness fees* in the costs awarded against the LLC. [Corps.C. § 17711.07(e)]

(e) [6:1110] **Payment of member's costs and attorney fees if reorganization abandoned:** *See ¶ 6:1124*.

7. [6:1111] **Distributions Offset Against Buyout Price:** Any cash distributions made by the LLC to a dissenting member between the date of consummation of the reorganization and the date of payment of the member's dissenting interest are credited against the total amount to be paid by the LLC for the dissenting interest. [Corps.C. § 17711.09]

8. [6:1112] **Continuation of Members' Rights Pending Buyout:** Dissenting members continue to have all the rights and privileges, including limited liability, incident to the interests until payment by the LLC for their dissenting interests. [Corps.C. § 17711.10]

9. [6:1113] **Limitation—No Buyout Payment If Constituting Prohibited Distribution or Voidable Transaction:** A buyout payment may not be made to the extent (a) the dissenting member would be required to return the payment (or portion thereof) by reason of Corps.C. § 17704.06 (¶ 6:338 ff.)—i.e., to the extent the payment would constitute a prohibited distribution (per Corps.C. § 17704.05, ¶ 6:331 ff.)—or (b) the payment would constitute a voidable transaction (per Civ.C. § 3429 et seq.). The dissenting members become LLC creditors for the amount not paid, together with interest at the legal rate on judgments (10%, per CCP § 685.010(a)) until the date of payment, but subordinate to all other creditors in a proceeding relating to the dissolution of the LLC. [Corps.C. § 17711.08]

a. [6:1114] **Comment:** Corps.C. § 17711.08 actually refers to Corps.C. § 17711.09 as the section that requires repayment of an unlawful distribution. (Section 17711.09 provides that any cash distributions made by an LLC to a dissenting member after the date of consummation of a reorganization but prior to the payment of the fair market value of the dissenting member's interest is to be credited against the amount to be paid by the LLC for such dissenting interest.) This is clearly a drafting error, and the reference should be to Corps.C. § 17704.06. The LLC dissenters' rights provisions were modeled after prior law, but former Corps.C. § 15607 referred to former Corps.C. § 17254(f) rather than to former Corps.C. § 17608 (the provision of prior law comparable to § 17711.09).

10. [6:1115] **Loss of Dissenting Status:** A dissenting interest loses its status as a dissenting interest, and the holder of the interest cases to be a dissenting member entitled to buyout of their interest, upon any of the following:

• The LLC *abandons* the reorganization;

• Where the dissenting member's interest is represented by a certificate, the member *transfers* the interest *prior to its submission for endorsement* (Corps.C. § 17711.04, ¶ 6:1093);

• The LLC and the member cannot agree to a buyout and neither files suit within the requisite six-month deadline (¶ 6:1103); or

• The dissenting member withdraws the buyout demand (with LLC consent, ¶ 6:1097). [Corps.C. § 17711.11]

11. [6:1116] **Restrictions on Challenges to Reorganization:** Dissenters' rights are intended in part to promote conversions, mergers and other reorganizations. Dissenters' rights thus replace many other rights a dissenting member may have to block the reorganization. Specifically, an LLC member having dissenters' rights may not bring suit to attack the *validity* of the reorganization or have the reorganization *set aside or rescinded*. [Corps.C. § 17711.14(a)]

[6:1117] ***Reserved.***

a. Exceptions permitting suit

(1) [6:1118] **Suit challenging vote:** A member having dissenters' rights may nevertheless bring suit to test whether the vote or consent of members required to authorize or approve the reorganization was obtained in accordance with the procedures established therefor in the operating agreement. [Corps.C. § 17711.14(a)]

(2) [6:1119] **Suit against manager or LLC:** A member having dissenters' rights may also bring an action against a manager, the LLC, or any person controlling a member for breach of fiduciary duty, fraud or any other matter so long as the suit does not attack the validity of the reorganization or seek to set aside or rescind the reorganization. [Corps.C. § 17711.14(e)]

(3) [6:1120] **Suit involving reorganizations between related entities:** If an LLC is directly or indirectly controlled by, or under common control with, another party to the reorganization, a member of the controlled LLC may, *in lieu of* exercising the right of a dissenting member to be bought out, bring suit to attack the validity of the reorganization or have it set aside or rescinded. The member loses the right to be bought out regardless of the outcome of the suit. [Corps.C. § 17711.14(b)]

(a) [6:1121] **"Control":** "Control" has the same meaning as used in exchange reorganizations (¶ 6:1054)—i.e., possession of the direct or indirect power to *direct the management and policies* of the LLC (or other business entity). [Corps.C. § 17711.01(b); *see ¶ 6:1055*]

(b) [6:1122] **Inapplicable where majority of other members approve reorganization:** But this exception does not apply (i.e., a dissenting member is barred from bringing an action challenging the validity of the reorganization) where a majority in interest of the members *other than members directly or indirectly controlled by, or under common control with, another party to the reorganization*, approve or consent to the reorganization. In these circumstances, the fact that "neutral" or "unaffected" members approved the transaction provides sufficient assurance of its overall fairness. [Corps.C. § 17711.14(d)]

(c) [6:1123] **Burden of proof in suit:** In any action to attack the validity of the reorganization or to set aside or rescind the reorganization, a party controlling another party to the reorganization has the burden of proving that the transaction is "just and reasonable" as to the members of the controlled party. Also, in any such action, a person who controls *two or more* parties to the reorganization has the burden of proving the transaction is "just and reasonable" as to the members of *any* party so controlled. [Corps.C. § 17711.14(c)]

12. [6:1124] **Payment of Member's Court Costs and Attorney Fees if Reorganization Abandoned:** If the LLC abandons the reorganization, then it must pay, on demand, all reasonable expenses, including attorney's fees, incurred by any dissenting member who has initiated a permitted suit in good faith, including a suit seeking a determination of the fair market value of the member's dissenting interests (¶ 6:1102 ff.). [Corps.C. § 17711.11(a)]

[6:1125 - 6:1199] ***Reserved.***

End of Document

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Chapter 6. Limited Liability Company

J. Foreign Limited Liability Companies Operating in California

[6:1200] An LLC organized in a state or jurisdiction other than California may register with the Secretary of State to do business in California (*¶ 6:1220 ff.*). A foreign LLC that transacts intrastate business in California (*see ¶ 6:1203 ff.*) risks penalties if it fails to register (*see ¶ 6:1206*). [See Corps.C. § 17701.02(j)—foreign LLC defined as unincorporated entity denominated as LLC by law of its jurisdiction of formation]

1. [6:1201] **Allowable for Licensed Businesses Only If Permitted by California Licensing Authority:** Registration with the Secretary of State does not authorize a foreign LLC to engage in any business or exercise any power that an LLC may not engage in or exercise in California. I.e., the foreign LLC must still obtain any necessary licenses or comply with any other laws that its business may require. [Corps.C. § 17708.01(c)]

In particular, a foreign LLC may render services that require a license, certificate or registration authorized by the Business and Professions Code, the Chiropractic Act, the Osteopathic Act or the Ship Brokers Act *only* if permitted by the provisions of the applicable *California* law. This is so even if the laws of the foreign LLC's jurisdiction of formation permit the LLC to engage in those activities. Otherwise, these restrictions could be circumvented simply by forming a foreign LLC and then registering it with the Secretary of State. [Corps.C. § 17701.04(b), (e); *see ¶ 6:17*]

➪ [6:1202] ***PRACTICE POINTER:*** The California Governor's Office of Business and Economic Development maintains a website containing state-wide business licensing and permitting requirements. See *www.calgold.ca.gov*.

2. [6:1203] **"Transacting Intrastate Business":** For registration purposes, a foreign LLC is considered to be "transacting intrastate business" when it "enters into repeated and successive transactions of business in this state, *other than in interstate or foreign commerce*." [Corps.C. § 17708.03(a) (emphasis added)]

a. [6:1204] **Activities *not constituting intrastate business:*** A foreign LLC is *not* considered to be "transacting intrastate business" merely because its *subsidiary* transacts intrastate business in California, or because of its status as:

- A shareholder of a California corporation or of a foreign corporation transacting intrastate business;
- A limited partner of a California limited partnership or of a foreign limited partnership transacting intrastate business; *and/or*
- A member or manager of a California LLC or of a foreign LLC transacting intrastate business. [Corps.C. § 17708.03(c)]

Nor is a foreign LLC considered to be "transacting intrastate business" solely by engaging in one or more of the following activities in California:

- Maintaining or defending any action, suit or administrative or arbitration proceeding, or effecting a settlement of claims or disputes;

- Carrying on any activity concerning its "internal affairs," including holding meetings of its members or managers;
- Maintaining accounts in financial institutions;
- Maintaining offices or agencies for the transfer, exchange and registration of its own securities, or maintaining trustees or depositaries with respect to those securities;
- Selling through independent contractors;
- Soliciting or procuring orders, whether by mail or electronic means or through employees or agents or otherwise, where those orders require *acceptance outside of California* before becoming contracts;
- Creating or acquiring debt, evidences of debt, mortgages, liens or security interests in real or personal property;
- Securing or collecting debts or enforcing mortgages or other security interests in property securing the debts, and holding, protecting or maintaining property so acquired;
- Conducting an isolated transaction completed within 180 days and not in the course of a number of repeated transactions of a like nature;
- Transacting business in *interstate* commerce. [Corps.C. § 17708.03(b)(1)-(10); see *Conseco Marketing, LLC v. IFA & Ins. Services, Inc.* (2013) 221 CA4th 831, 836, 839-840, 164 CR3d 788, 791, 794-795—foreign LLC's enforcement of "sister state" judgment in California (per CCP § 1710.10 et seq.) did not constitute transacting intrastate business in California (decided under prior law)]

b. [6:1205] **Status as LLC member:** A *person* (individual, corporation, partnership, LLC or other entity) is not deemed to be transacting intrastate business in California solely because of its status as a member or manager of a California LLC or of a foreign LLC registered in California. (But this does not apply in determining the contacts or activities that may subject a foreign LLC to service of process, taxation, or regulation under any other California law.) [Corps.C. § 17708.03(d), (e); see Corps.C. § 17701.02(v) ("person" defined)]

c. [6:1206] **Penalties for unlawfully transacting business in California:** A unregistered foreign LLC that transacts business in California:

- May not *maintain* (but may *defend*) an action or proceeding in California. [Corps.C. § 17708.07(a), (b); see *Delamater v. Anytime Fitness, Inc.* (ED CA 2010) 722 F.Supp.2d 1168, 1175-1177—suit filed in California against Minnesota corporation registered in California that subsequently converted into Minnesota LLC registered in California, and counterclaims filed by Minnesota LLC, could be maintained because Minnesota law provided that action by or against converting entity may continue against converted entity as if conversion had not occurred (decided under prior law)]
- Is deemed to appoint the Secretary of State as its agent for service of process for rights of action arising out of transacting intrastate business in California. [Corps.C. § 17708.07(d)]
- May be the subject of an action by the Attorney General to restrain the partnership from transacting intrastate business in California. [Corps.C. § 17708.09]
- Is subject to a penalty of *$2000 per taxable year* if the LLC fails to file a return within *60 days after notice* from the FTB, unless the failure is due to "reasonable cause and not willful neglect." [Rev. & Tax.C. § 19135(a)(1), (2)(A)]

Additionally, if the LLC fails to file a required franchise tax return, a party to any contract entered into in California with the LLC while unregistered may sue to rescind the contract. (The LLC may take curative action by filing the required returns and paying any owed taxes (including interest and penalties) up until a final court order of rescission.) [Rev. & Tax.C. §§ 23304.1(b), (c)(2), 23304.5, 23305.1; see *White Dragon Productions, Inc. v. Performance Guarantees, Inc.* (1987) 196 CA3d 163, 168-173, 241 CR 745, 747-751]

(1) [6:1207] **Limitation—member or manager liability for LLC debts unaffected:** A member or manager of an unregistered foreign LLC that transacts intrastate business in California is not liable for the LLC's debts, obligations or other liabilities solely by reason of the LLC's failure to register. [Corps.C. § 17708.07(c)]

d. [6:1208] **Compare—"doing business" for tax purposes; members subject to California taxation:** Members of a foreign LLC that is "doing business" in California—as well as the LLC itself (¶ *6:1210*)—may be subject to California state income (franchise) taxation (*see* ¶ *6:6*).

(1) [6:1209] **"Doing business" defined:** For franchise tax purposes, "doing business" means "actively engaging in any transaction for the purpose of financial or pecuniary gain or profit." There need not be a regular course of business or transactions to constitute "doing business"; any activity in California that meets this definition suffices. Moreover, a transaction need not result in actual profit so long as the transaction was motivated by financial or pecuniary gain or profit. [Rev. & Tax.C. § 23101(a); FTB Legal Ruling 2014-01, as modified by FTB Legal Ruling 2018-01; see *Swart Enterprises, Inc. v. Franchise Tax Bd.* (2017) 7 CA5th 497, 503-504, 212 CR3d 670, 674; and *Hise v. McColgan* (1944) 24 C2d 147, 150-151, 148 P2d 616, 618; *Golden State Theater & Realty Corp. v. Johnson* (1943) 21 C2d 493, 496, 133 P2d 395, 396-397]

Additionally, a foreign LLC is "doing business" in California for any year in which:

- It is "commercially domiciled" in California;
- California sales exceed the *lesser* of $610,395 (indexed for inflation) or 25% of the LLC's total sales;
- Real and tangible personal property located in California exceeds the *lesser* of $61,040 (indexed for inflation) or 25% of the LLC's total real and tangible personal property; *or*
- Employee compensation paid in California exceeds the *lesser* of $61,040 (indexed for inflation) or 25% of total employee compensation. [Rev. & Tax.C. § 23101(b)(1)-(4), (c); see 18 CCR § 23037; *www.ftb.ca.gov/file/business/Doing-Business-in-California.html*]

(2) [6:1210] **Franchise taxes imposed on LLC:** In addition to any California franchise taxes that the members may owe, the foreign LLC itself is subject to an $800 minimum annual franchise tax plus additional annual fees for any year in which its total California income is $250,000 or more. [Rev. & Tax.C. §§ 17941(a), (d), 17942(a), 23153(d)(1); *see* ¶ *6:7*]

(3) [6:1211] **LLC doing business in California—nonresident members subject to California taxation?** The Franchise Tax Board has taken the position that if an LLC classified as a partnership for tax purposes is doing business in California (within the meaning of Rev. & Tax.C. § 23101, ¶ *6:1209*), then the LLC members are themselves deemed to be doing business in California and hence are subject to California taxation. [FTB Legal Ruling 2014-01, as modified by FTB Legal Ruling 2018-01]

(a) [6:1212] **Not applicable to nonmanaging member of manager-managed LLC:** A California court of appeals rejected this position with respect to a nonresident member of a *manager-managed* LLC who had no right of control over the LLC. Accordingly, members of a *manager-managed* LLC doing business in California who do not otherwise do business in California or control the LLC should be treated the same as limited partners of a limited partnership, and should not, solely by reason of such membership interest, be deemed to be doing business in California. [*Swart Enterprises, Inc. v. Franchise Tax Bd.* (2017) 7 CA5th 497, 502-514, 212 CR3d 670, 674-681—out-of-state corporation owning 0.2% interest in manager-managed California LLC was not doing business in California for purpose of Rev. & Tax.C. § 23101; see FTB Notice 2017-01—FTB will follow *Swart* in situations having same facts]

(b) [6:1213] **Applicable to LLC managers?** It would appear that out-of-state members of a *member-managed* LLC that is doing business in California, or out-of-state members who are also managers in a *manager-managed* LLC that is doing business in California, are themselves doing business in California and hence are subject to California taxation. [FTB Legal Ruling 2014-01, supra]

(c) [6:1214] **LLC liability for nonresident member taxes:** An LLC doing business in California that has a nonresident member (¶ *6:1213*) who fails to consent to California tax jurisdiction must pay the tax attributable to the non-consenting member's distributive share of LLC income. [See Rev. & Tax.C. § 18633.5(e); see also FTB Legal Ruling 2014-01, supra]

No such rule applies to partners of limited partnerships or limited liability partnerships.

(4) [6:1215] **LLC tax returns and reporting requirements:** *See ¶ 8:209 ff.*

[6:1216 - 6:1219] ***Reserved.***

3. [6:1220] **Registration with Secretary of State:** A foreign LLC may apply for a certificate of registration to transact business in California by delivering an application to the Secretary of State on a prescribed form. [Corps.C. § 17708.02(a)]

• ***FORM:*** The Secretary of State's standard form Application to Register a Foreign Limited Liability Company (LLC) (Form LLC-5) is available online at the Secretary of State's website (*www.sos.ca.gov*).

a. [6:1221] **Contents of application:** The application must contain the following information:

(1) [6:1222] **Name:** The application must state the LLC's name *exactly as it is shown on the accompanying "certificate of existence"* (*¶ 6:1232*). [Corps.C. § 17708.02(a)(1); see Instructions for Completing the Application to Register a Foreign Limited Liability Company (Form LLC-5), available on the Secretary of State's website (*www.sos.ca.gov*)]

(a) [6:1223] **Choice of name:** When selecting a name, a foreign LLC is subject to the same restrictions and requirements as a California LLC (*see ¶ 6:30 ff.*). If the foreign LLC's name does not meet those requirements, the LLC must, for the purpose of transacting business in California, adopt an alternate name that complies with those requirements. Use of the LLC's alternate name does not require compliance with the fictitious business name statute (Bus. & Prof.C. § 17900 et seq., *¶ 3:75 ff.*). [Corps.C. §§ 17708.02(a)(1), 17708.05(a)]

(b) [6:1224] **Name change:** *See ¶ 6:1250 ff.*

➪ [6:1225] ***PRACTICE POINTER:*** Do not submit an application (or amendment, *¶ 6:1250 ff.*) without first checking to see if the name is available in California; *see ¶ 6:50 ff.* Counsel may also wish to *reserve* an available name to be sure it is not taken by someone else in the time between the name check and submission of the application or amendment; *see ¶ 6:55 ff.*

(2) [6:1226] **Jurisdiction and date of formation:** The application must set forth the name of the jurisdiction under which the LLC is organized and a statement that the LLC is authorized to exercise its powers and privileges in that jurisdiction. [Corps.C. § 17708.02(a)(2)]

(3) [6:1227] **Address:** The application must set forth the *street* address or, if different, the *mailing* address of the LLC's principal office, as well as the *street* address of its principal office in California, if any. [Corps.C. § 17708.02(a)(3), (6); see Corps.C. § 17701.02(w)]

(a) [6:1228] **Change of address:** A change in any of the LLC's addresses set forth in the application must be reported to the Secretary of State by means of a new statement of information; *see ¶ 6:1237*.

(4) [6:1229] **Agent for service of process:** The application must set forth the LLC's initial agent for service of process in California (*see ¶ 6:650 ff.*). (A registered foreign LLC must continuously maintain a California agent for service of process.) The application must also state that the Secretary of State is appointed as agent for service of process if the agent resigns and is not replaced or if the agent cannot be found or served with the exercise of reasonable diligence. [Corps.C. §§ 17701.13(b), 17708.02(a)(4)(A), (5)]

(a) [6:1230] **Change of agent:** A change in the agent for service of process must be reported to the Secretary of State by means of a new statement of information; *see ¶ 6:1237*.

➪ [6:1231] ***PRACTICE POINTERS re agent for service of process*: *See ¶ 3:111*.

b. [6:1232] **"Certificate of existence":** The application must be accompanied by a "certificate of existence, status, or good standing or a record of similar import" issued within the preceding *six months* and signed by the secretary of state or other official having custody of the foreign LLC's publicly filed records in the jurisdiction under which the LLC is formed. The Secretary of State will accept a certificate that certifies that the partnership "is in existence, in active status, or in good standing." [Corps.C. § 17708.02(b); see Instructions for Completing the Application to Register a Foreign Limited Liability Company (Form LLC-5), available on the Secretary of State's website (*www.sos.ca.gov*)]

c. [6:1233] **Filing fee:** The fee for filing the application is $70 (plus a $15 special handling fee if hand delivered to the Secretary of State's office). [Gov.C. §§ 12182(a), 12190(c); 2 CCR § 21903(c)]

(1) [6:1234] **Cancellation by Secretary of State if check bounces:** The Secretary of State may cancel the application and registration if a check or other form of payment of the filing fee is not paid upon presentation. (The Secretary of State will first give the foreign LLC an opportunity to submit a cashier's check or equivalent.) [Corps.C. § 17708.06(c)]

d. [6:1235] **Effectiveness:** Unless the Secretary of State determines that the application does not comply with the filing requirements, the Secretary of State, upon payment of the filing fee (¶ *6:1233*), will file the application and issue a certificate of registration to transact intrastate business in California to the LLC or its representative. [Corps.C. § 17708.04]

4. [6:1236] **Governing Law ("Internal Affairs" Doctrine):** CRULLCA applies to all foreign LLCs registered to do business in California on or after January 1, 2014 regardless of when they were organized or registered to do business in California. [Corps.C. § 17713.04(a), (d)]

However, the laws of the jurisdiction under which a foreign LLC is *organized* specifically govern:

• The organization of the LLC, its internal affairs, and the authority of its members and managers; and

• The liability of a member as member and a manager as manager for the LLC's debts, obligations or other liabilities. [Corps.C. § 17708.01(a)(1) & (2)]

This is essentially a codification of the "internal affairs" doctrine which, as applied to LLCs, provides that only one state should have the authority to regulate an LLC's internal affairs in order to prevent conflicting demands upon the company. [See *Boschetti v. Pacific Bay Investments Inc.* (2019) 32 CA5th 1059, 1066-1069, 244 CR3d 480, 485-487—internal affairs doctrine precludes California court from ordering dissolution of foreign LLC doing business in California because dissolution governed by LLC's jurisdiction of organization (¶ *6:780*); see also *Delamater v. Anytime Fitness, Inc.* (ED CA 2010) 722 F.Supp.2d 1168, 1175-1177, *discussed at* ¶ *6:1206*]

a. [6:1236.1] **No effect on registration:** A foreign LLC may not be denied registration in California (*see* ¶ *6:1220 ff.*) by reason of any difference between California law and the laws of the jurisdiction under which the LLC is formed. [Corps.C. § 17708.01(b)]

b. Special provisions applicable to foreign limited partnerships

(1) [6:1237] **Biennial statement of information:** Within *90 days after registering* in California, a foreign LLC must file the same statement of information required of California LLCs. Thereafter, so long as the LLC remains registered in California, the LLC must file *biennially* a statement of information (or if there is no change to its most recently filed statement of information, a statement of no change). [Corps.C. § 17702.09(a), (c); *see* ¶ *6:660 ff.*]

(2) [6:1238] **Information and inspection rights:** If the foreign LLC's members who reside in California represent *25% or more* of the voting interests of the LLC's members, the California members are entitled to the same information and inspection rights provided to members of a California LLC (Corps.C. § 17704.10, ¶ *6:615 ff.*). These information rights include the *financial reports* that an LLC with *more than 35 members* must send to each member (¶ *6:671 ff.*) and the annual *tax* information that the LLC must send to its members (¶ *6:680*). [Corps.C. § 17708.08]

(3) [6:1239] **Property records for county assessor:** Upon request of a county assessor, a foreign LLC, like a California LLC, must keep a copy of the business records relevant to the amount, cost and value of all property that the LLC owns, claims, possesses or controls within that county. The records must be made available to the assessor at the LLC's principal office in California or the office it maintains in California or at a place mutually acceptable to the assessor and the LLC. [Corps.C. § 17701.13(e); *see* ¶ *6:610*]

(4) [6:1240] **Recordation with county recorder:** A foreign LLC may record in the county recorder's office a certified copy of its application for registration (or any amendment thereto). The recording conclusively establishes the statements contained in the registration in favor of any bona fide purchaser or encumbrancer for value of the LLC's real property located in that county. [Corps.C. § 17702.03(c); *see* ¶ *6:93*]

(5) [6:1241] **Insurance/guarantee where required by law:** Foreign LLCs are required to carry insurance (or provide an undertaking) to the same extent as required by any California law, rule or regulation that would apply if the LLC were a corporation. [Corps.C. § 17703.04(d); *see* ¶ *6:224*]

(6) [6:1242] **Members' class action against LLC:** Any member of a foreign LLC may bring a class action on behalf of all or a class of members to enforce any claim common to those members. [Corps.C. § 17709.01; *see* ¶ *6:710*]

(7) [6:1243] **Requirements for derivative action plaintiff:** A plaintiff member bringing a derivative action against a foreign LLC is subject to the same requirements as a plaintiff bringing a derivative action against a California LLC—i.e.:

- Plaintiff must have been a member *at the time of the transaction* (or any part of the transaction) that gave rise to the action (¶ *6:712*) unless excepted upon determination of the court (¶ *6:713*);

- Plaintiff must remain a member both *at commencement* of the litigation and *during its prosecution* (¶ *6:714*); and

- Plaintiff must first make a *demand* that the *managers* bring the action unless the demand would be "futile" (¶ *6:715*). [Corps.C. § 17709.02(a)]

(8) [6:1244] **Potential liability for "inaccurate" information in filed documents:** Persons who act on behalf of a foreign LLC are subject to the same potential liability as persons who act on behalf of a California LLC for "inaccuracies" in documents filed with the Secretary of State (¶ *6:704 ff.*). [See Corps.C. § 17702.07(a)]

(9) [6:1245] **Exemption from bonding statutes for membership interest issued to employee, officer or manager:** The exemption from the California bonding statutes for membership interests issued in connection with employee membership plans or options, or issued to LLC officers or managers, also extends to foreign LLCs. [Corps.C. § 17704.01(e); *see* ¶ *6:734*]

(10) [6:1246] **Dissenters' rights:** *See* ¶ *6:1072*.

[6:1247 - 6:1249] ***Reserved.***

5. [6:1250] **Name Change—Amended Application:** If the LLC changes its name, or changes or relinquishes its alternate name, it must file an amended application to transact intrastate business with the Secretary of State on a prescribed form. [Corps.C. § 17708.05(b)(1)]

➪ [6:1251] ***PRACTICE POINTERS:*** An amended application is used only to change the LLC's *name*. To change other information in the LLC's registration, such as the LLC's address or agent for service of process, the LLC must file a new *statement of information* (¶ *6:1237*). [Corps.C. § 17701.14(a)]

To *correct* any information that was *erroneous when made* in the LLC's registration, the LLC must file a *certificate of correction*. [Corps.C. § 17702.06; *see* ¶ *6:700 ff.*]

- ***FORM:*** Foreign Limited Liability Company (LLC) Name Change Amendment (Form LLC-6) is available online at the Secretary of State's website (*www.sos.ca.gov*).

a. [6:1252] **Contents:** The amended application must state the Secretary of State's file number, the LLC's old name or alternate name, and its new name or alternate name. [Corps.C. § 17708.05(b)(2)]

(1) [6:1253] **Choice of new name:** The new name, like the old, must comply with the same restrictions and requirements applicable to a California LLC's name (*see* ¶ *6:1223*). If the new name does not comply with these restrictions and requirements, the LLC must adopt an alternate name that so complies. If the new name so complies, it must conduct business under that name in California and relinquish its alternate name (unless it registered under that alternate name *prior to 2014*, in which case it need not relinquish its alternate name). [Corps.C. § 17708.05(b)(1)(A)-(C)]

b. [6:1254] **Certificate from LLC's jurisdiction of formation:** The amended application must be accompanied by a certificate issued within the past six months by the secretary of state or other official having custody of the LLC's publicly filed records in the LLC's jurisdiction of formation certifying that the change of name was made in accordance with the laws of that jurisdiction. (The certificate is not required if the LLC is changing only its *alternate* name.) [Corps.C. § 17708.05(b)(3)]

c. [6:1255] **Filing fee:** The fee for filing the amendment is $30 (plus a $15 special handling fee if delivered in person to the Secretary of State's office). [Gov.C. §§ 12182(a), 12190(f); 2 CCR § 21903(c)]

6. [6:1256] **Cancellation of Registration:** A foreign LLC that ceases doing business in California will nevertheless continue to be assessed California franchise taxes unless it cancels its registration by filing a certificate of cancellation on a prescribed form with the Secretary of State. [Rev. & Tax.C. §§ 17941(b), (e), 17947; Corps.C. § 17708.06(a)]

- ***FORM:*** The Secretary of State's standard form Certificate of Cancellation—Limited Liability Company (LLC) (Form LLC-4/7) is available online at the Secretary of State's website (*www.sos.ca.gov*).

  a. [6:1257] **Contents:** The certificate must state:

  - The name under which the LLC is authorized to transact intrastate business in California;
  - The Secretary of State's file number;
  - That all final state franchise (income) tax returns have been or will be filed with the Franchise Tax Board (see Rev. & Tax.C. § 17947); and
  - That upon the effective date of the certificate (*see ¶ 6:1259*), the LLC's registration is cancelled and its right to conduct intrastate business will cease. [Corps.C. § 17708.06(a)(1)-(3)]

  b. [6:1258] **Execution:** The certificate must be signed by a person with authority to do so under the LLC's jurisdiction of organization. [Corps.C. § 17708.06(a)]

  c. [6:1259] **Effective date:** The cancellation becomes effective on the date the certificate is *filed* (as evidenced by the Secretary of State's endorsement of the date on the certificate) or upon such *later* date (but not more than *90 days after filing*) as may be *set forth in the certificate*. [Corps.C. § 17702.05(c)]

  d. [6:1260] **Filing fee:** There is no fee for filing the certificate of cancellation. (However, there is a $15 special handling fee if the certificate is delivered in person to the Secretary of State's office.) [Gov.C. §§ 12182(a), 12190(n); 2 CCR § 21903(c)]

Cal. Prac. Guide Pass--Through Entities Form 6:A

California Practice Guide--Pass-Through Entities | August 2024 Update
Current Edition Authors: Jeffrey C. Soza and Matthew Jann; Original Authors: James F. Fotenos and Edward C. Rybka

Chapter 6. Limited Liability Company

Forms

[Form 6:A] Single-Member Operating Agreement

[Ed. note: Although this form provides for the admission of additional members, the admission of a new member will require preparation of a new agreement.]

LIMITED LIABILITY COMPANY OPERATING AGREEMENT

_____ LLC

A California Limited Liability Company

This Limited Liability Company Operating Agreement (the "Agreement") is entered into this ___ day of _____, 20__, by _____ as the sole member (hereinafter, the "Member").

The Member, by execution of this Agreement, hereby forms a limited liability company pursuant to and in accordance with the California Revised Uniform Limited Liability Company Act, Cal. Corp. Code § 17701.01 *et seq.* (the "Act"), and hereby agrees as follows:

ARTICLE I
ORGANIZATION AND BUSINESS

1.1. Name.

The name of the limited liability company formed hereby is "_____ LLC" (the "Company"). The Company may conduct business under that name or any other name approved by the Member.

1.2. Certificates.

(Name of person who filed Articles) , as an authorized person within the meaning of the Act, executed, delivered and filed the Articles of Organization of the Company (the "Articles") with the Secretary of State of the State of California on _____, 20__. With the filing of the Articles with the California Secretary of State, the Member's powers as an authorized person ceased and the Member is thereafter designated as an authorized person within the meaning of the Act. The Member or an Officer (Section 4.2) shall execute, deliver and file any other certificates (and any amendments and/or restatements thereof) necessary for the Company to qualify to do business in a jurisdiction in which the Company may wish to conduct business.

1.3. Effective Date.

This Agreement shall be effective as of _____, 20__.

1.4. Term.

The term of the Company commenced as of the date of the filing of the Company's Articles with the California Secretary of State and, unless the Company is dissolved before such date under Section 8.1 hereof, shall continue until _____.

1.5. Office and Agent.

The principal business office of the Company shall be _____ Street, _____, California _____, or such other location as the Member may determine. The registered office and registered agent shall be as stated in the Articles or as otherwise determined by the Member.

1.6. Business of the Company.

The purpose of the Company is to _____. The Company shall have the power and authority to engage in any activity incident or related thereto.

ARTICLE II
CAPITAL

2.1. Capital Contributions.

The Member shall make a capital contribution to the Company as specified on Exhibit A hereto, promptly after the execution of this Agreement.

2.2. Additional Capital Contributions.

Additional contributions to the capital of the Company shall be made as determined from time to time by the Member, in the Member's sole discretion.

2.3. Withdrawal of Capital. The Member may from time to time withdraw *(his) (her)* capital from the Company in such amounts as the Member may determine, subject to the limitations on such withdrawals imposed by Section 17704.05 of the Act.

2.4. No Interest.

The Company shall not pay any interest on capital contributions.

ARTICLE III
MEMBERS

3.1. Members.

The name, mailing address, capital contributions and limited liability company interest (expressed as a percentage) of the Member are set forth in Exhibit A attached hereto.

3.2. Admission of Additional Members.

Additional members may be admitted to the Company with the written consent of the Member. Additional members will participate in the management, profits, losses, and distributions of the Company on such terms as are determined by the Member. Exhibit A shall be amended upon the admission of an additional member or members to set forth such member's name and Capital Contribution to the Company.

3.3. Compensation Payable to Member.

The Member shall be entitled to reasonable compensation, as determined by the Member, for the services that the Member renders to the Company. In addition, the Company shall reimburse the Member for the third-party costs and expenses incurred by the Member in connection with the formation of the Company and the conduct of its business.

ARTICLE IV
RIGHTS, POWERS, AND DUTIES OF THE MEMBER

4.1. Management and Control of the Company.

In accordance with Section 17703.01(a) of the Act, the management of the Company shall be vested in the Member. The Member shall have the exclusive right to manage the business of the Company, and the Member is hereby authorized to take any action of any kind and to do anything and everything that may be necessary, convenient or incidental to or for the furtherance of the purposes described herein, including all powers, statutory or otherwise, possessed by members of a limited liability company under the laws of the State of California. The Member has the authority to bind the Company.

4.2. Officers.

The Member may, from time to time as the Member deems advisable, select natural persons who are employees or agents of the Company and designate them as officers of the Company (the “Officers”) and assign titles (including, without limitation, President, Vice President, Secretary, and Treasurer) to any such person. Unless the Member decides otherwise, if the title is one commonly used for officers of a business corporation formed under the California General Corporation Law, the assignment of such title shall constitute the delegation to such person of the authorities and duties that are normally associated with that office. Any delegation pursuant to this Section 4.2 may be revoked at any time by the Member. An Officer may be removed with or without cause by the Member.

4.3. Other Business of the Member.

The Company shall have no right, by virtue of this Agreement or the relationship created hereby, in or to any income or benefits derived by the Member from the conduct of any other business or the making of any other investment or to the income or

proceeds derived therefrom, and the pursuit of such ventures, even if competitive with the business of the Company, shall not be deemed wrongful or improper.

4.4. Limitation on Liability of the Member; Indemnification.

(a) Except as otherwise provided by the Act, the debts, obligations and liabilities of the Company, whether arising in contract, tort or otherwise, shall be solely the debts, obligations and liabilities of the Company, and the Member shall not be obligated personally for any such debt, obligation or liability of the Company solely by reason of being a member of the Company.

(b) No Member or Officer shall be liable to the Company, any other person or entity who has an interest in the Company for any loss, damage or claim incurred by reason of any act or omission performed or omitted by such Member or Officer in good faith on behalf of the Company and in a manner reasonably believed to be within the scope of the authority conferred on such Member or Officer by this Agreement, except that a Member or Officer shall be liable for any such loss, damage or claim incurred by reason of such Member's or Officer's willful misconduct. To the full extent permitted by applicable law, a Member or Officer shall be entitled to indemnification from the Company for any loss, damage or claim incurred by such Member or Officer by reason of any act or omission performed or omitted by such Member or Officer in good faith on behalf of the Company and in a manner reasonably believed to be within the scope of the authority conferred on such Member or Officer by this Agreement, except that no Member or Officer shall be entitled to be indemnified in respect of any loss, damage or claim incurred by such Member or Officer by reason of willful misconduct with respect to such acts or omissions; *provided, however*, that any indemnity under this Section 4.4 shall be provided out of and to the extent of Company assets only, and no Member shall have personal liability on account thereof.

(c) To the fullest extent permitted by applicable law, under no circumstance shall any director, officer, shareholder, employee, or agent of the Member have any personal responsibility for any liability or obligation of the Company or of the Member (whether on a theory of alter ego, piercing the corporate veil, or otherwise).

(d) The Company shall advance from the assets of the Company monies to the Member, any Officers or any affiliate of the Member for legal expenses and other costs incurred.

ARTICLE V
ALLOCATIONS AND DISTRIBUTIONS

5.1. Allocation of Profits and Losses.

The Company's profits and losses shall be allocated solely to the Member.

5.2. Distributions.

Distributions shall be made by the Company in such amounts and at such times as the Member shall determine, subject to the limitations on such distributions imposed by Section 17704.05 of the Act.

ARTICLE VI
TRANSFER AND ASSIGNMENT OF
LIMITED LIABILITY COMPANY INTEREST; RESIGNATION

6.1. Assignments.

The Member's limited liability company interest in the Company, including the Member's interest in the profits, losses, and distributions of the Company, and the Member's rights and privileges as a Member of the Company under the Act (collectively, the "Membership Interest") is transferable by the Member, in whole or in part, either voluntarily or by operation of law. If a Member transfers all of the Member's interest in the Company pursuant to this Section, the transferee shall be admitted to the Company upon its execution of an instrument signifying its agreement to be bound by the terms and conditions of this Agreement. Such admission shall be deemed effective immediately prior to the transfer, and immediately following such admission the transferor shall cease to be a Member of the Company and shall have no further rights or obligations under this Agreement or under the Act, except that the transferor shall have the right to such information as may be necessary for the computation of the transferor's tax liability.

6.2. Resignation.

The Member may at any time resign from the Company. If the Member resigns pursuant to this Section 6.2, an additional member shall be admitted to the Company, subject to Section 3.2 hereof, upon its execution of an instrument signifying its agreement to be bound by the terms and conditions of this Agreement. Such admission shall be deemed effective immediately prior to the resignation, and, immediately following such admission, the resigning Member shall cease to be a member of the Company.

ARTICLE VII
ACCOUNTING, RECORDS, AND REPORTS

7.1. Books and Records.

The books and records of the Company shall be kept in accordance with the accounting methods followed by the Company for Federal income tax purposes. The Member shall maintain at the offices of the Company all of the following on behalf of the Company:

(a) A current list of the full name and last known business or residence address of each Member of the Company, set forth in alphabetical order, together with the capital contributions, capital account, and Membership Interest of each Member;

(b) A copy of the Articles and any and all amendments thereto, together with executed copies of any powers of attorney pursuant to which the Articles or any amendments thereto have been executed;

(c) Copies of the Company's Federal, state, and local income tax or information returns and reports, if any, for the six (6) most recent taxable years;

(d) A copy of this Agreement and any and all amendments thereto, together with executed copies of any powers of attorney pursuant to which this Agreement or any amendments thereto have been executed;

(e) Copies of the financial statements of the Company, if any, for the six (6) most recent fiscal years; and

(f) The Company's books and records as they relate to the internal affairs of the Company for at least the current and past four (4) fiscal years.

7.2. Reports.

The Company shall cause to be filed, in accordance with the Act, all reports and documents required to be filed with any governmental agency. The Company shall cause to be prepared at least annually information concerning the Company's operations necessary for the completion of the Member's Federal and state income tax returns. The Company shall send or cause

to be sent to each Member within ninety (90) days after the end of each taxable year (i) such information as is necessary to complete the Member's Federal and state income tax or information returns, and (ii) a copy of the Company's Federal, state, and local income tax or information returns for the year.

7.3. Bank Accounts.

The Member shall maintain the funds of the Company in one or more separate bank accounts in the name of the Company, and shall not permit the funds of the Company to be commingled in any fashion with the funds of any other person. Withdrawal of monies from the Company's bank accounts shall be made only in the regular course of the Company's business and on such signature or signatures as the Member may determine.

ARTICLE VIII
DISSOLUTION AND WINDING UP

8.1. Conditions of Dissolution.

(a) The Company shall dissolve and its affairs shall be wound up upon the occurrence of any of the following events:

(i) The written consent of the Member;

(ii) The retirement, resignation or dissolution of the Member or the occurrence of any other event which terminates the continued membership of the Member in the Company unless the business of the Company is continued in a manner permitted by the Act;

(iii) Upon a sale by the Company of all or substantially all of its assets; or

(iv) Upon the entry of a decree of judicial dissolution pursuant to Sections 17707.01(d) and 17707.03 of the Act.

(b) The bankruptcy of the Member will not cause the Member to cease to be a member of the Company and upon the occurrence of such an event, the business of the Company shall continue without dissolution.

8.2. Winding Up.

The winding up of the business of the Company, and the distribution of its assets, shall be conducted by the Member, which is hereby authorized to do any and all acts and things authorized by law for these purposes.

8.3. Order of Payment of Liabilities Upon Dissolution.

In the event of dissolution, the Company shall conduct only such activities as are necessary to wind up its affairs (including the sale of the assets of the Company in an orderly manner), and the assets of the Company shall be applied in the manner, and in the order of priority, set forth in Section 17707.05 of the Act. After satisfaction of all liabilities of the Company (whether by payment or the making of reasonable provision for payment thereof), the remaining assets of the Company shall be distributed to the Member in accordance with the Member's positive capital account balance, after taking into account the income and loss allocations for the Company's taxable year during which the liquidation occurs.

8.4. Certificate of Cancellation.

The Company shall file with the California Secretary of State a Certificate of Cancellation upon the completion of the winding up of the Company's affairs.

ARTICLE IX
MISCELLANEOUS

9.1. Entire Agreement.

This Agreement represents the complete statement of the limited liability company agreement of the Company.

9.2. Rights of Creditors and Third Parties Under the Agreement. This Agreement is intended to serve as the operating agreement of the Company under the Act, and is for the exclusive benefit of the Company, the Member, and their successors and assigns. This Agreement is not intended for the benefit of any creditor of the Company or any other person. Except and only to the extent provided by applicable statute, no creditor of the Company or any third party shall have rights under this Agreement.

9.3. Severability.

If any provision of this Agreement or the application of such provision to any person or any circumstance shall be held invalid, the remainder of this Agreement or the application of such provision to persons or circumstances other than those to which it is held invalid shall not be affected thereby.

9.4. Amendments.

All amendments to this Agreement shall be in writing and signed by the Member.

9.5. Governing Law.

This Agreement shall be governed by, and construed under, the laws of the State of California (without regard to conflict of laws principles), all rights and remedies being governed by said laws.

IN WITNESS WHEREOF, the Member has executed this Agreement as of the date and year first above written.

.....
Name: .....

EXHIBIT A
CAPITAL CONTRIBUTION AND ADDRESS OF MEMBER

OF _____ LLC

AS OF _____, 20__

Member's Name	Member's Address	Capital Contribution	Membership Interest

_____	_____ Street _____, California ___	$_____	100%

EXHIBIT B
CONSENT OF SPOUSE

I acknowledge that I have read the foregoing Agreement and that I know its contents. I hereby consent to and approve the provisions of this Agreement and agree that any community property interest or quasi community property interest in the Company is subject to the provisions of this Agreement, and I will take no action at any time to hinder operation of this Agreement.

I agree that if my spouse's membership interest in the Company, or any portion of such membership interest, or any community property interest or quasi community property interest in such membership interest, is hereafter transferred or delivered to me, whether as separate property or otherwise (as a result of death or otherwise), such portion of the membership interest that I then receive or own shall be subject to the provisions of this Agreement as though I were initially a Member and had executed this Agreement.

I am aware that the legal, financial and related matters contained in the Agreement are complex and that I am free to seek independent professional guidance of counsel with respect to this consent. I either have sought such guidance of counsel or determined after reviewing this Agreement carefully that I will waive such right.

Dated: _____, 20__
Signature: _____
Print name: _____

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California Practice Guide--Pass-Through Entities | August 2024 Update
Current Edition Authors: Jeffrey C. Soza and Matthew Jann; Original Authors: James F. Fotenos and Edward C. Rybka

Chapter 6. Limited Liability Company

Forms

[Form 6:B] Single-Member Operating Agreement Additional and Alternative Provisions

Spouses as Sole Member

This Limited Liability Operating Agreement (the "Agreement") is entered into this _ day of _____, 20__, by _____ and _____, *(husband and wife) (spouses)*, as the sole member (hereinafter, the "Member").

[Ed. note: Spouses (including same-sex married couples) in a community property state such as California may treat the LLC as a single-member LLC that is disregarded for federal and state income tax purposes. However, registered domestic partners cannot use the single-member LLC form (unless they are married); rather, they are treated as two members and the LLC is treated as a partnership for federal and state income taxes. See IRC § 318(a)(1)(A)(i); Rev. Proc. 2002-69, 2002-2 CB 831; IRS, "Answers to Frequently Asked Questions for Registered Domestic Partners and Individuals in Civil Unions," Question 27 (3/3/20), available on the IRS website (www.irs.gov); FTB Pub. 737 at 7 (2019).]

[Signature lines should be provided for both spouses, and the Consent of Spouse (Exhibit B) should be deleted.]

Cal. Prac. Guide Pass--Through Entities Form 6:C

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Chapter 6. Limited Liability Company

Forms

[Form 6:C] Multi-Member Operating Agreement


Image 1 within document in PDF format.

End of Document

Cal. Prac. Guide Pass--Through Entities Form 6:D.1

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Chapter 6. Limited Liability Company

Forms

[Form 6:D.1] LLC Equity Incentive Plan

NEW VENTURES, LLC

EQUITY INCENTIVE PLAN

Effective _____ ___, 20_

1. Establishment and Purpose

New Ventures, LLC, a California limited liability company (the "Company"), hereby establishes the New Ventures, LLC Equity Incentive Plan (the "Plan"). The purpose of the Plan is to promote the profitability and growth of the Company by providing equity-based incentives to encourage certain key management and other service providers to the Company to contribute to the Company's growth and financial success. The Company has reserved a pool of Incentive Units (as defined below) through the Plan to be awarded from time to time by the Compensation Committee of the Company.

2. Definitions

Terms used herein shall have the meanings set forth below or, if not defined herein, as defined in the LLC Agreement, except where the context otherwise indicates:

(a) "Award" means an award of an Incentive Unit in the Company.

(b) "Incentive Unit" means an Incentive Unit in the Company representing a profits interest in the Company as more fully described in Article IV(A) of the LLC Agreement.*

(c) "Incentive Unit Agreement" means a written document memorializing the Award granted to the Participant pursuant to the Plan.

(d) "Committee" means the "Compensation Committee" that is appointed by the Manager(s) to administer the Plan. If the Managers do not appoint a Compensation Committee, then the Manager(s) themselves shall act as the Compensation Committee, and all references in this Plan to the Committee shall be deemed to refer to the Manager(s).

(e) "LLC Agreement" means the Limited Liability Agreement of New Ventures, LLC, and as amended from time to time.

(f) "Participant" means an individual granted an Award under the Plan.

3. Administration

(a) Administration of the Plan. The Plan shall be administered by the Committee, which shall have all authority specified in the Plan and an Incentive Unit Agreement, including, but not limited to, the following authority:

(i) *Plan Participation*. The Committee shall have absolute discretion to grant Awards under the Plan and to prescribe the form of Incentive Unit Agreements evidencing such Awards. The Committee in its discretion may grant Awards to managers, officers, employees, and consultants of the Company or an Affiliate of the Company that is a direct or indirect subsidiary of the Company (hereinafter, a "Subsidiary"). The Committee may also grant Awards to prospective employees or consultants in connection with hiring, retention or otherwise, provided that vesting of Incentive Units may not occur until the Award recipient has commenced providing services to the Company or a Subsidiary. An individual who receives an Award under the Plan will be designated a Participant.

(ii) *Terms of Awards*. The Committee is authorized to: (A) determine the eligible persons to whom, and the time or times at which, Awards shall be granted; (B) determine the number of Incentive Units to be covered by each Award; (C) impose such terms, limitations, restrictions and conditions upon any such Award as the Committee shall deem appropriate, including, but not limited to, those relating to the vesting of Awards, if any; and (D) modify or amend outstanding Awards.

(iii) *Plan and Award Interpretation*. The Committee shall have full power and authority, in its sole and absolute discretion, to administer, construe and interpret the Plan, the Incentive Unit Agreements and all other documents relevant to the Plan and Awards issued thereunder, to establish, amend, rescind and interpret such rules, regulations, agreements, guidelines and instruments for the administration of the Plan and for the conduct of its business as the Committee deems necessary or advisable, and to correct any defect, supply any omission or reconcile any inconsistency in the Plan or in any Award in the manner and to the extent the Committee shall deem it desirable to carry it into effect.

(b) Non-Uniform Determinations. The Committee's determinations under the Plan (including, without limitation, determinations of the persons to receive Awards, the form, amount and timing of such Awards, the terms and provisions of such Awards and the Incentive Unit Agreements evidencing such Awards) need not be uniform and may be made by the Committee selectively among persons who receive, or are eligible to receive, Awards under the Plan, whether or not such persons are similarly situated.

(c) Limited Liability. To the maximum extent permitted by law, the Committee (and any Committee member) shall not be liable for any action taken or decision made in good faith relating to the Plan or any Award thereunder.

(d) Indemnification. To the maximum extent permitted by law and under the LLC Agreement, the Committee (and any member of the Committee) shall be indemnified by the Company in respect of all of their activities under the Plan.

(e) Effect of Committee's Decision. All actions taken and decisions and determinations made by the Committee on all matters relating to the Plan pursuant to the powers vested in it hereunder shall be in the Committee's sole and absolute discretion and shall be conclusive and binding on all parties concerned.

4. Awards

(a) Reservation of Units. The maximum aggregate number of Incentive Units that may be issued pursuant to the Plan is _____ Incentive Units. This number of Incentive Units shall increase at the time or times that the Company engages in a capital transaction that increases the number of outstanding membership units (not taking into account Incentive Units) of the Company, in such amount and on such terms as the Committee determines, in its sole discretion, is appropriate.

(b) Adjustments for Recapitalization, Etc. The number of Incentive Units reserved in Section 4(a) for issuance under the Plan shall be adjusted by the Committee by way of increase or decrease, as the Committee deems appropriate, in the event of a recapitalization, split, consolidation or similar transaction involving the equity of the Company.

(c) Determination of Units Awarded Under Plan. An Award of Incentive Units to a Participant will count against the number of Units reserved in Section 4(a) hereunder, except in the following circumstances: (i) Incentive Units awarded to individuals who are founders of the Company or who provide their services as Manager(s) of the Company; or (ii) Incentive Units awarded under the terms of a definitive acquisition agreement entered into by the Company or an Affiliate.

(d) Reissuance of Units. Incentive Units that are forfeited for any reason or repurchased by the Company under the terms of an Incentive Unit Agreement will again be available for issuance under an Award.

(e) Terms of LLC Agreement. Awards are subject to the terms and conditions provided in the Plan and the Incentive Unit Agreement. By accepting an Award under the Plan, a Participant is deemed to have consented to the applicable terms of the LLC Agreement.

(f) Tax Election. Unless stated otherwise in an Incentive Unit Agreement, Participants shall be directed to make an effective protective election with the Internal Revenue Service under Section 83(b) of the Internal Revenue Code and the regulations promulgated thereunder within 30 days of the grant of an Award. A form of the 83(b) form of election may be provided by the Company.

5. Termination, Amendment and Modification of the Plan

The Plan will continue indefinitely until terminated by the Committee or the Manager(s). The Committee may terminate, amend or modify the Plan or any portion thereof at any time, provided that, subject to the provisions of Section 6(b), an amendment that diminishes the rights of a Participant will not be effective with respect to such Participant until executed in writing by the Participant.

6. Miscellaneous

(a) Non-Guarantee of Employment or Service. Nothing in the Plan or an Incentive Unit Agreement shall confer any right on a Participant to continue in the service of the Company or any of its Subsidiary or shall interfere in any way with the right of the Company or any such Subsidiary to terminate such service at any time with or without cause or notice and whether or not such termination results in: (i) the failure of any Award to vest; (ii) the forfeiture of any unvested portion of any Award; or (iii) any other adverse effect on a Participant's interests under the Plan.

(b) Status of Incentive Units Profits Interests. The Company intends that the Incentive Units be treated as "profits interests" as such term is used in Revenue Procedures 93-27 and 2001-43, and that Participants not realize income upon the grant of Incentive Units to them by the Company. In furtherance of this intention, the Company may modify the terms of any Incentive Unit Agreement, and/or the distributions of the Company payable thereunder, without the consent or approval of the Participants, so that Participants are not deemed to have shared in the value of the Company's assets as of the date of grant of Incentive Units by the Company to the Participants but only share in the subsequent appreciation in the value of the Company's assets through their holding of the Incentive Units and receipt of distributions or payments with respect thereto.

(c) Section 409A. The Company intends that the Plan and the Incentive Units granted pursuant to the provisions of the Plan be exempt from or comply with the requirements of Section 409A of the Internal Revenue Code and the regulations promulgated thereunder, and that all provisions of the Plan and the Incentive Award Agreements entered into pursuant to the terms of the Plan be construed and interpreted in accordance with such intent.

(d) Compliance with Securities Laws. If at any time the Committee determines that the delivery of an Incentive Unit under the Plan is or may be unlawful under the laws of any applicable jurisdiction, or federal, state or foreign securities laws, the right to receive Incentive Units or a payment pursuant to an Award shall be suspended until the Committee determines that such delivery or payment is lawful. The Company shall have no obligation to effect any registration or qualification of the Incentive Units under federal, state or foreign laws.

(e) No Trust or Fund Created. Neither the Plan nor any Award shall create or be construed to create a trust or separate fund of any kind or a fiduciary relationship between the Company and a Participant or any other person. To the extent that any Participant or other person acquires a right to receive payments from the Company pursuant to an Award, such right shall be no greater than the rights set forth for a person holding an Economic Interest in the Company under the LLC Agreement.

(f) Governing Law. The validity, construction and effect of the Plan, an Incentive Unit Agreement entered into pursuant to the Plan, and any rules, regulations, determinations or decisions made by the Committee relating to the Plan or such Incentive Unit Agreement, and the rights of any and all persons having or claiming to have any interest therein or thereunder, shall be determined exclusively in accordance with applicable federal laws and the laws of the State of California, without regard to any conflict of laws principles that would result in the application of the laws of any other jurisdiction.

(g) Inconsistencies. This Plan, the Incentive Unit Agreements and the LLC Agreement are intended to be complementary and shall be interpreted in a manner that construes such instruments as consistent with each other. However, in the event of any inconsistencies between the Plan, an Incentive Unit Agreement and the LLC Agreement, the LLC Agreement shall in all cases govern.

(h) No Transfers. No Participant shall transfer any Incentive Unit, in whole or in part, or any of its rights under this Plan, except for transfers that are permitted in the LLC Agreement.

(i) Further Assurances. The Committee shall take such further actions as are reasonably deemed by it to be necessary or desirable in order to effectively carry out the intent and purpose of this Plan and the transactions and agreements contemplated hereby.

(j) Non-Waiver; Separability of Provisions. Each provision of this Plan shall be considered separable; and if, for any reason, any provision or provisions herein are determined to be invalid and contrary to any existing or future law, such invalidity shall not impair the operation of or affect those portions of this Plan which are valid.

(k) Successors and Assigns. Subject to the restrictions on transfer of Incentive Units set forth herein, this Plan shall be binding upon and shall inure to the benefit of the Company and the Participants and their respective successors and permitted assigns.

(l) Rights under the LLC Agreement. Notwithstanding anything herein or in the LLC Agreement to the contrary, Participants shall not be entitled to any information rights (including financials) or access to books and records accorded to the Members of the Company, in each case, with respect to the Company, except to the extent required by law.

[Signature page follows.]

IN WITNESS WHEREOF, the undersigned has executed this instrument on this the _____ day of _____, 20_.

NEW VENTURES, LLC
By: _____
Name: _____
Title: _____

Footnotes

* Ed. Note: Typically the incentive units entitle a holder to participate in a liquidity event (an IPO, merger, consolidation, or sale of assets) if the "money" members or partners who have contributed money or assets to the Company will receive a return of capital and a defined preferred return on their capital from distributions to be made to them from the liquidity event.

End of Document

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Chapter 6. Limited Liability Company

Forms

[Form 6:D.2] Equity Incentive Award Agreement

NEW VENTURES, LLC

EQUITY INCENTIVE AWARD AGREEMENT

THIS EQUITY INCENTIVE AWARD AGREEMENT ("Award" or "Agreement"), dated as of _____, 20_, is by and between New Ventures, LLC, a limited liability company organized and existing under the laws of the State of California (the "Company"), and the manager/officer/employee/consultant whose name appears on the signature page hereof ("Participant"), and is entered into pursuant to the New Ventures, LLC, Equity Incentive Plan, as in effect and as amended from time to time (the "Plan").

Recitals

WHEREAS, the Company desires to grant to Participant Incentive Units pursuant to the terms of the Plan and this Agreement; and

WHEREAS, the Company has adopted the Plan in order to provide incentives to eligible participants selected by the Committee to participate in the Plan; and

WHEREAS, Participant is eligible to participate in the Plan, and the Compensation Committee of the Company has determined that it is in the interest of the Company to grant Incentive Units to Participant.

Agreement

NOW, THEREFORE, in consideration of the premises and subject to the terms and conditions set forth herein and in the Plan, the parties hereto agree as follows:

1. Confirmation of Award; No Purchase Price

(a) Confirmation of Award. The Company hereby evidences and confirms the award to the Participant, effective as of the date hereof, of the number of Incentive Units set forth on the signature page of this Agreement.

(b) No Purchase Price. No purchase price is payable by Participant for the Incentive Units granted by this Award.

(c) Vesting Schedule. Subject to acceleration pursuant to Sections 3(a) and 4(a) of this Award, the Participant's Incentive Units shall vest ___% on the first anniversary of the date of this Award (and not before), and the balance of the Incentive Units shall vest *pro rata*, [monthly] [quarterly], thereafter over a period of _____ (_____) months, provided that Participant continuously remains a [manager/officer/employee/consultant] of the Company or a Subsidiary.

2. **Participation in Excess Member Return; Definitions**

(a) Participation. Participant shall participate in the Excess Member Return, in accordance with the Participant's *pro rata* share of all outstanding Incentive Units, and equal to the quotient obtained by dividing the Incentive Units granted to Participant by this Award by the aggregate number of Incentive Units granted and outstanding to all participants (including Participant) under the Plan, determined as of the date of the distribution or payment of any Excess Member Return by the Company or by a third party to the Members of the Company (and in all events within ninety (90) days of a Change-in-Control Event or, if sooner, seventy-five (75) days after the end of the fiscal year of the Company in which the Change-in-Control Event occurs), subject to any withholding for the payment of taxes by the Company or the Subsidiary of the Company that is the employer of Participant in connection with the payment in respect of Participant's Incentive Units.

(b) Definitions. For purposes of this Agreement, the following terms shall have the meanings set forth below. Capitalized terms that are not defined herein shall have the meanings given to such terms in the Plan.

"Aggregate Member Investment in Company Units" refers to the aggregate amount (stated in U.S. dollars) paid by the Members (as the identity of the Members and the number of Units they hold are determined immediately prior to the date of a Change-in-Control Event) to the Company for the Units owned by them, minus any distributions theretofore received by them from the Company with respect to their Units. Amounts paid by a Member for its Units purchased from another Member of the Company shall not be taken into account in determining the Aggregate Member Investment in Company Units; rather, in such event, the amount included in the Aggregate Member Investment in Company Units shall only include the amounts paid by the selling Member (or its predecessor-in-interest) to the Company for the Units.

"Cause" shall mean a felony conviction of a Participant or the failure of a Participant to contest prosecution for a felony, or a Participant's willful misconduct or dishonesty, any of which, in the judgment of the Committee, is harmful to the business or reputation of the Company or any Subsidiary; or any material violation of the Code of Ethics, if any, of the Company, or any agreement between the Participant and the Company.

"Change in Control" refers to any transaction or series of related transactions constituting:

(i) a direct or indirect transfer, in one or a series of transactions, of all or substantially all (i.e., at least 66-2/3% by fair market value) of the consolidated assets of the Company and its Subsidiaries; or

(ii) a sale, amalgamation, merger, reclassification, recapitalization, restructuring, consolidation or business combination or any other similar transaction of or involving the Company (unless with respect to any transaction described in clause (i) or (ii), the holders of record of the Company's Units as constituted immediately prior to the consummation of any such transaction will immediately after such transaction hold greater than fifty percent (50%) of the voting shares or equity interests of the acquiring entity or surviving entity, or either of such entities' parent, in approximately the same relative percentages after any such transaction as before any such transaction); or

(iii) the consummation of any transaction by which any person or group (as referred to in Section 13(d)(3) of the Exchange Act), other than the Members of the Company as of the date of the adoption of the Plan or any of their respective permitted transferees under the LLC Agreement, is or becomes the "beneficial owner" (as such term is defined in Rule 13d-3 under the Exchange Act), directly or indirectly, of more than fifty percent (50%) of the outstanding Units of the Company; or

(iv) a Public Offering.

"Change-in-Control Event" refers to any event or occurrence defined in the definition of Change in Control above.

"Code" refers to the Internal Revenue Code of 1986, as amended.

"Committee" means the Compensation Committee of the Company, or, in the absence of the appointment by the Manager(s) of a Compensation Committee, the Manager(s). In such latter event, all references in this Award to the Committee shall be deemed to refer to the Manager(s).

"Disability" means a mental or physical condition which, in the opinion of the Committee, renders the Participant unable or incompetent to carry out the job responsibilities held by the Participant or the duties assigned to the Participant at the time such condition arose or was incurred, and which is expected to be permanent or for an indefinite duration.

"Exchange Act" refers to the Securities Exchange Act of 1934, as amended.

"Excess Member Return" refers to (i) the aggregate net proceeds from a Change-in-Control Event *minus* the greater of (ii) the Aggregate Member Investment in Company Units *plus* an aggregate internal rate of return (as calculated on an annualized basis) of ___ percent (___%) calculated to the date of closing of the Change-in-Control Event (or payment of the consideration to the Company or its Members in connection therewith, if later), or (iii) the fair value of all outstanding Units of the Company as of the end of the Company's fiscal year preceding the year in which the Award is made by the Company to Participant, as determined by the Committee. Excess Member Return shall be calculated after giving full effect to the dilution, if any, caused thereto by the outstanding Incentive Units. In calculating the Excess Member Return, the internal rate of return under clause (ii) shall be calculated taking into account the date or dates of the investment(s) made by Members for their Units and the date or dates of any distributions paid by the Company with respect thereto and any payments made or payable to the Members in connection with a Change-in-Control Event. The value of consideration paid in-kind rather than in cash shall be determined by the Committee. The calculation of the Excess Member Return in connection with a Public Offering shall be as determined by the Committee.

"Incentive Pool" refers to the product of _____ percent (___ %) and the Excess Member Return.

"LLC Agreement" refers to the LLC Agreement of the Company, dated as of _____, 20___.

"Public Offering" refers to the sale by the Company of its Units (or of common shares or equity of any direct or indirect holding company of the Company) in a firm commitment underwritten public offering pursuant to a registration statement under the Securities Act of 1933, as amended, or pursuant to an applicable foreign securities law.

"Subsidiary" means any entity (other than the Company) in an unbroken chain of entities beginning with the Company if each of the entities (other than the last entity in the unbroken chain) owns equity interests possessing more than 50% of the total combined voting power of all classes of equity interests in one of the other entities in such chain.

"Units" refers to the outstanding units of membership interest of the Company, as determined from time to time.

(c) Calculations. All calculations and determinations required or contemplated by this Section 2 shall be made in the sole determination of the Committee and shall be final and binding on the Company and Participant.

3. Termination of Employment

(a) If Participant's employment by the Company or any Subsidiary terminates by reason of death or Disability, or by reason of a termination without Cause, then any Award held by the Participant shall vest, and any restrictions shall lapse, as to 100% of the Participant's Incentive Units granted to the Participant as of the date of death, Disability (as of the date the Participant is deemed subject to a Disability by the Committee), or termination, as the case may be. In such event, the Company shall purchase and redeem the Incentive Units then held by the Participant for cash, in an amount equal to the fair value of the Incentive Units, with the amount so determined paid to the Participant (or his estate or representative) within sixty (60) days after the Participant's death, Disability, or termination, or as soon thereafter as is practicable, as determined by the Committee, but in all events prior to seventy-five (75) days after the close of the Company's fiscal year in which the death, Disability, or termination occurs. For this purpose, the fair value of such a Participant's Incentive Units shall be equal to what the Participant would receive on a deemed Change in Control occurring on the date of death, Disability (as of the date the Participant is deemed subject to a Disability by the Committee), or termination pursuant to the provisions of Section 2(a), as determined by the Committee. The Committee's determination of such fair value for this purpose shall be binding and conclusive, absent manifest error.

(b) If Participant's employment with the Company or any Subsidiary is terminated voluntarily by the Participant or the Participant is terminated for Cause, then all Incentive Units that have not vested pursuant to the vesting schedule as set forth in Section 1(c) of the Award held by the Participant shall terminate in their entirety as of the date of Participant's termination, the Participant shall not be entitled to any redemption or payment for his or her unvested Incentive Units, and such unvested Incentive Units shall be forfeited and revert to the status of authorized but unissued Incentive Units under the Plan. With respect to the Incentive Units of any such Participant that have vested under the Award held by the Participant, the Company shall purchase and redeem such Incentive Units on the terms set forth in Section 3(a) above applicable to the purchase and redemption of Incentive Units as set forth therein.

4. Change in Control

In the event of a Change in Control, all outstanding Incentive Units of the Participant, if then employed by the Company or by a Subsidiary, shall be deemed fully vested.

5. Status of Incentive Units as Profits Interests

(a) The Company and Participant intend that the Incentive Units be treated as "profits interests" as such term is used in Revenue Procedures 93-27 and 2001-43, and that the Participant not realize income upon the grant of Incentive Units made by this Award. In furtherance of this intention, Participant agrees that the Company may, in the discretion of the Committee, amend the terms and provisions of this Award without the consent or approval of Participant and/or limit distributions made by the Company with respect to the Incentive Units under the provisions of Section 2.(a), so that Participant is not deemed to have shared in the value of the Company's assets as of the date of this Award but will only share in subsequent appreciation in the value of the Company's assets through the operation and implementation of this Agreement.

(b) Participant agrees to make a protective election with the Internal Revenue Service under Section 83(b) of the Code within 30 days of the date of this Award, in the form attached hereto as Annex 1, and to provide a copy of the election, as filed with the Internal Revenue Service, to the Company, attention Secretary.

6. Tax Withholding

Whenever the Participant's Incentive Units are liquidated or any cash payment is made with respect thereto hereunder, the Company or any Subsidiary shall have the power to withhold, or require Participant to remit to the Company or such Subsidiary, an amount sufficient to satisfy the statutory minimum federal, state, local or foreign, as applicable, withholding tax requirements

relating to such transaction, and the Company or such Subsidiary may defer payment of cash with respect to Participant's Incentive Units until such requirements are satisfied.

7. **Non-Transferability of Awards**

The Participant's Incentive Units granted hereby may not be sold, transferred, pledged, assigned, encumbered or otherwise alienated or hypothecated, other than by will or by the laws of descent and distribution or, on such terms and conditions as the Committee shall establish, to a "Permitted Transferee." For this purpose, a Permitted Transferee refers to a trust, corporation, partnership or limited liability company established by and for the benefit of Participant for estate planning purposes of Participant. All rights with respect to the Participant's Incentive Units awarded to Participant hereunder shall be exercisable during his or her lifetime only by Participant or, if permitted by the Committee, a Permitted Transferee. Following Participant's death, all rights with respect to the Participant's Incentive Units that were exercisable at the time of Participant's death and have not terminated shall be exercised by his or her designated beneficiary, his or her estate or, if permitted by the Committee, by a Permitted Transferee.

8. **Buyout and Settlement of Award**

The Committee may at any time offer to buy out for a payment in cash or Units of the Company the Participant's Incentive Units awarded hereunder, based on such terms and conditions as the Committee shall establish and communicate to Participant at the time that such offer is made and Participant may decide to accept such offer, but Participant is not required to do so. Upon payment of cash or the distribution of Units pursuant to this Section 8, Participant's rights as to the Participant's Incentive Units which is the subject of such payment or distribution shall be deemed satisfied in full.

9. **Beneficiary Designation**

Participant may from time to time name any beneficiary or beneficiaries (who may be named contingently or successively) by whom any right under the Plan and this Agreement is to be exercised in case of his or her death. Each designation will revoke all prior designations by Participant, shall be in a form reasonably prescribed by the Committee, and will be effective only when filed by Participant in writing with the Committee during his or her lifetime.

10. **No Guarantee of Employment**

Nothing in this Agreement shall interfere with or limit in any way the right of the Company or any Subsidiary to terminate Participant's employment at any time, or confer upon Participant any right to continue in the employ of the Company or any Subsidiary.

11. **No Rights as Member**

Participant shall not have any rights as a Member of the Company or any Subsidiary with respect to the Participant's Incentive Units awarded hereby. No distributions, whether in cash or in kind, shall be paid by the Company on Participant's Incentive Units, and Participant shall have no right to vote with respect to the Participant's Incentive Units, whether or not vested. The Participant's Incentive Units shall not represent any right to receive any Units of the Company or to exercise any rights with respect to the Units or other securities of the Company. The sole economic benefit of the Participant's Incentive Units is the right to participate in the Incentive Pool in accordance with the terms of the Plan and this Agreement.

12. **Interpretation; Construction**

Any determination or interpretation by the Committee under or pursuant to this Agreement shall be final and conclusive on all persons affected hereby. Except as otherwise expressly provided in the Plan, in the event of a conflict between any term of this Agreement and the terms of the Plan, the terms of the Plan shall control.

13. **Amendments**

The Committee may, in its sole discretion, at any time and from time to time alter or amend this Agreement and the terms and conditions of the Participant's Incentive Units (but not any portion of Participant's Incentive Units that have vested) awarded pursuant to this Agreement in whole or in part, *provided* that, if such alteration, amendment, suspension or termination shall not preserve the economic value, as determined by the Committee in its sole good faith discretion, of any previously awarded Participant's Incentive Units, then the Committee shall only be permitted to alter, amend, suspend or terminate such previously awarded Participant's Incentive Units if it shall obtain the consent of Participant. The Company shall give written notice to Participant of any such alteration or amendment of this Agreement as promptly as practicable after the adoption thereof. This Agreement may also be amended by a writing signed by both the Company and Participant.

14. **Miscellaneous**

(a) Notices. All notices, requests, demands, letters, waivers and other communications required or permitted to be given under this Agreement shall be in writing and shall be deemed to have been duly given if (i) delivered personally, (ii) mailed, certified or registered mail with postage prepaid, (iii) sent by two-day or overnight mail or delivery, or (iv) sent by fax or email, as follows:

(i) If to the Company, to it at:

New Ventures, LLC
.....
.....
.....
Telephone: .....
Fax: .....
Email: .....
Attention: .....

(ii) If to Participant, to Participant's address set forth on the signature page hereof, or to such other person or address as any party shall specify by notice in writing to the Company. All such notices, requests, demands, letters, waivers and other communications shall be deemed to have been received (w) if by personal delivery on the day after such delivery, (x) if by certified or registered mail, on the fifth business day after the mailing thereof, (y) if by two-day or overnight mail or delivery, on the day delivered, or (z) if by fax or email, on the day delivered, *provided* that such delivery is confirmed.

(b) Binding Effect; Benefits. This Agreement shall be binding upon and inure to the benefit of the parties to this Agreement and their respective successors and assigns. Nothing in this Agreement, express or implied, is intended or shall be construed to give any person other than the parties to this Agreement or their respective successors or assigns any legal or equitable right, remedy or claim under or in respect of any agreement or any provision contained herein.

(c) Waiver. Either party hereto may by written notice to the other (i) extend the time for the performance of any of the obligations or other actions of the other under this Agreement, (ii) waive compliance with any of the conditions or covenants of the other contained in this Agreement and (iii) waive or modify performance of any of the obligations of the other under this Agreement. Except as provided in the preceding sentence, no action taken pursuant to this Agreement, including, without limitation, any investigation by or on behalf of either party, shall be deemed to constitute a waiver by the party taking such action of compliance with any representations, warranties, covenants or agreements contained herein. The waiver by either party hereto of a breach of any provision of this Agreement shall not operate or be construed as a waiver of any preceding or succeeding breach and no

failure by either party to exercise any right or privilege hereunder shall be deemed a waiver of such party's rights or privileges hereunder or shall be deemed a waiver of such party's rights to exercise the same at any subsequent time or times hereunder.

(d) Applicable Law. This Agreement shall be governed by and construed in accordance with the laws of the State of California, regardless of the law that might be applied under principles of conflict of laws.

(e) Section 409A. This Agreement is intended to be exempt from or comply with the requirements of Section 409A of the Code, and all provisions contained herein, including, but not limited to, any adjustment provisions, shall be construed and interpreted in accordance with such intent.

(f) Section and Other Headings. The section and other headings contained in this Agreement are for reference purposes only and shall not affect the meaning or interpretation of this Agreement.

(g) Counterparts. This Agreement may be executed in any number of counterparts, each of which shall be deemed to be an original and all of which together shall be deemed to be one and the same instrument.

_____

[Signature page follows.]

IN WITNESS WHEREOF, the Company and Participant have duly executed this Agreement as of the date first above written.

NEW VENTURES, LLC
By: .....
Name: .....
Title: .....

PARTICIPANT
Name: .....
Address: .....
.....
.....

AWARD:
Number of Participant's
Incentive Units: .....

Annex 1

Form of Section 83(b) Election

Form of
Section 83(b) Election

The undersigned makes the following statement under Code § 83(b), pursuant to Treas. Reg. § 1.83-2:

1. The Taxpayer performing the services is:

[Employee name]

[Employee address]

Social Security No. [xxx-xx-xxxx]

2. Description of property with respect to which the election is being made:

   [xx] Incentive Units of New Ventures, LLC, a California limited liability company (the "***Incentive Units*** " in the "***Company*** ").

3. The date on which the property was transferred:

   The Incentive Units were transferred on [date]; the taxable year to which this election relates is [calendar year].

4. The nature of the restriction to which the property is subject:

   [describe vesting and transfer restrictions]

5. Fair market value of the property:

   The fair market value of the Incentive Units at the time of transfer, determined without regard to restrictions other than restrictions which by their terms will never lapse, was $[xx] per Incentive Unit.

6. Amount paid for property:

   The amount paid by the Taxpayer for the Incentive Units was $[xx] per Incentive Unit.

7. Delivery:

   A copy of this statement has been furnished to the Company.

   Dated: _____

   _____
   Taxpayer

This election must be filed with the Internal Revenue Service Center with which taxpayer files his or her Federal income tax returns and must be made within thirty (30) days after the transfer date of the property. This filing should be made by registered or certified mail, return receipt requested. The taxpayer must retain two (2) copies of the completed form for filing with his or her federal and state tax returns for the current tax year and an additional copy for his or her records.

Cal. Prac. Guide Pass--Through Entities Form 6:D.3

California Practice Guide--Pass-Through Entities | August 2024 Update
Current Edition Authors: Jeffrey C. Soza and Matthew Jann; Original Authors: James F. Fotenos and Edward C. Rybka

Chapter 6. Limited Liability Company

Forms

[Form 6:D.3] Operating Agreement Provisions Re Treatment of Incentive Units

[Ed. note: The following provisions are intended for use in the Company's Operating Agreement in the event that the Company adopts an Equity Incentive Plan and form of Equity Incentive Award Agreement included in the Guide as Forms 6:D.1 and 6:D.2.]

ARTICLE IV(A)

INCENTIVE UNITS

4(A).1: Incentive Units. Reference is made to the Company's Equity Incentive Plan, adopted and effective _____ _, 20_ (the "Plan"). All capitalized terms not defined in this Article IV(A) shall have the meaning given to them by the Plan. Under the Plan, Incentive Units, not exceeding in number _____ Incentive Units (subject to adjustment as set forth in the Plan), may be granted from time to time by the Committee to eligible officers, employees, and consultants and to the Manager(s) of the Company or an Affiliate of the Company (referred to under the Plan as "Participants").

(a) Participants shall have no rights as a Member of the Company with respect to the Incentive Units held by the Participant. No distributions, whether in cash or in kind, shall be paid on a Participant's Incentive Units, Participants have no right to vote with respect to the Participant's Incentive Units, whether or not vested, and Participants shall have no right to financial information concerning the Company or to access to the books and records of the Company. The sole benefit of the Incentive Units is the right of Participants to participate in the Incentive Pool in accordance with the terms of the Plan and the individual Equity Incentive Award Agreements entered into by the Company with Participants.

(b) A Participant's Incentive Units may not be sold, transferred, pledged, assigned, encumbered, or otherwise alienated or hypothecated, other than by will or by the laws of descent and distribution, or on such terms and conditions as the Committee may establish, to a "Permitted Transferee" as defined in the Company's form of Equity Incentive Award Agreement.

4(A).2: Allocation of Profit and Loss. For purposes of allocating profits and losses of the Company, and each item thereof, the "Percentage Interest" of Participants, with respect to their Incentive Units, for all purposes of the Company's Operating Agreement, shall be zero; provided, however, that, if and to the extent a Participant participates or is entitled to participate in Distributions from any Change-in-Control Event (as defined in the form of the Company's form of Equity Incentive Award Agreement), or otherwise pursuant to the terms of a Participant's Equity Incentive Award Agreement, then and in such event the Percentage Interest of the Participant, for purposes of allocating profit and loss for the year in which any such Distribution is made or, if earlier, for the year in which the Change-in-Control Event occurs, shall be equal to the quotient obtained by dividing the Distributions made or to be made by the Company to the Participant by the Distributions made or to be made by the Company to all Members and to all Participants for the applicable year(s).

4(A).3: Incentive Units as Profits Interests. The Company and the Members intend that the Incentive Units be treated as "profits interests" as such term is used in Revenue Procedures 93-27 and 2001-43, and that the Participants not realize income upon the grant of Incentive Units to the Participants by the Company. In furtherance of such intention, Distributions in respect of Incentive Units may be limited, as determined by the Manager(s) in their sole discretion, so that Participants do not share in the value of the Company's assets as of the date of the grant of Incentive Units but only share in subsequent appreciation in the value of the Company's assets.

End of Document