

NIESAR & VESTAL LLP
ATTORNEYS AT LAW

90 NEW MONTGOMERY STREET 9TH FLOOR
SAN FRANCISCO, CALIFORNIA 94105
TELEPHONE (415) 882-5300
FACSIMILE (415) 882-5400
www.nvlawllp.com

Law Alert

To: Firm Clients and Contacts

From: Niesar & Vestal LLP

Date: January 8, 2016

Re: **California LLC Act Clean-up Legislation Adopted, Effective January 1, 2016**

On October 11, 2015, AB 506 was filed with the California Secretary of State. This new law, which became effective on January 1, 2016, is “clean-up” legislation, intended to correct some of the problems that existed with the California Revised Uniform Limited Liability Company Act (CRULLCA). In most cases, the amendments to CRULLCA do not require any changes to existing LLC Operating Agreements as the amendments are primarily intended to clarify ambiguities and disconnects in the legislation. However, in some cases it may be wise to consider an amendment to the Operating Agreement for purposes of clarification and avoiding unnecessary disputes in later years. Additionally, in some cases the amendment may provide additional flexibility that Members of an LLC will desire to work into their Operating Agreement. In this regard, see in particular the discussion in points 4 through 8 below.

Summary of Key Changes: The following is a summary of what we believe to be the most important changes effected by AB 506.

1. 17701.02(v): The word “Person” has been amended to provide that a trustee is a Person. The change to 17701.02(v) is a useful recognition that trustees, rather than the trusts for which they serve, can (and in our opinion, should) be members of LLCs.

2. 17701.10: This Sub-section, which provides rules as to what an Operating Agreement may and may not do, has seen several amendments that are primarily technical tweaks. Many of the changes merely reposition provisions to other Sub-sections. Others correct oversights in the CRULLCA; for instance, subparagraph (e) makes clear that its requirements as to modification of fiduciary duties apply to the duties of Members of a Member-managed LLC, as well as the Managers of a Manager-managed LLC.

3. 17704.01(e): This is a new Sub-section, which reinserts into CRULLCA the exemptions from Labor Code Sections 406 and 407 for the issuance of LLC interests to an employee, a welcome correction of what seems to have been an oversight in the original CRULLCA. The Prior Act had provided these exemptions.

4. 17704.04(e): This is also a new Sub-section. It provides that if the Operating Agreement does not specify how profits and losses are to be allocated, the allocation shall be in proportion to the value of the contributions the LLC has received from each Member. It is unlikely that written Operating Agreements do not specify how profits and losses are to be allocated. But for those LLCs that exist under an oral, instead of written, Operating Agreement, this can create a significant litigation issue in the event there is an understanding that profits get allocated on a percentage or other basis that is different from what this new statutory provision provides.

5. 17704.07(c)(4)(B): This Sub-section has been deleted. It provided that in a Manager-managed LLC approval of a merger or conversion required unanimous consent by all the Members. That requirement could have been varied, but only by a written Operating Agreement. Effective January 1, 2016, any LLC merger needs to be approved by a Majority of the Members unless the Operating Agreement specifies a greater percentage. (Amended Sections 17710.12(a) and 17710.03(b)(1), respectively.)

6. 17704.07(C)(4)(d): This Sub-section has been deleted. It had prohibited amendment of a Manager-managed Operating Agreement with less than unanimous approval.

7. 17704.08(b): This Sub-section has been added (and the prior (b) was made (c)). The new (b) expands the permissible reimbursements and indemnifications to include Persons other than Managers.

8. 17704.08(d): This Sub-section has been added. It provides basically the same level of mandatory indemnification for an agent of the LLC as is provided for agents of California corporations. To qualify for mandatory indemnification the agent must have been successful on the merits in defense or settlement of the claim or other matter that was the subject of the dispute at issue. Presumably this indemnification obligation may not be eliminated by the Operating Agreement; see Sub-section 17701.10(g) which allows modification or elimination of permissive indemnification in Sub-section 17704.08(a), but does not refer to Sub-section 17704.08(d).

9. 17707.06(a): This Sub-section has been amended to provide that an LLC that has filed a certificate of cancellation nevertheless continues to exist for purposes of winding up. This has been a problem for cancelled LLCs involved in litigation, or needing to be brought into litigation, for example where a post-cancellation lawsuit involves former Managers who might be able to assert an LLC claim as an offset.

10. 17713.04(b): This Sub-section has been amended to make clear that an Operating Agreement or other contract entered into before January 1, 2014 is not governed by the CRULLCA but apparently appears to be governed by the Prior Act (which has been repealed). It is not clear which act will apply to an Operating Agreement entered into prior to January 1, 2014, but amended in some regard after that date. On this issue of application of the new or old act generally, see *Kennedy v. Kennedy*, 235 Cal. App. 4th 1474, 2d Dist. 2015 where the Court of Appeal, finding it a close call, nevertheless decided that the Prior Act should govern whether withdrawal of an involuntary dissolution cuts off the right of the non-moving party to compel a buyout of the moving party's interest; CRULLCA affords the moving party that right, but the Prior Act did not.

11. 17713.04(c): This Sub-section has been amended to provide that any vote or consent prior to January 1, 2014 is governed by the Prior Act. It seems to open up for dispute whether a vote taken post January 1, 2014 that may be permitted or prohibited by the Prior Act, but is prohibited or permitted under CRULLCA, will be governed by the pre-CRULLCA Operating Agreement, or by CRULLCA.

To learn more about the California Revised Uniform Limited Liability Company Act (CRULLCA) and California LLC practice, contact any Niesar & Vestal attorney. You may also refer to "California Limited Liability Company Forms and Practice Manual" written by Gerald V. Neisar, Esq., Benjamin Berk, Esq., and Ellen Kaye Fleishhacker, Esq., and published by Data Trace. Information about the Manual can be found at: <http://www.datatrace.com/california-limited-liability.html>.

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