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Preface

The increasing emphasis in our culture on service and service industries and the shift away from large corporations for innovation and job growth have spurred the growth of small business entities. Working closely with entrepreneurs, California attorneys demand focused information to assist them in providing quick, accurate legal and practical guidance to their clients.

The first edition of *Selecting and Forming Business Entities* contained in one volume all the forms necessary to structure each of the commonly used business entities. This new, two-volume edition continues the practical advice and easy access to useful information of the first edition.

To make content and forms easily accessible and useful in this book, chapters contain brief discussions of significant elements in forming and operating each entity, checklists and charts to guide the practitioner in identifying issues that regularly arise when forming an entity, and extensive forms to enable practitioners to implement a selected course of action. These forms include official Secretary of State forms necessary for forming an entity, as well as detailed long-form operating agreements, articles of incorporation, bylaws, and other attorney-drafted forms, each with comprehensive annotations to guide the practitioner on the proper use of each clause.

In addition, to assist practitioners in selecting the most appropriate entity for a particular business, [Chapter 2](#) gives a brief initial overview of each type of entity, then compares and contrasts ease of formation, transaction costs, federal and state income taxes, management, transferability of interests, and liability of owners for each entity.

This book does not provide information on procedures that are required following the formation of an entity. For example, to operate a business, most owners must also procure financing, issue shares or interests and qualify or file for an exemption for those shares, obtain business licenses and permits, transfer property to the entity, and file tax returns. Two other CEB titles, [Financing and Protecting California Businesses \(Cal CEB 2006\)](#) and [Advising California Employers and Employees \(Cal CEB 2005\)](#) provide information on these important procedures for start-up businesses.

CEB gratefully acknowledges the California attorneys who wrote chapters for this new edition and generously provided their knowledge and specialized skills. For their biographical information, see About the Authors. CEB would also like to thank the members of the Partnerships and LLCs Committee of the Business Law Section of the State Bar of California for their generous assistance in drafting this book and for their review of the manuscript, practical comments, and other substantial contributions. In addition, CEB acknowledges the contributions of the other practicing attorneys who reviewed each chapter manuscript and contributed many helpful suggestions to the text. For a list of their names, see Special Acknowledgments.

CEB Attorney Editor Jean Magistrale and Legal Editors Sally St. Lawrence, Kristin Schwaighart, Enrique DeAnda, Christopher J. Dow, Alice Kostin, and Andy Rosner contributed to this book. Administrative support was provided by Akanke Peyton and Nila Kanzaria. Karen Lamoreux handled copyediting and production. Robert W. Burke and Kathryn Te Selle created the index. Composition was performed by CEB's Electronic Publishing staff.

**May 2010 Update**

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The following attorneys served as consultants for this book by reviewing and commenting on one or more chapters. Their suggestions have made the book more accurate, more practical, and more reflective of actual practice. To each of them we express our special thanks:

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**Chapter 9:** Portions of this chapter are based on an article written for the California Business Law Practitioner (20 Cal Bus L Prac 15 (Winter 2005)) by James F. Fotenos, James K. Dyer, Jr., and Suzanne L. Weakley.

**Chapter 10:** The authors, Thomas A. Maier and Elspeth Delaney-Paul, would like to acknowledge the assistance of ERISA specialist Sara Langford Ennor, owner of the Law Offices of Sara Langford Ennor, in reviewing the retirement plan aspects of the chapter. They would also like to thank Maureen Houlihan for her help in assembling the manuscript.

**Chapter 11:** The long form limited liability company operating agreement in this chapter is based on the form of operating agreement prepared by Allan B. Duboff, Esq., of Loeb & Loeb LLP, and is used with his kind permission. All "improvements" to the form are the responsibility of the author of the chapter, Charles E. McKee.

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Selected Developments

**May 2010 Update**

As of January 1, 2010, an attorney who does not carry professional liability insurance must inform a client, in writing, at the time of the engagement. Cal Rules of Prof Cond 3-410. See [§§1.22-1.23](#).

The Second Appellate District of California held that a former law firm client waived his right to arbitration of a fee dispute under the Mandatory Fee Arbitration Act by requesting affirmative relief for the law firm's alleged malpractice. *Fagelbaum v Heller LLP v Smylie* (2009) 174 CA4th 1351, 95 CR3d 252. See [§1.20](#).

Effective January 1, 2010, the Uniform Limited Partnership Act of 2008 (Re-RULPA) ([Corp C §§15900-15912.07](#)) applies to all California limited partnerships. Discussions throughout the book have been revised as appropriate to accommodate this final phase-in of the new law. See, e.g., [§§2.60, 2.68, 2.70, 2.72, 2.106, 2.182, 4.21, 12.24, 12.29](#), and [chap 6](#).

A limited partner has no fiduciary duty to the limited partnership or the other partners solely by reason of being a limited partner. [Corp C §15903.05\(a\)](#). See [§2.182](#).

The Secretary of State has adopted detailed regulations governing approval of business entity names. See 2 Cal Code Regs §§21000-21009. The regulations provide guidelines for the Secretary of State to use to determine whether proposed business entity names are the same as, deceptively similar to, or substantially the same as an existing name. See [§§3.6, 3.20, 3.22, 3.27](#).

Effective January 1, 2010, if the United States Postal Service returns a notice of expiration of a fictitious business name to the county clerk as undeliverable, the clerk is not required to retain the notice. [Bus & P C §17929\(e\)](#). See [§3.9](#).

For taxable years beginning on or after January 1, 2011, a foreign corporation taxpayer that satisfies any of four conditions set forth in [Rev & T C §23101\(b\)](#) is "doing business" in California for the taxable year. See [§4.11](#).

An apportioning trade or business (other than one that derives more than 50 percent of its gross business receipts from conducting one or more specific "qualified" business activities) may now make an irrevocable annual election to apportion income with a single sales factor formula. See [§4.12](#).

The California Court of Appeal has held that there is no fiduciary duty under California law owed to creditors by directors of a corporation solely by virtue of its operating in the "zone" or "vicinity" of insolvency. *Berg v Berg Enters. v Boyle* (2009) 178 CA4th 1020, 100 CR3d 875. See [§4.16](#).

Profit sharing is not presumed to create a partnership when the profits are received in payment for services as an independent contractor. *The Fifth Day, LLC v Bolotin* (2009) 172 CA4th 939, 91 CR3d 633 (dissenting opinion of Mosk, J). See [§5.3](#).

Limited partners may take any action required or permitted by law to pursue, settle, or terminate a derivative action on behalf of the limited partnership without incurring the liability of a general partner. See [§6.11](#).

[Business and Professions Code §§6174 and 6174.5](#), signed by the Governor on January 25, 2010, and effective as emergency legislation the same day, codify the obligations of LLPs engaged in the practice of law. See [§§7.8, 7.29](#).

Investors had shareholder standing to bring action to invalidate election of directors, even though no shares had been issued. *Haab v Kim* (2009) 175 CA4th 45, 95 CR3d 515. See [§8.48](#).

The legislature amended [Corp C §20](#), effective January 1, 2010, to eliminate the requirement that an electronic transmission to a shareholder or member satisfies the federal Electronic Signatures in Global and National Commerce Act (E-Sign Act) (15 USC §§7001-7006) and to provide that a shareholder's consent to electronic transmissions include a written statement. See [§8.61](#).

The exclusion ceiling for public transit has been increased temporarily, during the period from February 17, 2009, through January 1, 2011, to equal the exclusion ceiling for qualified parking. See [§10.12](#).

The Supreme Court denied certiorari in *Ventas Fin. I, LLC v California Franchise Tax Bd.* (2008) 165 CA4th 1207, 81 CR3d 823, cert denied (2009) \_\_\_ US \_\_\_, 173 L Ed 2d 1076, 129 S Ct 1917, a case in which the Court of Appeal held that when a foreign LLC conducts business both within and outside of California, the LLC is entitled to a refund of an amount of its annual California fees apportioned based on the extent of out-of-state business it conducted. See [§11.7](#).

**Source:** Business Law/Selecting and Forming Business Entities/Cutoff Dates and CEB Citation

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# Attorney-Client Relationship

Demetrios Dimitriou

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## **§1.1 I. SCOPE OF CHAPTER**

Business attorneys and their clients need to understand the terms and scope of the professional engagement and the respective responsibilities of each party. An attorney-client engagement agreement helps accomplish this objective by identifying the client, establishing the scope and terms of the engagement, and setting the fee.

Before drafting the attorney-client engagement agreement, the attorney should consider the ethical issues raised by the California Rules of Professional Conduct, ethics opinions, statutory provisions, and court rules. Because satisfactory engagement arrangements in one area of law may not be suitable in another, a standard agreement may be difficult to create. Engagement agreements require the same degree of custom drafting as any other business contract.

This chapter briefly discusses the practical and ethical concerns arising from initiation, as well as termination, of the attorney-client relationship. For a letter of nonengagement, see §1.26. For a complete letter of engagement, see §§1.27-1.42. For a letter of disengagement on completion of legal services, see §1.43. For a letter of disengagement before legal services are completed, see §1.44.

## **II. ETHICAL ISSUES IN REPRESENTING BUSINESS ORGANIZATIONS**

### **§1.2 A. Determining Whether Representation Is Appropriate**

Before representing a prospective client who requires advice in organizing and operating a business entity, the attorney must gather enough preliminary information to determine whether it is appropriate to represent the client, including:

- The identities, brief background biographies, and business affiliations of each of the principals (e.g., members, officers, shareholders, partners) of the business to be organized;
- The identities, brief background biographies, and business affiliations of any persons who are expected to enter into material relationships with the business to be organized;
- A summary of the business operations in which the entity plans to engage and the business plan of the entity in sufficient detail to permit the attorney to identify potential areas of legal advice and services that the client will need during the business's organizational and initial operating stages; and
- Any trade names under which the individuals or the business entity operate or will operate.

This information will help the attorney learn at the earliest possible stage whether the subject matter of the representation falls within his or her areas of professional expertise. See §1.3. At a minimum, the attorney should know enough to prevent unnecessary delay or other prejudice to the client's interests if the attorney must later refer the client to another attorney or otherwise decline further representation.

**NOTE:** An attorney has a duty to protect confidential information acquired from a potential client during the information-gathering stage whether or not the attorney accepts the engagement. See Bus & P C §6068(e). There is a limited exception to this confidential communication privilege. An attorney may, but is not required to, reveal a client confidence to the extent that the attorney reasonably believes it is necessary to prevent a criminal act likely to result in death or substantial bodily harm. Bus & P C §6068(e). See Cal Rules of Prof Conduct 3-100(B).

The preliminary information gathered by the attorney should enable him or her to identify any potential conflicts of interest before discussing significant confidential information and rendering substantive legal advice. Although issues of professional competency and conflict of interest must be continually reviewed during the subsequent stages of the attorney-client relationship, the initial screening process should help eliminate unnecessary problems that might otherwise result if the attorney proceeds prematurely.

### **§1.3 B. Assessing Attorney's Professional Competence to Represent Client**

Before advising a client on any matter, the attorney must have the skill and expertise to handle the matter competently. Cal Rules of Prof Cond 3-110; ABA Model Rules of Prof Cond 1.1. Advising a client about organizing or operating a business entity requires not only competence in the business organization of sole proprietorships, corporations, partnerships, limited liability partnerships, limited liability companies, and associations but also expertise in other areas of law (e.g., taxation, securities regulation, estate planning, family, labor, real property, intellectual property). In addition, the attorney may need to be familiar with special areas of law that apply to the specific business entity to be formed. Some of these issues may be within the range of a general or business attorney's expertise; others may not.

As pointed out in Cal Rules of Prof Cond 3-110(A), an attorney may not intentionally, recklessly, or repeatedly fail to perform legal services with competence. "Competence" is defined to mean that the legal services must be rendered with diligence, learning, and skill and the mental, emotional, and physical ability reasonably necessary for the performance of such services. Cal Rules of Prof Cond 3-110(B). See, e.g., *In re Brockway* (2006) 4 Cal St Bar Ct Rptr 944, 2006 Cal Op Lexis 3 (attorney violated Rule 3-110(A) and acted in reckless disregard of client's cause by not completing or filing documentation for client, thereby missing urgent deadline relevant to client's matter). If an attorney does not have the requisite competence, he or she can either (Cal Rules of Prof Cond 3-110(C)):

- Associate with or professionally consult with another attorney who is reasonably believed to be competent, or
- Acquire sufficient learning and skill to become competent before performance is required.

For further information on the applicability of Cal Rules of Prof Cond 3-110, see *Layton v State Bar* (1990) 50 C3d 889, 268 CR 845; *Horne v Peckham* (1979) 97 CA3d 404, 158 CR 714, disapproved on other grounds in *ITT Small Bus. Fin. Corp. v Niles* (1994) 9 C4th 245, 256, 36 CR2d 552. In addition to liability for negligence, an attorney is subject to discipline for failure to associate or consult with a specialist if he or she lacks necessary knowledge or experience. See *Lewis v State Bar* (1981) 28 C3d 683, 170 CR 634.

At every stage of an engagement, attorneys should review their ability to provide the necessary level of competence. They should be candid with their clients about the need to associate with another attorney or to refer their clients to another attorney.

## **§1.4 C. Identifying Potential Conflicts of Interest**

Among other responsibilities, an attorney representing a client has the following duties:

- The duty of undivided loyalty to the client (e.g., *Flatt v Superior Court* (1994) 9 C4th 275, 36 CR2d 537);
- The duty to avoid representing adverse interests (Cal Rules of Prof Cond 3-300, 3-310);
- The duty to keep the client reasonably informed and make available copies of significant documents when necessary to keep the client informed (Bus & P C §6068(m); Cal Rules of Prof Cond 3-500); and
- The duty to maintain client confidences and secrets (Bus & P C §6068(e); *Goldstein v Lees* (1975) 46 CA3d 614, 120 CR 253; California State Bar Formal Opinion No. 1993-133).

When an attorney represents more than one client in a matter, the attorney-client engagement letter must address these four conflicting duties in a manner consistent with Cal Rules of Prof Cond 3-310(C). In *Gong v RFG Oil, Inc.* (2008) 166 CA4th 209, 82 CR3d 416, the court found that counsel was disqualified from concurrently representing the majority shareholder and the corporation in a suit by a minority shareholder for involuntary dissolution. Given the plaintiff's allegations that the majority shareholder misused corporate funds, interests of the corporation and the majority shareholder were adverse; counsel would be unable to satisfy the duty of undivided loyalty to either client. 166 CA4th at 216.

**NOTE:** An attorney who is "of counsel" to a firm or other lawyer may be subject to the rule that imputes a conflict of interest to members of the same firm, with the consequence of automatic disqualification. See *People ex rel Department of Corps. v Speedee Oil Change Sys., Inc.* (1999) 20 C4th 1135, 86 CR2d 816. For further information regarding the "of counsel" relationship, including a definition of the term, its uses, current status, and scope, see American Bar Association, Senior Lawyers Division, *The Of Counsel Agreement: A Guide For Law Firm and Practitioner* (3d ed 2005).

## **§1.5 1. Conflicts Among Parties**

Attorneys hired to form or advise a business entity are often asked to represent individuals with conflicting interests. Although the interests of associated individuals may differ with respect to capital investments, liquidity, control, allocations of profits and losses, and taxes, prospective clients commonly ask a single attorney to represent both the entity and multiple participants with divergent interests.

An attorney may not represent multiple parties with conflicting interests except with the informed written consent of each party. Under Cal Rules of Prof Cond 3-310(C):

A member shall not, without the informed written consent of each client: (1) Accept representation of more than one client in a matter in which the interests of the clients *potentially* conflict; or (2) Accept or continue representation of more than one client in a matter in which the interests of the clients *actually* conflict; or (3) Represent a client in a matter and at the same time in a separate matter accept as a client a person or entity whose interest in the first matter is adverse to the client in the first matter. [Emphasis added.]

Thus, the attorney must comply with Rule 3-310(C) with respect to both potential and actual conflicts. Three distinct conflict-of-interest scenarios may confront an attorney:

(1) If no potential or actual conflict exists, Cal Rules of Prof Cond 3-310 does not apply.

(2) If a potential conflict exists at the beginning of the attorney-client engagement or subsequently arises during the course of representation, Rule 3-310 applies and requires the attorney to obtain the client's written consent to initial or continued representation.

(3) If an actual conflict exists at the beginning of the attorney-client engagement or subsequently arises during the course of representation, Rule 3-310 applies and requires the attorney to obtain the client's written consent to initial or continued representation. Even if the client's written consent was obtained when a potential conflict existed or arose, another written consent is required when the potential conflict becomes an actual conflict.

An attorney representing more than one client should be alert for possible conflicts of interest throughout the entire period of representation. If multiple representation initially appears appropriate but interests diverge or an actual conflict arises during the course of representation, the attorney must inform the parties in writing of the nature of the conflict and its foreseeable consequences. The attorney should obtain the parties' informed written consent to continued representation despite any prior consents that the parties may have granted. Cal Rules of Prof Cond 3-310(C)(1)-(2).

Unless the engagement letter makes it clear that any communication received by the attorney from one client cannot be kept secret from the other clients, the attorney may be placed in an ethically untenable position. If one of the clients disclosed a secret to the attorney that was material to the representation, the attorney would be required to disclose to the other clients that such a communication was received (without disclosing the content of the communication) and then would be forced to withdraw from representing the group. Instead of giving each client this power to force the attorney to withdraw, the engagement letter should prohibit the clients from giving the attorney information that cannot be disclosed to the other clients.

Explicit ethical guidelines apply for an attorney representing an organization. See Cal Rules of Prof Cond 3-600(A); *Responsible Citizens v Superior Court* (1993) 16 CA4th 1717, 20 CR2d 756. The attorney must explain the client's identity to management, investors, employees, members, or other constituents when the organization's interests are or may become adverse to those of the individuals representing the organization. Cal Rules of Prof Cond 3-600(D). On the duty of an attorney representing a corporation or another organization when corporate and individual interests differ, see ABA Model Rules of Prof Cond 1.13.

**NOTE:** Nothing in Rule 3-600 prohibits an attorney from representing an organization and its directors, officers, employers, shareholders, or other constituents except as provided in Cal Rules of Prof Cond 3-310. See Cal Rules of Prof Cond 3-600(E). See also *Gong v RFG Oil, Inc.* (2008) 166 CA4th 209, 82 CR3d 416 (corporate counsel disqualified from concurrently representing majority shareholder and corporation when they had adverse interests under Rule 3-310 because, given that plaintiff's claim was majority shareholder's alleged misuse of

corporate funds, counsel could not satisfy undivided duty of loyalty).

For a form of disclosure of potential conflicts between an individual client and the business entity, see §1.38. For a form of disclosure of potential conflicts among multiple clients, see §1.39. For a form of disclosure and waiver of conflict with another client of the firm, see §1.40.

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**Source:** Business Law/Selecting and Forming Business Entities/1 Attorney-Client Relationship/ 2. Conflicts Between Attorney and Client/§1.6 a. Prior Relationship

## **2. Conflicts Between Attorney and Client**

### **§1.6 a. Prior Relationship**

An attorney may not accept or continue representation of a client without providing written disclosure to the client if the attorney:

- Has a legal, business, financial, professional, or personal relationship with a party in the same matter (Cal Rules of Prof Cond 3-310(B)(1));
- Knows or reasonably should know that the attorney previously had a legal, business, financial, professional, or personal relationship with a party or witness in the same matter and that that relationship would substantially affect the representation (Cal Rules of Prof Cond 3-310(B)(2));
- Has or had a legal, business, financial, professional, or personal relationship with another person or entity who the attorney knows, or reasonably should know, would be substantially affected by resolution of the matter (Cal Rules of Prof Cond 3-310(B)(3)); or
- Has or had a legal, business, financial, or professional interest in the subject matter of the representation (Cal Rules of Prof Cond 3-310(B)(4)).

Disqualification of the attorney does not require proof that the attorney actually possesses confidential information. The attorney's knowledge of confidential information is presumed if a substantial relationship has been shown to exist between a former representation and the current one, and when it appears from the nature of the former representation or the relationship of the attorney to the former client that confidential information material to the current dispute would normally have been imparted to the attorney *Largo Concrete, Inc. v Liberty Mut. Fire Ins. Co.* (ND Cal, Jan. 2, 2008, No. C 07-04651 CRB) 2007 US Dist Lexis 95690.

For a form of disclosure and waiver of conflict with another client, see §1.40.

**Source:** Business Law/Selecting and Forming Business Entities/1 Attorney-Client Relationship/§1.7 b. Investment in Client's Business

## **§1.7            b. Investment in Client's Business**

Conflicts arise if the attorney wants to invest in a client's business, accept an economic interest in the business in lieu of fees, or enter into transactions to provide goods or nonlegal services to a client. In any business transaction with a client or in any situation in which an attorney otherwise knowingly acquires a pecuniary interest adverse to the client, the attorney must (Cal Rules of Prof Cond 3-300; see ABA Model Rules of Prof Cond 1.8, 1.13):

- Fully disclose the transaction in writing to the client;
- Ascertain the fairness of its terms;
- Advise the client in writing that the client may seek independent legal advice;
- Provide the client with a reasonable opportunity to seek such advice; and
- Obtain the client's informed written consent to the transaction.

The attorney may also need to disclose the transaction in writing to others (*e.g.*, directors, shareholders, limited partners) and obtain their informed written consent.

### **§1.8 c. Ownership Interest in Exchange for Services**

When an attorney accepts an ownership interest in an enterprise in payment for services, the attorney obtains a financial interest in the business, invoking the ethical concerns discussed in §1.7. The attorney may have to disgorge all or part of the property if disputes arise over the reasonable value of the attorney's services and subsequent events demonstrate that the fee was unconscionable. The attorney's interest in a business enterprise may also make him or her a "business partner" of the client and create a future conflict of interest between the two.

Few California cases directly address the acceptance of attorney fees in the form of an interest in a business or property. In *Hawk v State Bar* (1988) 45 C3d 589, 247 CR 599, however, the court held that an attorney's acquisition of a note secured by a deed of trust on the client's property as payment for attorney fees was subject to former Cal Rules of Prof Cond 5-101 (now Cal Rules of Prof Cond 3-300). Rule 3-300 applies to situations in which the attorney obtains a pecuniary interest in a client's business or assets as part of a fee arrangement. The rule requires the client's written consent following the attorney's fair and full disclosure of the arrangement and its ramifications. The client must also be advised of the right to seek the advice of an independent attorney and be given a reasonable opportunity to seek that advice. See *Ritter v State Bar* (1985) 40 C3d 595, 221 CR 134. Any acquisition of an interest in a client's business under terms generally available to the public would not, however, violate Rule 3-300.

Rule 3-300 also applies when an attorney intends to use a lien provision in a retainer agreement as security for payment of his or her attorney fees. *Fletcher v Davis* (2004) 33 C4th 61, 14 CR3d 58. In *Fletcher*, the California Supreme Court held that such a provision in a retainer agreement is a charging lien, which can be created only with the client's prior written consent in compliance with the requirements of Rule 3-300. The court clarified that in California a charging lien can be created only by contract; the lien does not arise automatically from the fact that the attorney performed services on the client's behalf. The court specifically excluded contingency fee matters from its opinion in *Fletcher*. However, in a formal ethics opinion, the California State Bar has indicated that an attorney need not comply with Rule 3-300 when entering into a contingency fee agreement that includes a provision for a charging lien. California State Bar Formal Opinion No. 2006-170.

**Source:** Business Law/Selecting and Forming Business Entities/1 Attorney-Client Relationship/§1.9 d. Service as Both Counselor to and Director or Officer of Entity

#### **§1.9 d. Service as Both Counselor to and Director or Officer of Entity**

Attorneys are often asked to serve as directors or officers of corporations and may be asked to serve in similar quasi-managerial capacities in other forms of business ventures. Many pitfalls may arise in such an arrangement, including the following:

- If the attorney is serving the entity both as counsel and in a managerial role, the attorney's advice may be less independent and therefore subject to material conflicts of interest.
- Because of the attorney's profession and training, he or she may be held to a higher standard of conduct in the managerial capacity than a nonattorney.
- At a committee or management board meeting, other managers may have difficulty distinguishing when the attorney's statements constitute legal advice and when they are made as a manager in a business context.
- Economic benefits resulting from the attorney's managerial role would be subject to Cal Rules of Prof Cond 3-300.

Any actual or apparent impairment of the attorney's independence of judgment in such dual roles may be a source of misunderstanding and liability. For these and other reasons, many experienced attorneys and law firms refuse, as a matter of policy, to serve in management roles.

**Source:** Business Law/Selecting and Forming Business Entities/1 Attorney-Client Relationship/§1.10 D. Limiting Advice to Attorney's Area of Expertise

#### **§1.10 D. Limiting Advice to Attorney's Area of Expertise**

Depending on the extent of the client's business experience, the attorney may be asked to advise on business as well as legal issues that arise during formation of the business entity. For example, an attorney representing an entrepreneur may find it necessary to supplement legal advice with a candid discussion of the client's financing needs and unrealistic economic expectations and the tax consequences of certain business decisions. In many circumstances, it may be difficult to separate the two types of advice.

Because attorneys providing business advice to their clients may be held to the same professional standards as those rendering legal advice, attorneys should always limit advice to their area of expertise. See *Libarian v State Bar* (1943) 21 C2d 862, 136 P2d 321.

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**Source:** Business Law/Selecting and Forming Business Entities/1 Attorney-Client Relationship/§1.11 E. Fee Disgorgement

### **§1.11 E. Fee Disgorgement**

If an attorney fails to comply with the California Rules of Professional Conduct, attorney fees earned and collected may be subject to refund to the client As the court in *Goldstein v Lees* (1975) 46 CA3d 614, 618, 120 CR 253, stated:

It is settled in California that an attorney may not recover for services rendered if those services are rendered in contradiction to the requirements of professional responsibility.

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### **§1.12 III. DOCUMENTING THE ATTORNEY-CLIENT RELATIONSHIP**

Although Bus & P C §6148 does not require a written attorney-client engagement agreement in all situations (see §1.14), it is generally sound practice to use a written agreement for any client who is starting a business venture. A written engagement agreement may clarify the identity of the parties, the scope of the engagement, and the compensation arrangement. In addition to establishing a professional tone at the outset of the attorney-client relationship, the agreement may address such issues as conflicts of interest. See the form of engagement letter in §§1.27-1.42.

An engagement letter need not necessarily contain all the suggested provisions contained in the forms in §§1.27-1.42. The attorney should edit the suggested material to reflect the attorney's own needs for completeness, the relative sophistication of the client, the attorney's historical relationship with the client, the level of economic risk that the representation entails for the attorney, and other business and practical considerations relevant to the engagement. The attorney should also include additional provisions as appropriate for the particular area of practice involved and suitable for the attorney's professional needs and practices.

**NOTE:** With respect to the scope of the engagement, the California Rules of Court provide for limited scope representation in some civil cases. See Cal Rules of Ct 3.35-3.36.

The attorney may also find it necessary to draft written nonengagement or disengagement letters. See forms in §§1.13, 1.24-1.25.

**Source:** Business Law/Selecting and Forming Business Entities/1 Attorney-Client Relationship/§1.13 A. Nonengagement Letters

### **§1.13 A. Nonengagement Letters**

Regardless of whether an engagement agreement is formally entered into by the parties, an attorney-client relationship may be considered to arise even if the attorney never undertakes representation of the prospective client. The key to determining the existence of an attorney-client relationship is whether legal advice is given—even if the person never becomes a client. See *Fox v Pollack* (1986) 181 CA3d 954, 226 CR 532; *Miller v Metzinger* (1979) 91 CA3d 31, 154 CR 22.

To prevent the unintended creation of an attorney-client relationship, the attorney should consider sending the prospective client a nonengagement letter. See §1.13. The letter should inform the person that the attorney is not representing him or her. If a statute of limitations issue is involved, the attorney should address this issue in the letter without giving specific advice concerning any particular limitations period. The attorney should return any documents received from the prospective client and, if appropriate, recommend alternative counsel.

If the attorney decides to represent only one of two spouses, the attorney may wish to send a nonengagement letter to the other spouse clarifying this issue. Such a letter may be necessary, for instance, when the attorney drafts a spousal consent form for a business buy-out agreement for a general or limited partnership or a limited liability company. See chaps 5, 6, 11. See *Business Buy-Sell Agreements* §4.64 (Cal CEB 1991). If the attorney does not intend to represent the client's spouse in such a situation, the attorney should be sure to avoid giving legal advice to the spouse.

## **B. Engagement Letters**

### **§1.14 1. Written Fee Agreement**

Fee agreements for legal services in the formation and counseling of business entities generally must be in writing. See Bus & P C §6148. Fee agreements under §6148 constitute confidential communications between the attorney and client. Bus & P C §6149. Because of the nature of services offered by attorneys in the formation and counseling of business entities, contingent fee arrangements (governed by Bus & P C §6147) are not typically entered into or appropriate in this context.

An unwritten fee agreement is enforceable under Bus & P C §6148 under any of the following conditions:

- It is reasonably foreseeable that the total expense to the client, including fees and costs, will not exceed \$1000. Bus & P C §6148(a).
- Foreseeable prejudice to the rights or interests of a client presents an emergency need for legal services, or a writing is otherwise impractical. Bus & P C §6148(d)(1).
- An agreement regarding fees can be implied by the facts that (a) the attorney has previously rendered services of the same general kind and (b) the client has paid for them. Bus & P C §6148(d)(2).
- After full disclosure of Bus & P C §6148, the client knowingly states in writing that a written fee agreement is not required. Bus & P C §6148(d)(3).
- The client is a corporation. Bus & P C §6148(d)(4).

The emergency-need exception to the in-writing requirement is unlikely to apply to the formation of a business venture. The corporate client exception might apply if the client is a corporation that is a principal party in the formation of a limited partnership or limited liability company, but there is no exception from the written agreement requirement for a client organized in the form of any type of entity other than a corporation (*e.g.*, general or limited partnership, business trust, limited liability partnership, or limited liability company).

**Source:** Business Law/Selecting and Forming Business Entities/1 Attorney-Client Relationship/§1.15 2. Statutory Requirements Governing Fee Agreements

## **§1.15 2. Statutory Requirements Governing Fee Agreements**

Fee agreements must contain the following information:

- The general nature of the legal services to be provided to the client (Bus & P C §6148(a)(2));
- The respective responsibilities of the attorney and client in performing the agreement (Bus & P C §6148(a)(3));  
and
- The hourly and other standard rates, including fees and charges that apply to the representation (Bus & P C §6148(a)(1)).

Unless exempt from the requirements of Bus & P C §6148, a fee agreement that does not comply with these requirements is voidable at the client's option. If the agreement is voided by the client, however, the attorney remains entitled to collect a reasonable fee for services rendered. Bus & P C §6148(c). In *In re Harney* (1995) 3 Cal St Bar Ct Rep 266, 1995 Cal Op Lexis 17, the Review Department of the State Bar Court held that violation of Bus & P C §§6147-6148 should not be considered disciplinable offenses.

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**Source:** Business Law/Selecting and Forming Business Entities/1 Attorney-Client Relationship/ 3. Attorney Fees/§1.16  
a. Amount of Fee

### **3. Attorney Fees**

#### **§1.16 a. Amount of Fee**

Under Cal Rules of Prof Cond 4-200(A), an attorney may not enter into an agreement for, charge, or collect an illegal or unconscionable fee. Unconscionability is determined on the basis of all facts and circumstances existing at the time the agreement is entered into, unless the parties intend the fee to be affected by later events. Once established in a written agreement, the fee may not be increased by the unilateral act of the attorney. See *Severson & Werson v Bolinger* (1991) 235 CA3d 1569, 1 CR2d 531.

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**§1.17            b. Advance Fees**

An engagement agreement may provide for the payment of advance fees, *i.e.*, fees received from a client for work or services to be performed after the fees are received. Prepaid fees may be called nonrefundable fees, minimum fees, flat fees, or similar designations. On nonrefundable fees, see §1.18.

With the exception of true retainer fees (see *Baranowski v State Bar* (1979) 24 C3d 153, 164 n4, 154 CR 752), there is no universal agreement on the proper treatment of advance fees. Some consider fees paid in advance to be funds held by the attorney for the client's benefit until the agreed-upon services have been rendered. Under this view, the funds belong to the client until earned and should be maintained in the attorney's client trust account. Others believe that such fees belong to the attorney and need not be placed in the trust account. To avoid misunderstandings, this issue should be addressed and resolved in the engagement letter.

If, for example, the engagement letter provides that client funds are received as security for fees to be paid to the attorney for future services, the funds must be deposited in the client trust account and promptly withdrawn by the attorney when earned. Cal Rules of Prof Cond 4-100. "No funds belonging to the member... shall be deposited" in the trust account. Cal Rules of Prof Cond 4-100(A). When funds belong in part to the attorney and in part to the client, "the portion belonging to the member or law firm must be withdrawn at the earliest reasonable time after the member's interest in that portion becomes fixed." Cal Rules of Prof Cond 4-100(A)(2). In other words, an attorney cannot commingle his or her funds with funds belonging to a client or, in effect, commingle attorney funds with funds belonging to a client by keeping funds in a trust account after the attorney's right to those funds becomes fixed (*i.e.*, after the fees have been earned).

**Source:** Business Law/Selecting and Forming Business Entities/1 Attorney-Client Relationship/§1.18 c. Nonrefundable Fees

### **§1.18 c. Nonrefundable Fees**

Attorneys sometimes attempt to protect themselves against defaulting clients by providing that the deposit for fees will be partially or fully nonrefundable. There is no explicit statutory or ethical prohibition against nonrefundable fees. As a general rule, attorney and client are free to contract as they wish regarding fees. See CCP §1021.

However, to be enforceable, a provision for nonrefundable fees must comply with Cal Rules of Prof Cond 4-200 (member may not charge or agree to illegal or unconscionable fee). In addition, Cal Rules of Prof Cond 3-700(D)(2) provides that an attorney whose employment has terminated must promptly "refund any part of a fee paid in advance that has not been earned." Failure to refund an unearned fee can result in discipline. See *Matthew v State Bar* (1989) 49 C3d 784, 263 CR 660; *In re Lais* (1998) 3 Cal St Bar Ct Rptr 907, 1998 Cal Op Lexis 11. The refund requirement does not apply "to a true retainer fee which is paid solely for the purpose of ensuring the availability of the member for the matter." Cal Rules of Prof Cond 3-700(D)(2).

For a nonrefundable fee clause that may be included in the engagement letter, see §1.31.

**CAVEAT:** Attorneys should be aware of the risk that a nonrefundable fee will be found to be refundable in any particular fee dispute. See Peck, *Nonrefundable Fees and Toxic Fee Provisions*, Cal Law 14 (June 2006).

**Source:** Business Law/Selecting and Forming Business Entities/1 Attorney-Client Relationship/§1.19 d. Financial Arrangements Among Attorneys

**§1.19 d. Financial Arrangements Among Attorneys**

When the engagement agreement includes a provision for division of attorney fees among attorneys who are not partners, members, or employees of the same firm, the client must consent in writing to the arrangement after full written disclosure. Cal Rules of Prof Cond 2-200. Further, the total fee charged may not be increased solely because of this division, and the fee may not be unconscionable. Cal Rules of Prof Cond 2-200.

Absent client consent, an agreement between attorneys to divide a fee is unenforceable unless they are members of the same firm. See *Scolinos v Kolts* (1995) 37 CA4th 635, 44 CR2d 31. Not only is client consent required, the agreement must be in writing and signed by the attorneys and client for the provision dividing attorney fees to be enforceable. See *Margolin v Shemaria* (2000) 85 CA4th 891, 102 CR2d 502.

Rule 2-200 applies in every instance in which the amount of compensation paid to the outside attorney is based on fees received from the client or client matter. Rule 2-200 applies irrespective of whether the fee paid to the outside attorney is for work performed or for referring the client matter. See *Chambers v Kay* (2002) 29 C4th 142, 126 CR2d 536.

However, the outside attorney may be entitled to compensation based on quantum meruit even though the requirements of Rule 2-200 are not complied with. See *Huskinson & Brown v Appel & Wolf* (2004) 32 C4th 453, 9 CR3d 693.

## **§1.20 4. Arbitration Provisions**

A written agreement to submit an existing controversy or one arising thereafter to arbitration is valid and enforceable. CCP §1281. See *Grafton Partners LP v Superior Court* (2005) 36 C4th 944, 955, 32 CR3d 5 (distinguishing arbitration agreements from predispute jury trial waivers and specifically upholding the former). Clearly worded arbitration clauses in initial fee agreements are enforceable with respect to fee disputes, malpractice claims, or any other issues that the parties may wish to submit to arbitration as a way to resolve any disputes that arise between them. See *Powers v Dickson, Carlson & Campillo* (1997) 54 CA4th 1102, 63 CR2d 261.

A client may not be forced to submit to binding arbitration of a fee dispute, however, even if the original fee agreement provides for it. Under the Mandatory Fee Arbitration Act (MFAA) (Bus & P C §§6200-6206), the arbitrator's decision is advisory, rather than binding, absent a written agreement signed by the parties to the dispute. Under the MFAA, the parties may only agree to binding arbitration after a fee dispute arises. Bus & P C §6204(a). In addition, arbitration is voluntary for the client but mandatory for an attorney if started by the client. Bus & P C §6200(c). If the parties have not agreed that the MFAA arbitration will be binding, either party may seek a trial de novo after the arbitrator's decision. Bus & P C §6204(a). Moreover, if the parties have not agreed that the arbitration will be binding, a party unhappy with the result of the arbitration is entitled to invoke a pre-existing contractual agreement to arbitrate under the California Arbitration Act (CAA) (CCP 1280-1294.2). *Schatz v Allen Matkins Leck Gamble & Mallory LLP* (2009) 45 C4th 557, 87 CR3d 700.

The attorney must notify the client of the right to arbitrate through the mandatory fee arbitration program before initiating arbitration through another forum. This notice cannot be given until after a fee dispute has actually arisen. Bus & P C §6201(a).

The California Supreme Court has held that an attorney fee agreement containing a provision for arbitration of any fee dispute is enforceable against the client unless the client chooses to accept the benefits of the mandatory fee arbitration program under the MFAA. If the client fails to invoke his or her rights under the MFAA, then the fee agreement's arbitration provisions are enforceable. *Aguilar v Lerner* (2004) 32 C4th 974, 12 CR3d 287; *Ervin, Cohen & Jessup, LLP v Kassel* (2007) 147 CA4th 821, 54 CR3d 685.

Compliance with the mandatory fee arbitration act does not prevent any subsequent action by the client based on the same facts that formed the basis of the fee dispute. *Liska v Arns Law Firm* (2004) 117 CA4th 275, 12 CR3d 21.

When a malpractice claim is asserted in the context of a fee dispute, the arbitrator in the mandatory fee arbitration program (see Bus & P C §§6200-6204.5) may not award affirmative relief, in the form of damages or offset or otherwise, for injuries related to the malpractice claim. See *Fagelbaum & Heller LLP v Smylie* (2009) 174 CA4th 1351, 1362, 95 CR3d 252 (former client waived right to MFAA arbitration of fee dispute by requesting affirmative relief for firm's alleged malpractice (citing Bus & P C §6201(d)(2))). Evidence relating to claims of malpractice and professional misconduct, however, may be admitted by the arbitrator to the extent that those claims bear on the fees, costs, or both, to which the attorney is entitled. Bus & P C §6203(a).

With respect to modifying existing fee agreements to include arbitration provisions, ethical considerations require that the attorney fully disclose the terms and consequences of the provision and that the client knowingly consent. See *Mayhem v Benninghoff* (1997) 53 CA4th 1365, 62 CR2d 27 (discussing ethical considerations after professional relationship has begun).

The statute also provides for mediation of fee disputes. See Bus & P C §6200(c). For a fee dispute arbitration provision, see §1.32. For malpractice arbitration clauses, see §1.33.

**Source:** Business Law/Selecting and Forming Business Entities/1 Attorney-Client Relationship/§1.21 5. Judicial Reference as Alternative to Arbitration

## **§1.21 5. Judicial Reference as Alternative to Arbitration**

In some situations, the attorney may not wish to have arbitration provisions in the engagement letter. An alternative would be to provide that disputes concerning fees or attorney malpractice be heard by a "judicial reference." The judicial reference procedure is set forth in CCP §§638-645.2. It provides that a referee may be appointed on agreement of the parties to hear and make a determination on any or all of the issues and "to report a statement of decision." CCP §638(a). When the referee is appointed by agreement of the parties (a referee may also be appointed by the court on its own motion or the motion of any party; see CCP §639), the referee's decision becomes the decision of the court, and judgment may be entered on it. CCP §644(a). For a judicial reference clause that may be included in the engagement letter, see §1.34.

**NOTE:** The engagement letter should include either a provision for arbitration or one for judicial reference. Otherwise, there is a risk that fee disputes will be decided by jury trial. The California Supreme Court has held that the parties may not waive the right to jury trial before a dispute arises. *Grafton Partners LP v Superior Court* (2005) 36 C4th 944, 32 CR3d 5.

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**§1.22            6. Other Matters**

In addition to the possibilities discussed in §§1.14-1.21, a written fee agreement may be used to:

- Establish the time the attorney-client relationship begins;
- Define the termination of the engagement;
- Explain conflicts of interest between jointly represented clients and between attorneys and their clients;
- Obtain waivers of such conflicts;
- Confirm that the "client" is the business entity to be formed rather than the entity's owners; or
- If necessary, comply with the duty to inform a client in writing if the attorney does not carry professional liability insurance (Cal Rules of Prof Cond 3-410).

The agreement may also clarify the scope of the engagement (see, *e.g.*, form in §1.36, which excludes tax advice from the scope of services to be rendered) and explain when the attorney may withdraw from, and the client may terminate, the relationship (see §1.37). It might also be prudent that the fee agreement identify which individual is the responsible client representative, *i.e.*, the person the attorney reports to and can look to as having the authority to bind the client with respect to the various determinations that need to be made in rendering the legal services. See §1.28.

For an example of a complete written fee agreement, see §§1.27-1.42. For a more detailed discussion and examples of relevant fee clauses, see *Fee Agreement Forms Manual* (2d ed Cal CEB 2007).

**Source:** Business Law/Selecting and Forming Business Entities/1 Attorney-Client Relationship/§1.23 7. Checklist: Elements to Consider for Inclusion in Engagement Letter

## §1.23 7. Checklist: Elements to Consider for Inclusion in Engagement Letter

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- Identification of the client(s).
- Identification of other party(ies) to the transaction.
- Identification of other participants, e.g., accountants, investment bankers, or tax or securities specialists.
- Significant areas of responsibility for the attorney.
- If the attorney is authorized to engage outside experts, the identification of those experts and agreement on who will be responsible for paying them.
- Whether work will be delegated to attorneys within the firm.
- If time is a critical factor, the timetable for accomplishing significant tasks.
- The extent of the attorney's authority.
- The responsibilities of the client or clients.
- In a partnership or corporation, who will be responsible for communications with the attorney and have decisionmaking authority.
- The billing arrangement.
- If a retainer is being paid, its terms and conditions, including:
  - Is it refundable?
  - Is it earned when paid?
  - Will it bear interest, and, if so, for whom?
  - Is it applicable to fees, expenses, or both?
  - Must it be replenished and, if so, when?
- Whether the attorney is receiving security for payment and, if so, its terms.
- Disclosure of actual or potential conflicts of interest and of the actual and reasonably foreseeable adverse consequences to the client.
- Whether the attorney representing a partnership is authorized to continue to represent that entity even if its interests conflict with those of a partner.
- Whether the client has been advised to seek separate counsel before entering into the engagement agreement and, if so, whether the client has consulted with independent counsel or has declined to do so.
- If multiple clients are to be represented, disclosure of actual or potential conflicts of interest and of actual and reasonably foreseeable consequences to the clients of such conflicts, such as an explanation of the limits of the attorney-client privilege and the risk of future withdrawal of the attorney and need for all clients to retain new counsel.
- Written disclosure if the attorney does not carry professional liability insurance (see Cal Rules of Prof Cond 3-410).

*Comment:* An engagement letter need not contain all these provisions. On the required contents of an engagement letter, see §1.15. The attorney should draft an engagement letter to reflect the attorney's own needs for completeness, the relative sophistication of the client, the attorney's historical relationship with the client, the level of economic risk that the representation entails for the attorney, and other business and practical considerations relevant to the engagement.



## **C. Disengagement Letters**

### **§1.24 1. Disengagement Letter on Completion of Legal Services**

A disengagement letter may be necessary in two different situations. One would be to advise the client that the attorney has completed the legal services specified in the engagement agreement. When it is used for this reason, a disengagement letter accomplishes the same goal as a nonengagement letter, *i.e.*, it informs the client that the attorney will not be rendering any additional services unless the client indicates otherwise. If the attorney has not addressed client file retention issues in the engagement letter (*e.g.*, who will retain the original copies of documents), it would be appropriate to do so in the disengagement letter.

For a disengagement letter advising the client that the attorney has completed the agreed-on legal services, see form in §1.43.

**Source:** Business Law/Selecting and Forming Business Entities/1 Attorney-Client Relationship/§1.25 2. Disengagement Letter Terminating Professional Relationship Before Legal Services Completed

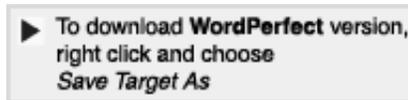
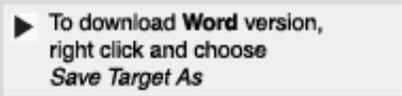
**§1.25            2. Disengagement Letter Terminating Professional Relationship Before Legal Services Completed**

In addition to the use discussed in §1.24, above, a disengagement letter also may be used is to advise the client that the attorney has decided to terminate the professional relationship before the attorney has completed the services for which he or she was hired. In *Gonzalez v Kalu* (2006) 140 CA4th 21, 43 CR3d 866, the court held that CCP §340.6, which provides a 1-year statute of limitations for malpractice suits, is tolled as long as the client believes the attorney is still representing the client in the matter. The decision in *Gonzalez* underscores the importance of using disengagement letters in situations when the agreed-on services may not have been completed. For a form of disengagement letter terminating the professional relationship before the completion of legal services, see form in §1.44.

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#### IV. FORMS

##### §1.26 A. Form: Nonengagement Letter



[Law firm letterhead]

\_\_ [Date] \_\_

\_\_ [Name and address of nonclient] \_\_

Dear \_\_ [Name of nonclient] \_\_:

**This letter confirms that you \_\_ [contacted me by \_\_ [telephone/letter] \_\_ /met with me] \_\_ on \_\_ [date] \_\_ to discuss \_\_ [describe subject matter or problem] \_\_ and whether this firm would be willing to represent you as your attorney. I have reviewed the matter \_\_ [together with all the documents you \_\_ [sent me/left with me] \_\_ ] \_\_. Unfortunately, I have concluded that the firm will not be able to represent you in this matter.**

**In concluding that the firm will not be able to represent you, neither I nor this firm is expressing an opinion of the merits of your \_\_ [matter/case] \_\_. You should not refrain from seeking legal assistance from another firm because of our decision not to represent you. Because any advice or opinions given during our initial consultation were only preliminary and not based on a thorough analysis of your \_\_ [matter/case] \_\_, you should not rely on these comments. Instead, you should seek the advice of another attorney.**

**It is important for you to know that every legal matter has deadlines. Failure to meet those deadlines can cause you to lose \_\_ [your case/important legal rights] \_\_. Because there may be critical dates that I have not mentioned, you should take steps to immediately contact another attorney to preserve any rights you may have. \_\_ [You may wish to contact \_\_ [name and address of attorney] \_\_, who may be able to assist you in this matter.] \_\_**

**Because this office has not given you any legal advice or agreed to represent you, there is no charge for any legal fees or expenses. Thank you for the opportunity to review this \_\_ [matter/case] \_\_.**

\_\_ [Enclosed are the materials you furnished for my review.] \_\_

**Sincerely yours,**

\_\_ [Name of law firm] \_\_

**By:** \_\_ [Signature of attorney] \_\_

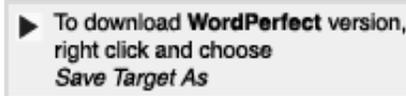
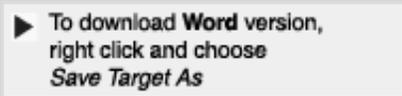
\_\_ [Typed name] \_\_

**Source:** Business Law/Selecting and Forming Business Entities/1 Attorney-Client Relationship/ B. Engagement Letter/  
§1.27 1. Form: Salutation and Introduction

## B. Engagement Letter

### §1.27 1. Form: Salutation and Introduction

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §1.27 and ends in §1.42



1.27-1 Salutation and introduction

*[Law firm letterhead]*

\_\_ *[Date]* \_\_

\_\_ *[Name and address of \_\_ [sole client/first party of multiple clients] \_\_ ]* \_\_

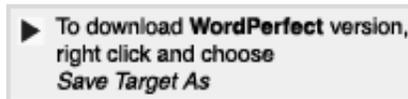
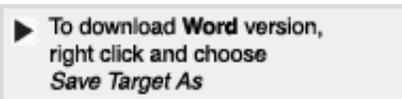
\_\_ *[Name and address of second party of multiple clients]* \_\_

Dear \_\_ *[Name(s) of client(s)]* \_\_:

**As we have discussed, I have prepared this letter to set out the details of our relationship, our agreement for the legal services to be provided, and the fees and costs relating to such services. If this letter accurately describes the services we are to perform for you and the terms for payment of the resulting legal fees and expenses that you will incur, please countersign one of the duplicate originals of this letter and return it to us. This agreement will not take effect, and we will have no obligation to provide legal services, until you return a fully executed copy to us.**

## §1.28 2. Form: Legal Services

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §1.27 and ends in §1.42



1.28-1 Legal services

**Legal Services.** You have asked us to provide legal services on your behalf. The legal services to be provided by us consist of our representing you in \_\_[describe scope of legal services to be rendered, e.g., organization of a new entity for your proposed business venture, to be known as \_\_[name of proposed entity]\_\_ (the Company)]\_\_\_. These services include analysis and consultation to confirm the appropriateness of the company form for your business and to determine the structure of the Company. The services also include preparation of organization documents and related documents and preparation and filing of any documents or notices necessary to comply with federal or state securities laws and regulations applicable to the entity mutually decided on. Unless otherwise mutually agreed in writing, our services do not include advising on or obtaining business licenses, permits, bonds, or insurance; reviewing proposed leases, employment agreements, sales agreements, or other transactional documents; or drafting buy-sell agreements for the Company's owners.

If you wish that we provide any legal services not covered by this agreement, a separate written agreement between you and us may be required. Any such additional services will be provided on the terms and at the hourly rates described in this agreement unless covered by a separate written agreement.

We will perform the legal services called for under this agreement, keep you informed of progress and developments, and respond promptly to your inquiries and communications. You will cooperate with us to the extent necessary to complete the services described in this letter; keep us reasonably informed of developments, changes in your legal status, and your address, telephone numbers, and whereabouts; and timely make any payments required by this agreement.

### §1.29 3. Form: Attorney Fees and Costs

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §1.27 and ends in §1.42

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#### 1.29-1 Attorney fees

**Fees.** You will pay us attorney fees for the legal services provided under this agreement at the respective hourly rates of the individuals providing the services. The rates fall within the following ranges: \$ \_\_[amount]\_\_ to \$ \_\_[amount]\_\_ per hour for partners; \$ \_\_[amount]\_\_ to \$ \_\_[amount]\_\_ per hour for associates; \$ \_\_[amount]\_\_ to \$ \_\_[amount]\_\_ per hour for law clerks; and \$ \_\_[amount]\_\_ to \$ \_\_[amount]\_\_ per hour for paralegals. If we change these rates in the future, we will apply the new rates to work done 30 days after receipt of written notice from the firm of those rate changes. If you choose not to consent to the changed rates, you may terminate our services under this agreement by written notice effective when we receive it.

We will charge in increments of \_\_[specify unit, e.g., one-tenth of an hour]\_\_, rounded off for each particular activity to the nearest \_\_[specify unit, e.g., one-tenth of an hour]\_\_. The minimum time charged for any particular activity will be \_\_[specify unit, e.g., one-tenth of an hour]\_\_.

We will charge for all activities undertaken in providing legal services to you under this agreement, including but not limited to the following: conferences (including preparation and participation), review and preparation of correspondence and legal documents, legal research, and telephone conversations. When two or more of our firm's personnel are engaged in working on the matter at the same time, such as in conferences between them or with you, the time of each will be charged.

#### 1.29-2 Costs

**Costs.** In addition to paying fees for legal services under this agreement, you will reimburse us for all costs we incur on your behalf in rendering such services. These costs include but are not limited to the following: all postage, telephone tolls, photocopying costs (at \$ \_\_[amount]\_\_ per page for in-house copying and invoice cost for outside vendor copying charges), word-processing charges (at \$ \_\_[amount]\_\_ per hour), express delivery charges, travel expenses, filing fees, and other similar costs.

## §1.30 4. Form: Estimated Fees and Costs

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §1.27 and ends in §1.42

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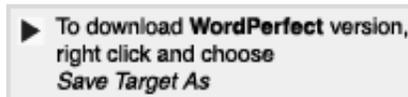
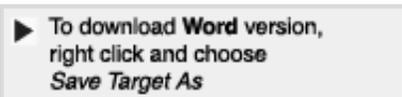
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1.30-1 Estimated fees and costs

***Estimated Fees and Costs.*** We estimate that the total amount of fees and costs for the services described in this letter will be approximately \$ \_\_[amount]\_\_ if the organization is structured generally in the manner discussed in our meeting of \_\_[date]\_\_. You understand that the amount of such fees may vary significantly from the estimate in the event of material changes to the transaction as it is currently proposed or as a result of unforeseen circumstances or developments. We will endeavor to keep you apprised if we anticipate any significant changes to such estimated fees during the course of the engagement, but we may not always be able to predict the timing or magnitude of such changes. Nevertheless, you acknowledge that we have not agreed to any maximum fee or any other promise about the total amount of legal fees and costs to be incurred by you under this agreement.

## §1.31 5. Form: Payment of Fees and Costs

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §1.27 and ends in §1.42



1.31-1 Payment of fees and costs

[Add one of the following alternatives]

[Alternative 1: Advance fees]

**Payment of Fees.** You will pay to us an initial deposit of \$ \_\_[amount]\_\_ , to be received by us before we begin our engagement for legal services. We will deposit this amount in a trust account as an advance against fees and costs to be incurred. You authorize us to withdraw the principal from the trust account to pay attorney fees and costs as they are incurred by you. If, at the termination of services under this agreement, the total amount incurred by you for attorney fees and costs is less than the amount of the initial deposit, the difference will be refunded to you. Whenever the full amount of any deposit has been applied to attorney fees or costs incurred by you, we may, at our option, request you to pay an additional deposit in an amount to be determined in our reasonable discretion. Deposit of such additional amounts will be made in the same manner as the initial deposit.

We will send monthly statements to you indicating attorney fees and costs incurred and their basis, any amounts applied from client trust account deposits, and any current balance owed. You will pay any balance in full within 30 days after the statement is mailed. Any balance remaining unpaid after 30 days will bear interest at the rate of \_\_[number]\_\_ percent per annum but in no event higher than the maximum interest permitted by law.

[Alternative 2: Nonrefundable fees]

**Payment of Fees.** We will charge you an initial nonrefundable fee of \$ \_\_[amount]\_\_ , which will be credited against fees, costs, and expenses incurred. This cash payment will be due and payable on execution of this agreement and will, under all circumstances, be nonrefundable. We will bill against this amount at our hourly rates, as set forth above, and also for the payment of other costs and expenses incurred, as set forth in the preceding paragraph. If, and when, our charges for legal services and expenses exceed \$ \_\_[amount]\_\_ , you will be responsible for paying all additional fees and expenses as they are incurred. In no event will any portion of this initial nonrefundable fee be refunded.

[If applicable, add the following option to Alternative 2]

[Option: Trial retainer]

In addition to the provisions relating to the initial nonrefundable fee in the preceding paragraph, if it becomes necessary for us to prepare for a trial, you agree to pay us a trial retainer no later than 2 weeks after we conclude that it is necessary to prepare for the trial. The amount of the trial retainer will be based on the estimated fees, costs, and expenses which may be incurred in trial preparation, in attendance at trial, and for related expenses. The amount of the trial retainer will be determined in consultation with you and deposited in our client trust account, and funds will be withdrawn and credited against actual fees and expenses incurred. Upon our rendering of a final statement for services, we will refund any credit balance due you remaining in our client trust account or you will pay any outstanding balance then due.

*Comment:* For a discussion of nonrefundable fees, see §1.18.

**Source:** Business Law/Selecting and Forming Business Entities/1 Attorney-Client Relationship/§1.32 6. Form: Arbitration of Fee Disputes

## §1.32 6. Form: Arbitration of Fee Disputes

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1.32-1 Arbitration of fee disputes

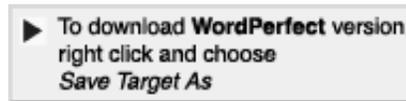
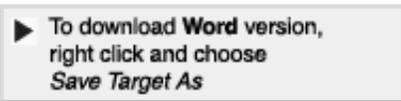
***Arbitration of Fee Disputes.*** If there is any disagreement between the parties to this agreement concerning fees, this agreement, or any other claim, including a claim of attorney malpractice, relating to your legal matter that arises out of your legal representation, you agree to submit that dispute to binding arbitration under the rules of the \_\_[*name of arbitration provider*]\_\_. The prevailing party will be entitled to reasonable attorney fees and costs incurred in enforcing any arbitration award or engaging in any court proceedings.

*Comment:* For a discussion of arbitration, see §1.20. As an alternative to arbitration, the attorney and the client may wish to provide for a determination of disputes by judicial reference. For a clause providing for judicial reference, see form 1.34-1. For a discussion of judicial reference, see §1.21.

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### §1.33 7. Form: Arbitration of Attorney Malpractice

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §1.27 and ends in §1.42



#### 1.33-1 Arbitration of attorney malpractice

**Arbitration of Attorney Malpractice.** If any dispute arises between the parties to this agreement regarding allegations of attorney malpractice, the parties agree that the dispute will be resolved by arbitration in accordance with Code of Civil Procedure §§1280-1294.2. The matter will be arbitrated in \_\_[city]\_\_, California, and will be decided by three arbitrators appointed as set forth below:

(1) Within \_\_[e.g., 30]\_\_ days after notice by either party to the other requesting arbitration and stating the basis of the party's claim, one arbitrator will be appointed by each party. Notice of the appointment will be given by each party to the other when made. If the other party fails to designate an arbitrator within the agreed time, the arbitrator appointed by the first party shall serve as sole arbitrator.

(2) When each party has appointed an arbitrator, the two arbitrators will immediately choose a third arbitrator to act with them. If the two arbitrators fail to select a third arbitrator within \_\_[e.g., 10]\_\_ days after the second arbitrator is appointed, at the request of either party, the additional arbitrator will be promptly appointed by \_\_[e.g., the Superior Court for the County of \_\_[county]\_\_, in accordance with Code of Civil Procedure §1281.6/the chair of the local bar association fee arbitration panel/other named individual]\_\_. The party making the application will give the other party \_\_[e.g., 10]\_\_ days' notice of the application.

#### 1.33-2 Definition of "service"

\_\_[Except as otherwise provided in this agreement, "service"/"Service"]\_\_ will include personal delivery as provided in Code of Civil Procedure §§413.10-413.40 (governing service of a summons) or the deposit of a writing in the United States mail in accordance with Code of Civil Procedure §§1010-1013a, except that Code of Civil Procedure §1013 (extending the time for exercising a right or performing an act) will not apply.

#### 1.33-3 Attorney fees and costs

All reasonable expenses incurred in the arbitration proceedings or in subsequent court proceedings to enforce the arbitration award, consisting of all fees and costs attributable to the arbitration or enforcement proceedings (including attorney fees, fees of expert witnesses, and arbitrator fees), will be awarded to the prevailing party. If a party either dismisses or abandons its claim or counterclaim before the rendering of an arbitrator's award and after commencement of the arbitration hearing, the other party will be considered to be the "prevailing party" under this agreement. If both parties receive an award on their respective claims, the party in whose favor the larger award is rendered will be considered to be the "prevailing party" under this agreement.

#### 1.33-4 Offers

At any time after the initiation of proceedings under the arbitration provisions of this agreement and not less than 30 days before the date set for commencement of the hearing, any party may serve a written offer on any other party to allow an award to be entered in accordance with the terms and conditions stated in the written offer. If the offer is accepted, the offer (together with the written acceptance of the offer) will be submitted to the arbitrator and an award will be entered in the same manner and with the same effect as if the award had been rendered after a full hearing before the arbitrator. If no written acceptance of the offer is served within 15 days before the date set for the commencement of the hearing or within 20 days after the offer is mailed (whichever occurs first), the offer will be considered to have been withdrawn and cannot be given in evidence at the arbitration hearing. If the party receiving the written offer fails to obtain a larger monetary or

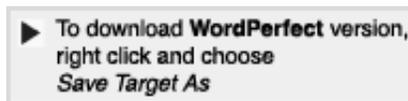
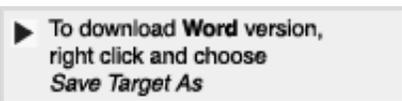
more beneficial arbitration award than that contained in the offer, the party to whom the offer was made must pay to the offering party the offering party's fees and costs (including attorney fees, fees of expert witnesses, and arbitrator fees). The offering party's fees and costs must be included in the arbitration award except to the extent that the arbitrator determines, based on clear and convincing evidence, that such fees and costs are unconscionable.

*Comment:* For a discussion of arbitration, see §1.20.

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## §1.34 8. Form: Judicial Reference of Disputes

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §1.27 and ends in §1.42



1.34-1 Judicial reference of disputes

***Judicial Reference of Disputes.*** Except to the extent that a dispute about attorney fees or attorney malpractice may be subject to the provisions of Business and Professions Code §§6200-6206, the attorney and client agree that in any civil action or proceeding involving a dispute arising out of or relating to this agreement, the action or proceeding shall be heard by a judicial reference, as provided in Code of Civil Procedure §§638-645.2. Except for disputes that may be subject to Business and Professions Code §§6200-6206, disputes arising out of this agreement include the reasonableness of the attorney's fees or costs incurred, the time expended by the attorney, the quality of legal services rendered by the attorney, issues relating to the timeliness, termination, or completion of the legal services provided, or any other issues arising out of or relating to this agreement.

The attorney and client agree to the appointment of a single referee and shall use their best efforts to agree on the selection of the referee. If the attorney and client are unable to agree on a referee within 10 calendar days of a written request to do so by either the attorney or client, either the attorney or client may thereafter seek to have a referee appointed under Code of Civil Procedure §§638 and 640.

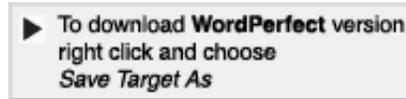
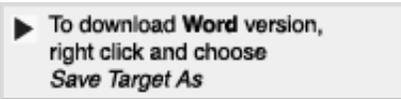
The attorney and client agree that the selected or appointed referee shall have the power to decide all issues in the action or proceeding, whether of fact or of law, and the referee shall issue a statement of decision on the issues.

*Comment:* This clause may be used as an alternative to the provisions for arbitration in the forms in §§1.32 and 1.33. On judicial reference as an alternative to arbitration, see §1.21.

**Source:** Business Law/Selecting and Forming Business Entities/1 Attorney-Client Relationship/§1.35 9. Form: Document Retention

## §1.35 9. Form: Document Retention

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §1.27 and ends in §1.42



1.35-1 Document retention

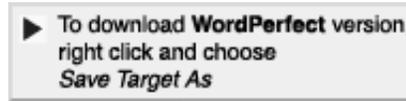
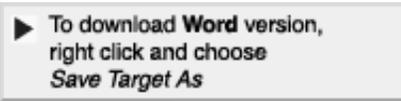
***Document Retention.*** It is our policy to retain and ultimately destroy all files, documents, records, and writings related to each engagement for which we have been retained without notifying clients or former clients of the destruction of these items. Therefore, to be certain that we have not retained any material that you may need or desire, we will return to you all original documents you made available to us (together with copies of any other files, documents, records, and writings relating to this engagement) if you instruct us in writing within 90 days after our mailing to you of our letter informing you that we have completed our services within the terms of this agreement.

*Comment:* This provision enables the firm to limit its responsibility for maintaining and storing client materials, shifting to the client any file-maintenance obligations. The firm will need to develop a file-retention policy before using this form, both with respect to clients' needs and with respect to the firm's own needs and decisions regarding maintaining or storing file material for its own uses and purposes. California State Bar Formal Opinion No. 2001-157 deals with the ethical duties of an attorney regarding the retention of former client files. The opinion is instructive in discussing the issues involved but does not set forth any specific time requirements for retaining client files after completing a representation.

**Source:** Business Law/Selecting and Forming Business Entities/1 Attorney-Client Relationship/§1.36 10. Form: Tax Advice

**§1.36 10. Form: Tax Advice**

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §1.27 and ends in §1.42



1.36-1 Tax advice

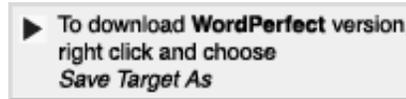
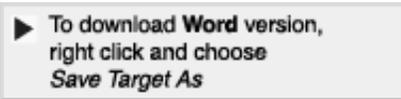
***Tax Advice.* Our firm has not been retained to provide you with any tax advice concerning this matter. Therefore, you should consult with your tax advisers about this matter and have them contact us so that we can coordinate our services with theirs consistent with your stated objectives.**

*Comment:* This provision illustrates the kind of exclusion a firm might include in an engagement letter to ensure that the client understands the limits or scope of the professional engagement.

**Source:** Business Law/Selecting and Forming Business Entities/1 Attorney-Client Relationship/§1.37 11. Form: Withdrawal and Termination

## §1.37 11. Form: Withdrawal and Termination

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §1.27 and ends in §1.42



1.37-1 Withdrawal and termination

***Withdrawal and Termination.*** Our firm reserves the right to withdraw from representing you if you fail to follow the terms of this agreement, you have misrepresented or failed to disclose material facts to the firm, or you choose not to follow our advice. If we are required to file a motion to withdraw as your attorneys, you have agreed that any of the above will constitute good cause for withdrawal. Good cause for withdrawal will also be any circumstance that would render our continuing representation unlawful or unethical. You retain the right to terminate this firm as your attorney at any time, in which case we ask to be advised of your decision in writing. On our termination, you will be responsible for the balance due us for costs and services rendered to the time of termination.

*Comment:* This provision is designed to impress on the client the responsibility the client has in the engagement and to remind the client that the quality of the firm's services will to a large extent depend on the facts and representations made by the client to the firm.

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**Source:** Business Law/Selecting and Forming Business Entities/1 Attorney-Client Relationship/§1.38 12. Form: Potential Conflicts of Interest--Individual Client

**§1.38 12. Form: Potential Conflicts of Interest—Individual Client**

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §1.27 and ends in §1.42

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1.38-1 Potential conflicts—individual client

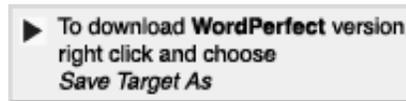
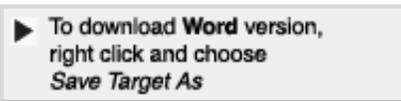
***Conflicts.*** As we have discussed with you, we do not believe, based on the information you have provided us, that our representation of you and the entity created by formation of the Company currently involves any objectionable conflicts of interest. You should be aware, however, that your individual interests and objectives on certain issues may become inconsistent with the interests and objectives of the Company.

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**Source:** Business Law/Selecting and Forming Business Entities/1 Attorney-Client Relationship/§1.39 13. Form: Potential Conflicts of Interest--Multiple Clients

### §1.39 13. Form: Potential Conflicts of Interest—Multiple Clients

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §1.27 and ends in §1.42



1.39-1 Potential conflicts—multiple clients

**Conflicts.** As we have discussed with you, we do not believe, based on the information you have provided us, that our representation of the multiple \_\_[e.g., owners of the Company]\_\_ and the entity created by formation of the Company currently involves any objectionable conflicts of interest. You should be aware, however, that your individual interests and objectives on certain issues may become inconsistent with the interests and objectives of the other \_\_[e.g., owners of the Company]\_\_ and the entity itself.

1.39-2 Balancing of interests

Our representation of multiple interests has significant implications that you should consider. For example, rather than our vigorously asserting a single client's interest on an issue, there likely will be a balancing of interests. Because parties to a new business venture have different talents, energy, and financial acumen, aggressive advocacy for a party could result in more favorable treatment for that party as compared with the more even-handed approach we would follow in representing multiple interests.

*[Explain general conflicts that may arise, such as the following]*

Participants' interests and objectives in the organization, financing, and management of the Company may differ with respect to their capital investments, liquidity needs, control objectives, allocations of profits and losses, individual tax postures, or other factors. In the formation of any company, an inherent conflict exists between the interests of members who will be active managers and the interests of those who will be passive investors in the business. Those who actively manage the company may seek to receive compensation based on a share of profits and may also receive separate salaries or fees for specific services. Those who have no active role in management typically depend solely on their share of the profits for a return on their investment. Accordingly, diverging interests among the members and other participants in the venture may arise at any point in the formation and operation of the Company. In particular, the participants in the venture have the following inherent conflicts of interests: \_\_[specify particular conflicts arising in connection with organization of company]\_\_.

1.39-3 Loss of attorney-client communications privilege

Our multiple representation will also result in the loss of the attorney-client privilege for communications between each of you and members of our firm. Thus, any communication relating to this engagement received by our firm from any party to this agreement will not be kept confidential from the others. Otherwise, the communicating party could force the attorney to withdraw from representing all the parties. For example, this situation may arise if the communicating party admits to fraudulent activities involving the Company.

1.39-4 Necessity of consents for representation

Further, in the event of a dispute among the Company members, partners, shareholders, and other participants, we may be precluded from further representing the Company or any individual party without first obtaining the consent of all concerned. In addition, any consenting party may withdraw his, her, or its consent to our multiple representation at any time, in which event we would be required to discontinue our representation of all parties to this agreement.

1.39-5 Rules governing representation of multiple clients

For these reasons, our normal practice is to represent only one party. You have advised us, however, that

none of you currently wishes to seek other counsel and instead that you wish that we represent your multiple interests in the formation of the entity. As attorneys, we are governed by specific rules relating to our representation of clients when present or potential conflicts of interest exist. Some of these rules are described below:

(1) We may not accept or continue representation of a client without providing written disclosure to the client if we have a legal, business, financial, professional, or personal relationship with a party in the same matter or if we previously had such a relationship that would substantially affect our representation.

(2) We may not accept or continue representation of a client without providing written disclosure to the client if we have or had a legal, business, financial, professional, or personal relationship with another person or entity we know or reasonably should know would be substantially affected by resolution of the matter.

(3) We may not accept or continue representation of a client without providing written disclosure to the client if we have or had a legal, business, financial, professional, or personal interest in the subject matter of the representation.

(4) We may not, without the informed written consent of each client, (a) accept representation of more than one client in a matter in which the interests of the clients potentially conflict; (b) accept or continue representation of more than one client in a matter in which the interests of the clients actually conflict; or (c) represent a client in a matter and, at the same time in a separate matter, accept as a client a person or entity whose interest in the first matter is adverse to the client in the second matter.

(5) We may not, without the informed written consent of a client or former client, accept employment adverse to a client or former client if, by reason of the representation of the client or former client, we have obtained confidential information material to the employment.

In representing an organization, certain special rules apply:

(1) We must conform our representation to the concept that the client is the organization itself, acting through its highest authorized officer, employee, body, or constituent overseeing the particular engagement.

(2) In dealing with an organization's directors, officers, employees, members, shareholders, or other constituents, we must explain the identity of the client for whom we act whenever it is or becomes apparent that the organization's interests are or may become adverse to those of the constituent or constituents with whom we are dealing.

(3) We must not mislead a constituent into believing that it may communicate information to us in a way that will keep the information confidential from the organization or other constituents being represented by the firm.

In order to comply with these rules that are designed to protect the separate interests of participants in the Company, we request that each of you sign and return to us a copy of this letter acknowledging that:

(1) You have been advised of the conflicts associated with your respective interests and of your right to obtain independent legal counsel regarding these conflicts;

(2) You have had an opportunity to obtain independent counsel regarding this consent; and

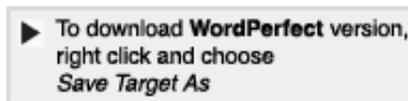
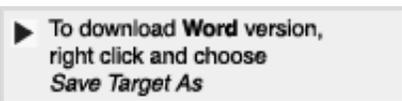
(3) You nevertheless want us to represent you in connection with the matters discussed above.

1.39-6 Right to seek independent counsel

We want to stress that each of you remains completely free to seek independent counsel at any time even if you decide to sign the consent set forth below. We strongly urge you to do so if you have any questions concerning your individual interests. Should you have any questions concerning this letter or the consent, please discuss them with us, or seek the advice of independent counsel, before signing and returning the enclosed copy of this letter.

#### §1.40 14. Form: Waiver of Conflict of Interest—Client and Another Client of Firm

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §1.27 and ends in §1.42



1.40-1 Waiver of conflict of interest-client and another client of the firm

**Conflicts.** As we have discussed with you, you have retained us in connection with \_\_ [describe legal services to be rendered, e.g., organization of a corporation for your proposed business venture] \_\_. We currently represent \_\_ [name of other client] \_\_ in connection with various legal matters unrelated to your matter. We believe that there may be a conflict of interest between you and \_\_ [name of other client] \_\_ because \_\_ [reason for conflict] \_\_.

Despite the fact that we have made the foregoing disclosures to you, two ethical considerations are raised by this type of legal representation. The first ethical consideration is the potential for, or your perception of, divided loyalties on our part. For instance, you might become concerned that our representation of you might potentially be negatively affected by our representation of \_\_ [name of other client] \_\_ in connection with current or subsequent matters unrelated to your matter. We agree that our representation of you shall not be negatively affected by our representation of \_\_ [name of other client] \_\_ in connection with current or subsequent matters unrelated to the your matter. In reliance on such assurance, you hereby agree that our representation of \_\_ [name of other client] \_\_ in connection with current or subsequent matters unrelated to your matter does not present such a concern.

The second ethical consideration is the sharing of confidential client information. Confidential information which we have obtained, or may obtain, from our representation of you is protected from disclosure to \_\_ [name of other client] \_\_ and any other third party, by the attorney-client privilege and attorney work-product doctrine and shall not, therefore, be disclosed.

Other potential conflicts of interest could exist as a result of our representation of you and \_\_ [name of other client] \_\_. As a practical matter, it is impossible to anticipate and describe all potential conflicts of interest that could arise. Because such conflicts of interest could arise, however, we must ask you to make an informed acknowledgment of the terms and limits of our representation.

In this regard, we must advise you of the following terms and provisions of the California Rules of Professional Conduct Rule 3-310 which provides:

*If a member has or had a relationship with another party interested in the representation, or has an interest in its subject matter, the member shall not accept or continue such representation without all affected clients' informed written consent.*

*A member shall not concurrently represent clients whose interests potentially conflict, except with their informed written consent.*

*A member shall not accept employment adverse to a client or former client where, by reason of the representation of the client or former client, the member has obtained confidential information material to the employment except with the informed written consent of the client or former client.*

*As used in this rule "informed" means full disclosure to the client of the circumstances and advice to the client of any actual or reasonably foreseeable adverse effects of those circumstances upon the representation.*

By signing below, you acknowledge your informed consent to our present representation of \_\_ [name of other client] \_\_ with respect to matters unrelated to your matter in accordance with the provisions of this letter. You acknowledge and agree that at no time will our representation of \_\_ [name of other client] \_\_ with respect to

**matters unrelated to your matter in strict compliance with all ethical rules and with the provisions of this letter, be construed, claimed, or deemed to be a conflict of interest or a breach or violation of our fiduciary duty to you.**

**We shall secure a similar conflict waiver from \_\_ *[name of other client]* \_\_.**

**You are urged to consult with independent counsel or other advisors in evaluating this written waiver. If additional information or details are required in this regard, please contact the undersigned at your earliest convenience.**

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**Source:** Business Law/Selecting and Forming Business Entities/1 Attorney-Client Relationship/§1.41 15. Form: Closing and Signature

## §1.41 15. Form: Closing and Signature

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1.41-1 Closing and signature

**On receipt of the above fees and costs deposit and an executed duplicate original copy of this agreement, we will begin rendering the legal services outlined above. We look forward to working with you on your new business venture.**

**Sincerely yours,**

\_\_ *[Name of law firm]* \_\_

**By:** \_\_ *[Signature of attorney]* \_\_  
\_\_ *[Typed name]* \_\_

## §1.42 16. Form: Client Consent

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §1.27 and ends in §1.42

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1.42-1 Client consent

[Add one of the following alternatives]

[Alternative 1: Individual client]

### CONSENT

The undersigned has read the foregoing terms for the provision of legal services by \_\_ *[name of law firm]* \_\_ and agrees to these terms and conditions.

Date: \_ \_ \_ \_ \_                      \_\_ *[Signature of client]* \_\_  
  \_\_ *[Typed name]* \_\_  
  \_\_ *[Capacity]* \_\_

[Alternative 2: Multiple clients]

### CONSENT

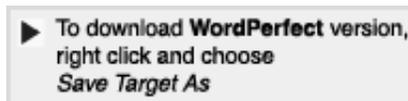
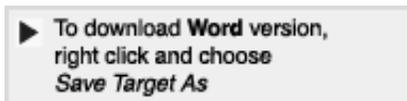
\_\_ *[Name of attorney]* \_\_ of \_\_ *[name of law firm]* \_\_ (Law Firm) has explained to each of the undersigned the present and future conflicting interests in the formation of \_\_ *[name of proposed business entity]* \_\_ (Company) and has informed each of us of the possible consequences of these conflicts and the fact that there is no attorney-client privilege protecting confidential communications between the Law Firm, the Company, and all the undersigned.

We acknowledge and understand that, on the formation of the Company, the Law Firm will represent the Company and will not represent the individual interests of any of us. We understand that we have the right, and acknowledge that we have had the opportunity, to seek independent counsel before signing this consent. We also understand that we have the right to seek independent counsel at any time in the future. Each of the undersigned nevertheless desires and consents to representation by the Law Firm to the extent described above.

Date: \_ \_ \_ \_ \_                      \_\_ *[Signature of first client]* \_\_  
  \_\_ *[Typed name]* \_\_  
  \_\_ *[Capacity]* \_\_

Date: \_ \_ \_ \_ \_                      \_\_ *[Signature of second client]* \_\_  
  \_\_ *[Typed name]* \_\_  
  \_\_ *[Capacity]* \_\_

§1.43 C. Form: Disengagement Letter on Completion of Services



[Law firm letterhead]

\_\_ [Date] \_\_

\_\_ [Name and address of \_\_ [sole client/first party of multiple clients] \_\_ ] \_\_

\_\_ [Name and address of second party of multiple clients] \_\_

RE: \_\_ [Title of matter] \_\_

Dear \_\_ [Name(s) of client(s)] \_\_:

Enclosed please find the executed final documents relating to the above matter, together with our closing statement reflecting the balance of fees and costs due us for our services. It is our understanding that we have completed the assignment for which you have retained us.

Now that this matter has been concluded, we have designated it as a closed file. It will be retained and ultimately destroyed in accordance with our office file retention policies. During our representation, we have provided you with copies of all the significant documents in the above matter and urge you to preserve your copies of those documents so that you will have access to them if needed. Please advise us, however, if you believe that work still remains to be done by us or if you expect us to perform any follow-up tasks.

We have returned to you all original documents that you made available to us. Because it is our policy to ultimately dispose of all closed files, please let us know immediately if you want the original or a copy of anything in our closed file. Unless we hear from you within 90 days after we mail this letter, we will assume that nothing in our closed file needs to be retained by us for your use or benefit or returned to you.

If you have any question about any of the above information or matters, please let us hear from you at your earliest convenience. We have appreciated working with you and hope to continue serving your legal needs in the future.

Sincerely yours,

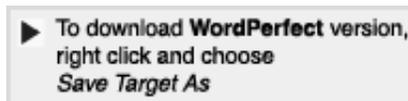
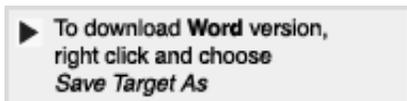
\_\_ [Name of law firm] \_\_

By: \_\_ [Signature of attorney] \_\_

\_\_ [Typed name] \_\_

*Comment:* This letter sets forth a basic file retention policy that should be modified as appropriate for the attorney and client. On what constitutes a "client file" and the ethical considerations involved in file disposal, see SF Bar Ass'n Legal Ethics Committee Formal Opinion 1996-1. On the use of disengagement letters generally, see §§1.24-1.25.

§1.44 D. Form: Disengagement Letter Before Services Completed



[Law firm letterhead]

\_\_ [Date] \_\_  
\_\_ [Name and address of \_\_ [sole client/first party of multiple clients] \_\_ ] \_\_  
\_\_ [Name and address of second party of multiple clients] \_\_

RE: \_\_ [Title of matter] \_\_

Dear \_\_ [Name(s) of client(s)] \_\_:

Pursuant to our fee engagement letter dated \_\_ [date] \_\_, we are exercising our right to terminate our representation of you in the above matter.

We regret that it is not feasible for us to continue any representation of you, and we will not represent you for any purpose on or after \_\_ [date] \_\_.

[If applicable, add the following option]

[Option: Pending litigation matter]

We are enclosing a substitution of attorneys which will substitute you as your own attorney so that you may seek other counsel. We would appreciate your signing this and returning it in the enclosed envelope. Once you have done so, you are your own attorney, and you will be receiving notices from other attorneys as to which you may have to seek the advice of other counsel or respond promptly.

Additionally, there are certain rigid time limitations which must be met in your pursuit of this matter. We do not undertake to advise you as to such limitations. If you intend to pursue this matter, we suggest you seek advice from other counsel without delay so he or she may advise you accordingly. We will, of course, cooperate with any lawyer representing you by providing him or her with your file materials and discussing the matter with him or her.

[Continue]

If you need a lawyer referral, the \_\_ [name of county] \_\_ County Bar Association's Lawyer Referral Service may be of assistance to you. Again, we are sorry that we are unable to continue your representation.

Sincerely yours,

\_\_ [Name of law firm] \_\_

By: \_\_ [Signature of attorney] \_\_

\_\_ [Typed name] \_\_

*Comment:* If applicable, enclose a substitution of attorney form and a self-addressed stamped envelope. On the use of a disengagement letter to terminate representation before legal services are completed, see §1.25.

## 2

# Evaluating Entity Choices

Carol A. Brittain  
W. Rod Stern

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**§2.1 I. SCOPE OF CHAPTER**

To assist attorneys in deciding which form of business entity to recommend to clients, this chapter identifies the differences among sole proprietorships, corporations (both C and S corporations), general partnerships, limited partnerships, limited liability companies (LLCs), and limited liability partnerships (LLPs), with brief discussion of other forms available to operate a business.

Following in §§2.2-2.97 is a brief overview of the types of forms and entities through which business may be conducted in California. Sections 2.98-2.199 analyze factors to consider in choosing an appropriate form or entity for the business. Notification of tax authorities upon an entity's formation is included in §§2.200-2.203. Charts comparing the business and tax aspects of common entities and an initial client interview sheet concerning business aspects of the proposed enterprise are included in §§2.204-2.205. The chapter also includes forms to obtain federal and state tax identification numbers and the Secretary of State's list of business entity filing fees. See §§2.207-2.209.

**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.2 II.  
CHARACTERISTICS OF MAJOR BUSINESS ENTITIES

## **§2.2 II. CHARACTERISTICS OF MAJOR BUSINESS ENTITIES**

One of the first and most important decisions a business owner makes is to choose the legal form or entity through which the business will be operated. The forms of business available in California provide varying levels of personal asset protection for the business owner, various tax advantages and disadvantages, complexity or simplicity of operation of the business, and other characteristics and choices. The traditional business forms of sole proprietorship, corporation and partnership were joined in the mid 1990s by newer forms of limited liability entities, all discussed and compared in §§2.3-2.97 below, along with brief reference to other less common forms of business entities. More detail on each of these forms of business is found in the following chapters.

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**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.3 A. Sole Proprietorships

### **§2.3 A. Sole Proprietorships**

A sole proprietorship is the simplest form of business organization, in which an individual engages in business personally and without either co-owners or the use of an entity such as a corporation. A sole proprietorship avoids many of the formalities and reporting requirements of business entities, but the business owner is personally liable for the debts and obligations of the business.

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**§2.4 1. Formation**

Creating a sole proprietorship does not involve registration with any governmental agency, except possible filings to obtain a local or municipal government business license and a fictitious business name (also called colloquially a "DBA," for "doing business as"). If a fictitious business name is used, the owner must file a DBA with the county recorder in the county where the proprietorship's principal place of business is located and may also file in any other county. Bus & P C §17915. The filing fee is usually modest. Periodic renewals of registrations are required. On obtaining a fictitious business name, see §§3.8-3.12.

**§2.5            2. Personal Liability**

A sole proprietor has unlimited personal liability for the debts and obligations of the business. Possible alternatives to a sole proprietorship are formation of an S or C corporation (see §8.5) or a single-member limited liability company (LLC) (see chap 11), which provide protection from personal liability. See §§2.17, 2.38. If more than one owner is involved, the business is a partnership. See §§2.49-2.59; chap 5.

**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.6 3. Anonymity

**§2.6            3. Anonymity**

A sole proprietor operates the business under his or her own name or under a fictitious business name (DBA) application and registration, in which the owner's name is public record.

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**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.7 4. Management and Control

**§2.7            4. Management and Control**

A sole proprietor is the manager and operator of the business, but he or she may have employees.

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**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.8 5. Working Capital

**§2.8            5. Working Capital**

A sole proprietor funds the business either out of personal funds and property or with borrowed funds, which he or she would be personally liable to repay.

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**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.9 6. Securities Issues

**§2.9            6. Securities Issues**

A sole proprietorship issues no stock or other securities.

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**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.10 7. Change of Ownership

**§2.10            7. Change of Ownership**

If a sole proprietor ceases to operate the business, it terminates. Alternatively, the assets and liabilities of the sole proprietorship can be sold to a buyer, at which time the business terminates. If a new owner is added to the business in addition to the sole proprietor, the business becomes a partnership, unless an entity such as a corporation or LLC is formed.

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**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.11 8. Termination

**§2.11            8. Termination**

A sole proprietorship terminates when the owner discontinues the business, winding up any pending obligations, contracts, and registrations (such as business licenses or permits) and completes all required tax filings regarding income, employees, and related matters.

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**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.12 9. Who May Operate as Sole Proprietor

**§2.12 9. Who May Operate as Sole Proprietor**

All businesses may operate as sole proprietorships. Attorneys, accountants, architects, and medical professionals may also offer their professional services as sole proprietors.

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**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.13 10. Taxation

**§2.13      10. Taxation**

Income and expenses of a sole proprietorship are reported as personal income and expenses on Schedule C of the owner's federal and state income tax returns. See IRC §§61(a), 62(a); Rev & T C §§17071-17072. Employment taxes and workers' compensation insurance must be paid on employees' wages.

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**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.14 11. Estate Planning

**§2.14 11. Estate Planning**

Sole proprietorships do not provide tax advantages for estate planning purposes.

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**§2.15 B. Corporations**

A corporation is a limited liability entity in which the owners, called *shareholders*, are generally not liable for the corporation's debts and obligations solely by reason of the owners' status as shareholders. Corporations formed "for profit" are governed by the General Corporation Law (Corp C §§100-2319) of California's Corporations Code. For a comprehensive discussion of corporations, see chap 8. See also *Organizing Corporations in California* (3d ed Cal CEB 2001).

Professional corporations are formed as "for profit" corporations and include additional restrictive language in their articles of incorporation, limiting ownership to certain licensed professionals. For a detailed discussion of professional corporations, see chap 10.

Nonprofit corporations, which are not discussed in this publication, are governed by Corp C §§5000-10841. For additional information on nonprofit corporations, see *Advising California Nonprofit Corporations* (3d ed Cal CEB 2009).

**§2.16 1. Formation**

A corporation is created by filing articles of incorporation with the Secretary of State and payment of a filing fee, currently \$100. Corp C §200(c); Govt C §12186(c). In addition, bylaws must be adopted, setting forth the corporate housekeeping rules of the corporation. The shareholders may negotiate and enter into an optional, separate shareholder "buy-sell" agreement including restrictions on the sale or transfer of shares, a formula for valuation of the shares upon a transfer, supermajority voting provisions, and other clauses.

**§2.17      2. Personal Liability**

Shareholders are not personally liable for corporate debts and obligations unless the shareholders:

- Personally guarantee corporate debts or obligations;
- Engage in tortious conduct;
- Receive improper distributions;
- Are subject to "alter ego" claims for commingling personal and corporate matters; or
- Breach duties to other shareholders or the corporation.

Shareholders who also serve as officers and directors may have additional liability exposure due to the additional control they have over corporate matters.

**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.18 3. Anonymity

**§2.18      3. Anonymity**

Shareholders' names are not public record, but other shareholders may obtain the names from the corporation's records. Names of officers and directors are public record.

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**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.19 4. Management and Control

**§2.19            4. Management and Control**

In a corporation, the incorporators appoint the initial directors, unless the directors are named in the articles of incorporation. See Corp C §210. Following the issuance of shares, the shareholders annually elect a board of directors who set policy for the corporation. The board of directors then elects officers to manage the day-to-day affairs of the corporation. Officers include at least a president, a corporate secretary, and a treasurer/chief financial officer. Shareholders exercise no management functions in the corporation, and if they do (except as duly elected directors or officers), the shareholders risk losing their limited liability protection.

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**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.20 5. Working Capital; Shares Issued

## **§2.20 5. Working Capital; Shares Issued**

Shareholders contribute assets (either cash or property) to the corporation, in exchange for shares of stock. If the assets contributed are non-cash, the fair market value of the assets establishes the price of the stock, as determined by the board of directors. A corporation may issue one or more classes or series of common or preferred stock with full, limited, or no voting rights and with other rights, preferences, privileges, and restrictions as stated in the articles of incorporation or a separate document. At least one class or series of stock must have voting rights and unlimited dividend and liquidation rights. Corp C §400(a). By varying the rights of different classes and series of stock, some shareholders may have superior rights with regard to voting control, distributions, and other aspects.

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**§2.21            6. Securities Issues**

Shares of stock in a corporation are generally characterized as securities. All offers and sales of securities in California require qualification with the Commissioner of Corporations unless either the transaction or the security itself is exempted from qualification. The securities laws of other states (so-called "blue sky" laws) may also apply to offers or sales of stock made outside California. In addition, federal securities laws should be considered. Regulatory filings may be required either to qualify an offering and sale or to receive an exemption. Corp C §§25000-25707; 10 Cal Code Regs §§250.9-260.617. See §8.7; Financing and Protecting California Businesses (Cal CEB 2006). See also Marsh & Volk, Practice Under the California Securities Laws (rev ed 1973). For federal securities law practice, see Loss & Seligman, Fundamentals of Securities Regulation (5th ed 2004).

**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.22 7. Change of Ownership

**§2.22            7. Change of Ownership**

A shareholder can readily transfer stock to a new owner, subject to restrictive agreements among shareholders (sometimes called shareholder "buy-sell" agreements), restrictions in a close corporation's articles of incorporation (see §9.26), and securities law requirements. Change of ownership does not dissolve or terminate a corporation.

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**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.23 8. Termination

**§2.23            8. Termination**

A corporation usually has no fixed termination date and can be dissolved by action of 50 percent or more of the voting power of the corporation's shareholders and the filing of a certificate of election with the Secretary of State. Corp C §§204(a)(4), 1900(a), 1901.

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**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.24 9. Who May Form Corporations or Professional Corporations

**§2.24 9. Who May Form Corporations or Professional Corporations**

One or more natural persons, partnerships, associations, or domestic or foreign corporations may form a corporation. Corp C 200(a).

Professionals permitted to form professional corporations are attorneys, accountants, and architects, as well as dentists, nurses, chiropractors, psychologists, clinical social workers, and others. See §10.4. "Professional services" do not include services provided by businesses which require only a nonprofessional, occupational license under the Business and Professions Code. See 87 Ops Cal Atty Gen 109 (2004). See also chap 10.

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**§2.25      10. Taxation**

A new corporation is always formed under state law and will be taxed under IRC subchapter C unless an election is made to be taxed under subchapter S. If no election is made, the corporation is referred to as a "C corporation" or "C corp." Net income of a C corp is taxable by both the federal and state governments at corporate tax rates. See §2.121. In addition, if the C corporation makes a distribution of dividends to its shareholders, the shareholders report the dividends received as income and must pay federal and state income taxes on the dividends. This is commonly referred to as "double taxation," because the C corporation's net income is taxed twice: first at the corporate level, and again if distributed as dividends to the shareholders. A corporation cannot deduct as an expense dividend payments made to shareholders.

Double taxation may be minimized in certain cases by the payment of wages to shareholder-employees, by payment of fair market rent or royalties to use assets owned by a shareholder, or by payment of fair market interest on a debt owed to a shareholder. In addition, a corporation that retains most of its income as capital reinvestment in the business may benefit from the corporate tax structure because the marginal rates applicable to corporations may be lower than the marginal rates applicable to individuals. See §2.121.

California corporations must pay a minimum annual tax of \$800 (called a *franchise tax*) to the State of California's Franchise Tax Board for the privilege of doing business. Employment taxes and workers' compensation insurance must be paid on employees' wages.

**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.26 11. Estate Planning

**§2.26 11. Estate Planning**

C corporations may provide some tax advantages for estate planning.

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**§2.27 C. S Corporations**

The shareholders of a corporation (see §2.15) may elect for the corporation to be taxed under IRC subchapter S, if the corporation meets certain qualifications to become an S corporation, including a maximum of 100 shareholders; the shareholders must be individuals who are United States citizens or legal United States residents, or must be a certain type of trust or estate, and must have only one class of stock. When a qualified trust is a shareholder of an S corporation, each potential current beneficiary of the trust is treated as a separate shareholder. Treas Reg §1.1361-1(e)(1). Related shareholders, whether owning shares directly or by deemed ownership as a beneficiary of a trust, may be treated as a single shareholder pursuant to family attribution rules. Treas Reg §1.1361-1(e)(3).

Such a corporation is sometimes referred to as an "S corporation" or "S corp."

Except as provided in §§2.28-2.30 below, all comments in §§2.15-2.26 above concerning C corps also apply to S corps. For restrictions on a corporation's ability to qualify as an S corp, see §2.129; see generally §§2.128-2.134.

**§2.28 1. Formation**

Formalities of creation for an S corporation are the same as for a C corporation (see §2.16), with an additional action by the shareholders to elect S corporation status and filing IRC Form 2553 to that effect with the Internal Revenue Service as well as Form 100S with the Franchise Tax Board. There is currently no fee to file the form with the IRS to become an S corp. An S corp is permitted to have up to 100 shareholders, all of whom (with some narrow exceptions) must be natural persons and cannot be non-resident aliens. It cannot have more than one class of stock. IRC §1361(b)(1). Shares that differ only as to voting rights are deemed to be the same class of shares.

**NOTE:** The Service has provided a simplified method for taxpayers to request relief for a late S corporation election and a late corporate classification election intended to be effective on the same date that the S corporation election was intended to be effective. See Rev Proc 2007-62, 2007-41 Int Rev Bull 786.

**§2.29            2. Taxation**

The advantage over a C corporation is that an S corporation's net income, losses, and tax credits are for California and federal tax purposes "passed through" to the corporation's shareholders, without being taxed at the corporate level. Thus "double taxation" is largely eliminated (except that California imposes a 1.5-percent tax on S corporation income; Rev & T C §§23151, 23501, 23802(b)(1)), with a tax result similar but not identical to that of a partnership. In all other respects, an S corp is operated as a C corp with regard to corporate governance by a board of directors and management by officers.

**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.30 3. Estate Planning

**§2.30            3. Estate Planning**

S corporations may provide some tax advantages in estate planning.

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**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.31 D. Close Corporations

## **§2.31 D. Close Corporations**

A close corporation (also called a statutory close corporation) is a corporation with no more than 35 shareholders who agree in writing to relax various corporate control and operating requirements otherwise required under the General Corporation Law. Corporations Code §300 specifies which provisions of the Code cannot be relaxed or varied. See §9.14.

Except as provided in §§2.32-2.35 below, all comments in §§2.15-2.26 above concerning C corporations also apply to close corporations.

For a comprehensive discussion of close corporations, see chap 9.

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**§2.32 1. Formation**

A close corporation is formed in the same way as any "for profit" corporation (see §2.16), with additional specific wording required in the articles of incorporation regarding election of close corporation status, placement of a legend on the stock certificates to that effect, and a written agreement among the corporation and its shareholders specifying the corporate formalities to be relaxed. Corp C §§300, 418(c). An existing corporation can also elect close corporation status by amending its articles of incorporation to add the required wording, but only if the amendment is approved by all shareholders. Corp C §158(b).

**§2.33            2. Termination**

A close corporation's existence is terminated in the same manner as any other corporation (see §2.23). Without terminating its existence, however, a close corporation can elect to become a regular C corp by amending its articles of incorporation to delete the provisions electing close corporation status, by the affirmative vote of two-thirds of each class of outstanding shares (or by a lesser percentage in some circumstances). Corp C §158(c).

**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.34 3. Taxation

**§2.34            3. Taxation**

A close corporation is taxed as a C corporation or, if the shareholders make an election to do so, as an S corporation. See §2.29.

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**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.35 4. Estate Planning

**§2.35            4. Estate Planning**

Close corporations may provide some tax advantages in estate planning and may reduce estate tax by use of a shareholder "buy-sell" agreement that restricts shareholder rights and thereby reduces the fair market value of the shares. See generally Corp C §300.

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**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.36 E. Limited Liability Companies (LLCs)

**§2.36 E. Limited Liability Companies (LLCs)**

A limited liability company (LLC) is a non-corporate business organization with one or more owners (called *members*) who normally do not have personal liability for the debts and obligations of the LLC. See Corp C §17101(a). See also Corp C §§17000-17656 (Beverly-Killea Limited Liability Company Act). An LLC may be described as a hybrid of a corporation (with limited liability for its members) with the tax attributes of a partnership (eliminating double taxation on the entity's income as well as on distributions to the members, with tax levied only at a single level).

For a comprehensive discussion of LLCs, see chap 11; see also *Forming and Operating California Limited Liability Companies* (2d ed Cal CEB 2007).

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**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.37 1. Formation

**§2.37 1. Formation**

An LLC is created by filing executed articles of organization on Form LLC-1 with the Secretary of State and payment of a filing fee, currently \$70. Corp C §§17050(a), 17051 (contents); Govt C §12190(b). Members enter into an operating agreement among themselves to establish operational and financial aspects of the LLC's operation. An oral operating agreement among the members is legally sufficient, but a written agreement is recommended for certainty of the terms intended.

**NOTE:** A business entity, including an LLC, that comes into existence after the establishment of a contract made on its behalf or in its name may enforce that preorganization contract if it adopted or ratified the agreement. *02 Dev., LLC v 607 S. Park, LLC* (2008) 159 CA4th 609, 71 CR3d 608.

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**§2.38 2. Personal Liability**

Members of an LLC are not personally liable for debts and obligations of the LLC, unless the members:

- Personally guarantee debts of the LLC;
- Participate in tortious conduct;
- Receive improper distributions; or
- Are subject to "alter ego" claims for commingling personal and LLC matters.

Members who also serve as managers may have additional liability due to the additional control they have over LLC matters, to the extent they engage in improper conduct,.

**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.39 3. Anonymity

**§2.39            3. Anonymity**

Names of LLC managers are public record due to filings with the Secretary of State. Unless members serve as managers, their names are not public record.

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**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.40 4. Management and Control

**§2.40            4. Management and Control**

LLCs are structured more flexibly than corporations, vesting management in one or more managers (who may but need not be members) and consolidating all aspects of and agreements about the LLC's operations and finances in a single document called an operating agreement. If permitted by the operating agreement, an LLC's managers (whether members or non-members) may for convenience in dealing with third parties have officer titles such as president, secretary, and CFO/treasurer, and the LLC may have a board of directors. An operating agreement need not be written, but a written agreement is recommended for certainty of the terms intended.

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**§2.41 5. Working Capital; Membership Interests Issued**

An LLC is funded through its members' capital contributions of cash and property, and through loans from its members and third parties. In exchange for their capital contributions, members receive membership interests issued by the LLC as provided in the articles of organization, in the LLC operating agreement, or (if not specified in the operating agreement) upon the vote of a majority in interest of the other members, followed by execution of the LLC operating agreement. Corp C §§17100(a). Unless the articles of organization or the operating agreement provide otherwise, members are not required to contribute funding in excess of their original capital contributions. Corp C §17200(b).

By varying the rights of different classes of membership interests, some members may have superior rights with regard to voting control, distributions, and other aspects. Corp C §17102. Because of the organizational and structural flexibility of LLCs, the ability of members to engage actively in management without risk of liability, and the ability of members to receive special allocations and deduct losses, LLCs may be attractive to investors in real estate ventures.

**§2.42            6. Securities Issues**

Whether membership interests in a particular LLC constitute securities under the federal securities laws is determined on a case-by-case basis. A membership interest in an LLC constitutes a security under the California Corporate Securities Law of 1968 (Corp C §§25000-25707) unless all the members engage actively in the management of the LLC. Corp C §25019.

All offers and sales of securities in California require qualification with the Commissioner of Corporations unless either the transaction or the security itself is exempted from qualification. The securities laws of other states (so-called "blue sky" laws) may also apply to offers or sales of membership interests outside California. Federal securities laws should also be considered. Regulatory filings may be required either to qualify an offering and sale or to receive an exemption. Corp C §§25000-25707; 10 Cal Code Regs §§250.9-260.617. See §11.11; see also Forming and Operating California Limited Liability Companies, chap 12 (2d ed Cal CEB 2007). See also Marsh & Volk, Practice Under the California Securities Laws (rev ed 1973). For federal securities law practice, see Loss & Seligman, Fundamentals of Securities Regulation (5th ed 2004).

If a member transfers or assigns a membership interest to a third party, and if the assignee is not then admitted to the LLC as a member (see §2.43), the assignee has no rights to participate in the management of the LLC. Without management rights, the assignee holds a passive investment that may be classified as a security. See §11.9.

**§2.43 7. Change of Ownership**

If a member transfers or assigns a membership interest to a third party, the assignee becomes a member of the LLC only upon the affirmative vote of a majority in interest of the other members (except as otherwise provided in the articles of organization or in the operating agreement), followed by execution of the operating agreement. Corp C §§17100(a), 17303(a).

If an assignee is not admitted as a member of the LLC, the assignee holds only an "economic interest" in the LLC, meaning that the assignee is entitled to share in the income, gains, losses, deductions, distributions and other economic aspects of the LLC, but has no voting or management rights and (with certain exceptions) no right to information about the LLC's business and affairs. Corp C §§17001(n), (z), 17106. See §2.42.

The operating agreement may provide for the termination, in whole or in part, of a member's membership interest or economic interest in the LLC. Any such provision in the operating agreement is enforceable according to its terms, unless the member establishes that the provision was unreasonable at the time the operating agreement was made. If a member's economic interest is so terminated, then the member is entitled to receive a return of his or her contribution. Corp C §§17100(c), 17005(b).

**§2.44            8. Termination**

An LLC is dissolved and its affairs wound up at the time or on events (if any) specified in the articles of organization or a written operating agreement, or by the affirmative vote of a majority in interest of the members (or a greater percentage if specified in the articles or operating agreement). The LLC's managers then file a certificate of dissolution with the Secretary of State. Corp C §17350. Notwithstanding the filing of a certificate of dissolution, a majority in interest of the LLC's members may file a certificate of continuation. Corp C §17357.

**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.45 9. Who May Form LLCs

**§2.45 9. Who May Form LLCs**

One or more individuals, partnerships, limited partnerships, trusts, estates, associations, corporations, LLCs, or other entities may form an LLC. Corp C §§17001(t), (x), (ae).

LLCs may not be formed to render professional services, as defined in Corp C §§13401(a) and 13401.3. Corp C §17375. See Forming and Operating California Limited Liability Companies §7.13 (2d ed Cal CEB 2007). Therefore, attorneys, accountants, architects, and medical professionals are not permitted to practice through an LLC. For information on entities available to these professionals, see §2.97 and chap 10.

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**§2.46 10. Taxation**

Like a partnership, an LLC is generally not subject to federal or California income tax (unless it elects to be taxed as a corporation). See §§2.25, 2.117, 2.145. California permits the formation of single-member LLCs. Corp C §§17001(t), 17050(b). A single-member LLC is treated as a sole proprietorship for federal and California income tax purposes unless the LLC elects to be treated as a corporation. See §2.117.

An LLC must pay a minimum annual franchise tax of \$800 to the State of California's Franchise Tax Board, plus a statutory fee of an additional \$900 or more for any year in which the LLC's total gross revenue from all sources derived from or attributable to California is \$250,000 or more. Rev & T C §17942(a). See §2.158.

**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.47 11. Estate Planning

**§2.47 11. Estate Planning**

LLCs may provide some tax advantages for estate planning.

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**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.48 F. General Partnerships

**§2.48 F. General Partnerships**

A general partnership is an association of two or more persons to carry on a business as co-owners, whether or not the persons intend to form a partnership. Corp C §§16101(9), 16202(a). Individuals and entities may be partners in a general partnership. Corp C §16101(13). A partnership is an entity distinct from its partners and may be formed by written, oral, or implied agreement among the partners. See Corp C §§16101(8), 16201. Although an oral or implied agreement among the partners is legally sufficient to create a general partnership, a written partnership agreement is recommended for certainty of the terms intended.

For discussion of general partnerships, see chap 5; see also Advising California Partnerships, chap 5 (3d ed Cal CEB 1999).

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**§2.49 1. Formation**

Creating a general partnership currently requires no filing with the Secretary of State or any other governmental authority. However, a general partnership may file a statement of partnership authority (see Corp C §16303(a)) with the Secretary of State's office along with a filing fee, currently \$70. Corp C §16113(a); Govt C §12187(a). The general partnership may also record its partnership agreement at the county level at the county recorder's office where the general partnership is located. See Corp C §16303(b).

**§2.50            2. Personal Liability**

General partners are personally liable, jointly and severally, for all debts and obligations and most wrongdoing of the partnership, unless agreed otherwise by the claimant or provided by law, and except for any partnership obligation incurred before a person is admitted as a partner. Corp C §16306(a)-(b). A judgment against a partnership may not be satisfied from a partner's separate assets unless there is also a separate judgment against the partner individually, or under other specified circumstances. Corp C §16307(c)-(d). All partners have fiduciary duties of loyalty and care to each other. Corp C §16404.

**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.51 3. Anonymity

**§2.51            3. Anonymity**

Names of general partners are public record only if a statement of partnership authority (Corp C §16303) or a fictitious business name application is filed or the partnership agreement is recorded. A fictitious business name is sometimes referred to colloquially as a "DBA," meaning "doing business as."

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**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.52 4. Management and Control

**§2.52            4. Management and Control**

General partnerships do not have a board of directors or officers as corporations do, but instead are managed and operated by the partners themselves, although a partnership may have employees. Each partner is an agent of the partnership and can bind the partnership in the ordinary course of business. Corp C §16301(1).

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**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.53 5. Working Capital; Partnership Interests Issued

**§2.53 5. Working Capital; Partnership Interests Issued**

A general partnership's working capital usually comes from partners' contributions of cash and property and may come from secured or unsecured loans from partners or third parties. General partnerships are usually not attractive investments to passive investors because of personal liability for partnership debts and obligations and the lack of easy transferability of partnership interests. Unless otherwise provided in the partnership agreement, each partner is entitled to receive an equal share of the partnership profits and a share of the partnership losses in proportion to the partner's share of the profits. Corp C §16401(b).

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**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.54 6. Securities

**§2.54          6. Securities**

Ownership interests in a general partnership are usually not characterized as securities, due to the personal involvement of the partners in management of the business.

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**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.55 7. Change of Ownership

**§2.55            7. Change of Ownership**

All partners must agree to the admission of new partners. Corp C §16401(i). Unless the partnership agreement provides otherwise, a general partner may assign his or her economic interest in the general partnership, but the assignee is entitled only to an economic interest and does not become a partner. Such an assignment does not by itself cause the dissolution of the partnership or the dissociation of the assignor. Corp C §16503.

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**§2.56 8. Termination**

Dissociation of a partner (whether through withdrawal, retirement, or death) does not necessarily result in dissolution and winding up of a general partnership. A partnership formed for a definite term or undertaking is dissolved and wound up on dissociation of a partner unless a majority in interest of the remaining partners agrees within 90 days to continue the partnership. Corp C §16801(2). By contrast, a partnership at will (that is, without a definite term or undertaking) is dissolved on a dissociation only on the affirmative vote of at least half the partners. Corp C §16801(1). The partnership agreement may vary these provisions.

On dissolution, all the partners may agree to reconstitute as a new partnership to carry on the business of the dissolved partnership. Corp C §16802.

**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.57 9. Who May Form General Partnerships

**§2.57 9. Who May Form General Partnerships**

Two or more individuals, corporations, business trusts, estates, trusts, partnerships, limited partnerships, LLCs, associations, joint ventures, governments (and subdivisions, agencies, and instrumentalities), and other legal or commercial entities may form a general partnership. See Corp C §16101(9), (13). Attorneys, accountants, architects, and medical professionals may practice as general partnerships, but personal liability is joint and several among all partners. Therefore a limited liability entity such as a professional corporation or a limited liability partnership (LLP) may be preferable. See §2.97; see also chaps 7, 10.

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**§2.58      10. Taxation**

Although a general partnership is generally not subject to federal income tax or to California income or franchise tax, the partnership's net income and losses are reportable on the partnership's tax return and the percentage of income and loss allocated to each partner is reported on each individual partner's personal income tax return. See §§2.116, 2.135. Employment taxes and workers' compensation insurance must be paid on employees' wages.

**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.59 11. Estate Planning

**§2.59 11. Estate Planning**

General partnerships do not provide tax advantages for estate planning purposes.

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**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.60 G. Limited Partnerships

## **§2.60 G. Limited Partnerships**

**NOTE:** As of January 1, 2010, the Uniform Limited Partnership Act of 2008 (Re-RULPA) (Corp C §§15900-15912.07) became applicable to all California limited partnerships, with a few exceptional transition provisions described in Corp C §§15912.01-15912.07. As of January 1, 2008, Re-RULPA governs foreign limited partnerships whenever formed (Corp C §15912.04). The Corporations Code sections cited below refer to Re-RULPA.

A limited partnership is a partnership formed by two or more persons or entities and having *both* (1) one or more *general partners*, who engage actively in the management and control of the business and have unlimited personal liability for the partnership's debts and obligations, *and* (2) one or more *limited partners*, who are not personally liable for the partnership's debts and obligations unless they participate in the control of the business. Corp C §§15901.02(m), (p), (y).

For discussion of limited partnerships, see chap 6; see also *Advising California Partnerships*, chap 7 (3d ed Cal CEB 1999).

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**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.61 1. Formation

**§2.61 1. Formation**

A limited partnership is formed by the partners signing and acknowledging a Certificate of Limited Partnership (Secretary of State Form LP-1), recording it with the Secretary of State, and paying a filing fee, currently \$70. Corp C §15902.01; Govt C §12188(b). An oral partnership agreement among the partners is legally sufficient, but a written partnership agreement is recommended for certainty of the terms intended. Corp C §§15901.02(x), 15902.01.

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**§2.62            2. Personal Liability**

The general partner(s) of a limited partnership can be an individual or an entity such as a corporation. Corp C §15901.02(y). If the general partner is an entity with limited liability (such as a corporation or limited liability company (LLC)), then the owners of the general partner avoid the personal liability an individual general partner could incur, but use of an entity as a general partner increases the administrative and accounting costs associated with operation of two entities (*i.e.*, the limited partnership itself and a limited-liability general partner).

*General partner(s)* of a limited partnership are, jointly and severally, personally liable for partnership obligations to the same extent as a general partner of a general partnership.

*Limited partner(s)* are not personally liable for partnership debts and obligations, unless they participate in control of the partnership business. If the limited partnership operates outside California, the laws of other states may apply in determining a limited partner's liability.

**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.63 3. Anonymity

**§2.63            3. Anonymity**

Names of general partners appear on the certificate of limited partnership filed with the Secretary of State and are public record. Names of limited partners are not public record.

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**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.64 4. Management and Control

**§2.64      4. Management and Control**

General partner(s) manage the business of a limited partnership and may receive a salary or other payment for doing so. Limited partners who also participate in management of the partnership risk losing their limited liability protection.

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**§2.65 5. Working Capital; Partnership Interests Issued**

Partners contribute cash and property to the limited partnership in exchange for their ownership interests. Because of limited liability and pass-through tax treatment, limited partnership interests are attractive to certain passive investors, especially in connection with real estate ventures and tax-advantaged investments. However, because limited partners cannot participate in management without the risk of incurring general partner liability, a limited partnership investment is generally unattractive to venture capitalists.

Both general and limited partnership interests can be issued in more than one class, with the limited partnership agreement establishing the rights, powers, and duties of each class, including with regard to voting. Corp C §§15903.07, 15904.09. By varying the rights of different classes of partnership interest, some partners may have superior rights with regard to voting control, distributions, and other aspects.

**§2.66            6. Securities Issues**

Limited partnership interests are generally characterized as securities. All offers and sales of securities in California require qualification with the Commissioner of Corporations unless either the transaction or the security itself is exempted from qualification. The securities laws of other states (so-called "blue sky" laws) may also apply. Filings may be required either to qualify an offering and sale or to receive an exemption. Corp C §§25000-25707; 10 Cal Code Reg §§250.9-260.617. See §6.8; see also Financing and Protecting California Businesses (Cal CEB 2006).

**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.67 7. Change of Ownership

**§2.67            7. Change of Ownership**

A limited partnership interest is personal property and is transferrable in whole or in part. A transfer does not dissolve a limited partnership or entitle the transferee to become a partner or to exercise any rights of a partner. Corp C §§15907.01-15907.02.

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**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/ a. Departing Partners/  
§2.68 (1) Under CRLPA

**a. Departing Partners**

**§2.68 (1) Under CRLPA**

As of January 1, 2010, the California Revised Limited Partnership Act (CRLPA) (former Corp C §§15611-15723) no longer governs limited partnerships (other than in a few transitional situations), and dissociation of a partner is governed by Re-RULPA. See §2.69.

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**§2.69 (2) Under Re-RULPA**

A *general partner* has the power to dissociate at any time, but the general partner may be liable to the limited partnership if the dissociation is wrongful, for example, in breach of the limited partnership agreement or prior to the termination of the limited partnership. Corp C §§15906.03-15906.04.

A *limited partner* has no right to dissociate from the limited partnership before the termination of the limited partnership, but the limited partner may be dissociated by permission or action of the limited partnership. Corp C §15906.01.

**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/ b. New Partners/§2.70 (1)  
Under CRLPA

**b. New Partners**

**§2.70 (1) Under CRLPA**

As of January 1, 2010, CRLPA no longer governs limited partnerships (other than in a few exceptional transitional situations), and admission of a partner is governed by Re-RULPA. See §2.71.

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**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.71 (2) Under Re-RULPA

**§2.71 (2) Under Re-RULPA**

A new *general partner* is admitted as provided in the limited partnership agreement, as the result of a conversion or merger, or with the consent of the limited partners on departure of a previous general partner. Corp C §§15904.01, 15908.01(c)(2).

A new *limited partner* is admitted as provided in the limited partnership agreement, as the result of a conversion or merger, or with the consent of all the partners. Corp C §15903.01.

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**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/ 8. Termination/§2.72 a. Under CRLPA

## **8. Termination**

### **§2.72 a. Under CRLPA**

As of January 1, 2010, CRLPA no longer governs limited partnerships (other than in a few exceptional transitional situations). Termination of a limited partnership is governed by Re-RULPA. See §2.73.

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**§2.73            b. Under Re-RULPA**

A limited partnership dissolves and its activities are wound up only on the occurrence of (Corp C §15908.01):

- An event specified in the limited partnership agreement;
- The consent of all general partners and of limited partners owning a majority of the rights to receive distributions;  
or
- On departure of a general partner, under certain circumstances. See §6.125.

**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.74 9. Who May Form Limited Partnerships

**§2.74 9. Who May Form Limited Partnerships**

One or more individuals, partnerships, limited partnerships, trusts, estates, associations, corporations, LLCs, or other entities may form a limited partnership. See Corp C 15901.02(m), (p), (q), (y). However, attorneys, accountants, architects, and medical professionals are not permitted to practice through limited partnerships. For information on entities available to these professionals, see §2.97.

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**§2.75      10. Taxation**

A limited partnership, like a general partnership, is not subject to federal or state income tax at the entity level unless it elects to be taxed as a corporation. Unlike a general partnership, a limited partnership is subject to an annual franchise tax of \$800 paid to the State of California's Franchise Tax Board. Rev & T C §§17935, 23153. Employment taxes and workers' compensation insurance are required on employees' wages.

**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.76 11. Estate Planning

**§2.76 11. Estate Planning**

Limited partnerships may provide some tax advantages in estate planning.

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**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.77 H. Limited Liability Partnerships (LLPs)

## **§2.77 H. Limited Liability Partnerships (LLPs)**

Limited liability partnerships (LLPs) are a relatively recent development, and some risk exists in their use because statutory interpretation and case law are not yet as extensive as that for more established entity forms such as corporations and general and limited partnerships.

California authorizes the formation of LLPs by attorneys, accountants, and architects under the Uniform Partnership Act of 1994 (RUPA) (Corp C §§16100-16962), which also governs general partnerships. Corp C §16101(8), (14); see Corp C §§16951-16962 (limited liability partnerships). An LLP is therefore a form of general partnership with some limited liability permitted.

For discussion of LLPs, see chap 7; see also *Advising California Partnerships*, chap 9 (3d ed Cal CEB 1999).

**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.78 1. Formation

**§2.78            1. Formation**

Formalities of creation for a limited liability partnership (LLP) require executing a Form LLP-1 and filing it with the Secretary of State with a fee, currently \$70. Corp C §16953(a)-(b); Govt C §12189(a). An LLP is also required to provide security for claims against it through either insurance, a deposit with a financial institution, or meeting certain net worth requirements. Corp C §16956. A legal services LLP must also register with the State Bar of California. See State Bar LLP R 4.1-4.6.

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**§2.79 2. Personal Liability**

An LLP is a form of general partnership in which a partner is not liable for the debts and obligations of the LLP or for the tortious conduct of other partners (unless the partners agree otherwise) if all of the following are true (see §§7.4-7.5):

- The LLP is registered as an LLP;
- If it is a law services LLP, the LLP is registered with the State Bar of California; and
- Certain security requirements are met.

A partner may not limit liability for his or her own tortious conduct, but is protected from vicarious liability for the acts of his or her partners. Corp C §16306(c)-(e).

**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.80 3. Anonymity

**§2.80            3. Anonymity**

The names of members of LLPs are public record.

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**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.81 4. Management and Control

**§2.81            4. Management and Control**

An LLP is managed by its partners.

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**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.82 5. Working Capital

**§2.82            5. Working Capital**

Owners of an LLP fund the business either with personal funds and property or with borrowed funds. The LLP's lenders may require personal guarantees from the partners.

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**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.83 6. Securities Issues

**§2.83            6. Securities Issues**

Ownership interests in a general partnership are usually not characterized as securities, due to the personal involvement of the partners in management of the business. See §7.10; see also Advising California Partnerships, chap 5 (3d ed Cal CEB 1999).

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**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.84 7. Change of Ownership

**§2.84            7. Change of Ownership**

Transfer of LLP interests may be made only to licensed professionals and otherwise have the same restrictions and requirements as other securities.

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**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.85 8. Termination

**§2.85            8. Termination**

An LLP continues in existence until a notice of cessation is filed with the Secretary of State or until the LLP has been dissolved and finally wound up. Corp C §§16953(e), 16954(b).

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**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.86 9. Who May Form LLPs

**§2.86 9. Who May Form LLPs**

Use of an LLP is restricted to certain licensed professionals, specifically attorneys, accountants, and architects. See §7.3.

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**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.87 10. Taxation

**§2.87      10. Taxation**

A California LLP is generally treated as a partnership for federal and California income tax purposes. See §§2.116-2.117.

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**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.88 11. Estate Planning

**§2.88 11. Estate Planning**

An LLP does not provide tax advantages for estate planning purposes. Ownership is restricted to specified licensed professionals.

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**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.89 I. Other Forms of Business

**§2.89 I. Other Forms of Business**

The brief descriptions in §§2.90-2.96 are intended not as complete discussions of the entities named, but rather as definitions to assist an attorney in differentiating these entities from those discussed more fully in this publication. For additional information on the following forms of business, see Organizing Corporations in California, chap 1 (3d ed Cal CEB 2001).

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**§2.90 1. Unincorporated Associations**

An unincorporated association is an unincorporated group of two or more persons joined by mutual consent for a common lawful purpose. Corp C §18035. See generally Corp C §§18000-24001.5. Unincorporated associations include, among other things, joint stock associations (Corp C §§22000-22003) and real estate investment trusts (Corp C §§23000-23006). Real estate investment trusts ("REITs") are discussed below in §2.91.

Except as otherwise provided by law, an unincorporated association is liable for its own acts and omissions and for those of its directors, officers, agents, and employees acting within the scope of their offices or employment, to the same extent as if the association were a natural person. Corp C §18250. Judgments may be enforced only against the property of the unincorporated association except in specific circumstances. See, *e.g.*, Corp C §§18260, 18270, 18605-18640, 22002, 23002, 24001.5.

An unincorporated association is taxable as a partnership unless it elects to be taxed as a corporation. Treas Reg §301.7701-3.

Ownership interests in unincorporated associations are included in the definition of securities under California law. Corp C §25019. All offers and sales of securities in California require qualification with the Commissioner of Corporations unless either the transaction or the security itself is exempted from qualification. The securities laws of other states (so-called "blue sky" laws) may also apply to offers or sales outside California. Federal securities laws should also be considered. Regulatory filings may be required either to qualify an offering and sale or to receive an exemption. Corp C §§25000-25707; 10 Cal Code Regs §§250.9-260.617. For more discussion of unincorporated associations, see *Advising California Nonprofit Corporations*, chap 2 (3d ed Cal CEB 2009); on offers and sales of securities in California, see *Financing and Protecting California Businesses* (Cal CEB 2006). See also Marsh & Volk, *Practice Under the California Securities Laws* (rev ed 1973). For federal securities law practice, see Loss & Seligman, *Fundamentals of Securities Regulation* (5th ed 2004).

**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/ 2. Entities Formed to Hold Real Estate/§2.91 a. Real Estate Investment Trusts (REITs)

## **2. Entities Formed to Hold Real Estate**

### **§2.91 a. Real Estate Investment Trusts (REITs)**

A real estate investment trust (commonly called a "REIT" and pronounced "reet") is a type of unincorporated association (see §2.90) or trust formed to engage in certain real estate transactions and investments. The REIT is managed by, or under the direction of, one or more trustees for the benefit of the holders or owners and must meet requirements under Corp C §23000 to be recognized as a REIT. Investors in a qualified REIT are not personally liable for debts or obligations of the REIT. Corp C §§23001-23004.

A REIT itself pays little or no federal or California income tax if it meets certain requirements, including annual distribution of at least 90 percent of its taxable income to its investors/shareholders. Amounts retained by the REIT are taxable at the corporate rate. See IRC §§856-860; Treas Reg §1.857-1.

Ownership interests in REITs issued under the authority of the Real Estate Commissioner may be exempt from California securities registration requirements. See Corp C §25100(e).

For further discussion of REITs, see California Real Estate Finance Practice: Strategies and Forms (Cal CEB 2000).

**§2.92            b. Condominiums**

A condominium is a format for the purchase and ownership of real property in which each owner holds (1) ownership of the owner's own unit, *and* (2) an undivided interest in the common areas and facilities of the entire property. CC §§783, 1350-1376. The condominium format can be used both for units in residential multiple-unit properties (such as apartment buildings) as well as for commercial units (such as suites in office buildings and retail stores in shopping centers). The covenants, conditions, and restrictions recorded against the entire project restrict the use of the property and define the responsibilities of the association as a whole as well as of the owners individually.

Ownership interests in condominiums issued under the authority of the Real Estate Commissioner may be exempt from California securities registration requirements. See Corp C §25100(e).

For further discussion of condominiums, see *Forming California Common Interest Developments* (Cal CEB 2004) and *Advising California Common Interest Communities* (Cal CEB 2003).

**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.93 c. Stock Cooperatives

**§2.93 c. Stock Cooperatives**

A stock cooperative is a corporation formed to hold title to real property, and the corporation's shareholders receive a right of exclusive occupancy in a portion of the property. CC §§1351(m), 1350-1376.

Ownership interests in stock cooperatives issued under the authority of the Real Estate Commissioner may be exempt from California securities registration requirements. See Corp C §25100(e).

For further discussion, see Forming California Common Interest Developments (Cal CEB 2004) and Advising California Common Interest Communities (Cal CEB 2003).

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**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.94 3. Cooperative Corporations

**§2.94 3. Cooperative Corporations**

Cooperative corporations conduct business primarily for the mutual benefit of their members as patrons of the corporation. The earnings, savings, or benefits of the cooperative corporation are used for the general welfare of the members or are proportionately and equitably distributed to its members or patrons on the basis of their patronage of the corporation. Corp C §12201; see generally Corp C §§12200-12704.

Cooperative corporations formed under Food & A C §54001-54294 and Consumer Cooperative Corporations formed under Corp C §§12200-12704 may be exempt from securities registration requirements. See Corp C §25100(m), (r).

For further discussion, see Advising California Common Interest Communities (Cal CEB 2003).

**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.95 4. Business Trusts (Massachusetts Trusts)

**§2.95 4. Business Trusts (Massachusetts Trusts)**

The infrequently used business trust (sometimes called a "Massachusetts trust") is an unincorporated business association. Investors contribute property to the trust, which then issues trust certificates to the investors (called "beneficiaries"). Management of the trust is conducted by trustees. As with limited partnerships, the beneficiaries do not have a managerial role and are not personally liable for the debts or obligations of the trust. Interests in a business trust may be characterized as securities. See §8.7.

The Internal Revenue Code does not use the term "business trust," and a business trust must elect to be taxed as a corporation, partnership, or sole proprietorship. See Treas Reg §301.7701-4(b).

Converting an existing business trust to a corporation is governed by Corp C §200.5.

**§2.96            5. Joint Ventures**

A joint venture is an entity or contractual arrangement formed for a limited or temporary business purpose such as a single project. See *Pellegrini v Weiss* (2008) 165 CA4th 515, 525, 81 CR3d 387 ("The essential element of a joint venture is an undertaking by two or more persons to carry out a single business enterprise jointly for profit."). Joint ventures are usually interpreted under laws controlling general partnerships, but some courts have used breach-of-contract analysis to determine rights and remedies between joint venturers, rather than applying principles of general partnerships. See, e.g., *Elsbach v Mulligan* (1943) 58 CA2d 354, 369, 136 P2d 651.

Because the term "joint venture" is sometimes used loosely to apply to a variety of business arrangements, care should be taken to analyze, structure, and document the parties' intended rights and obligations. Ownership interests in a joint venture may be characterized as securities. See §8.7.

For tax purposes, joint ventures are taxed as general partnerships. See §2.58.

**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.96A 6. Family Limited Partnerships (FLPs) and Family Limited Liability Companies (FLLCs)

## **§2.96A 6. Family Limited Partnerships (FLPs) and Family Limited Liability Companies (FLLCs)**

Family limited partnerships (FLPs) and family limited liability companies (FLLCs) can be used as estate planning vehicles. Valuation discounts for estate and gift tax purposes and limited liability for most or all of the owners may apply to each of these entities. These two entities have enjoyed the most popularity as family business entities, due in part to their flow-through nature for income tax purposes and in part to the flexibility in management that they can provide.

FLPs can be used to transfer interests in a family business or real estate from the owner to the FLP and, ultimately, to the next generation. A properly organized FLP can (a) reduce gifts taxes; (b) permit retained management and income from transferred property; and (c) avoid inclusion of the transferred interest in the transferor's gross estate at death. The transfer of minority interests to the FLP can be structured to take advantage of valuation discounts and reduced liquidation rights. For further discussion of limited partnerships, see §§2.60-2.76 and chap 6. For further discussion of estate planning for family businesses, see §2.199. For further discussion of FLPs, see California Estate Planning, chap 18 (Cal CEB 2002).

**NOTE:** The Uniform Limited Partnership Act of 2008 (Re-RULPA) (Corp C §§15900-15912.07), which is applicable to virtually all limited partnerships as of January 1, 2010, eliminates the statutory right of limited partners to remove a general partner that existed under prior law. Thus limited partners have no statutory right to remove a general partner.

Although LLCs were not traditionally used for estate planning, they have become increasingly useful for estate planning purposes as FLLCs. Unlike FLPs, no one is liable for the debts of the entity. See Estate Plan, chap 18. California law allows the formation of single-member LLCs. Corp C §17050(b). This difference from FLPs may make the FLLC more attractive when only one person will form the entity. Further, if limited liability is the most important factor for a family and most family members will be involved in management, the FLLC may be more appropriate because limited liability is extended to all members and managers. If a limited partner were to participate in management of an FLP, he or she would lose the protection of limited liability. Unlike the FLP, family members may actively participate in the business operation of an FLLC without automatically losing protection from personal liability.

**NOTE:** If a practitioner believes that an FLP is a better estate planning device, consideration should be given to forming an FLLC as a general partner of the FLP. The older generation would contribute assets to the FLP in return for limited partnership interests, which would then be given to family members. This two-tier structure limits the liability of the older generation through the FLLC but may allow discounts to be calculated on the gift of the limited partnership interests.

**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.97 J. Entities Available to Attorneys, Accountants, Architects, and Medical Professionals

**§2.97 J. Entities Available to Attorneys, Accountants, Architects, and Medical Professionals**

Attorneys, accountants, architects, and medical professionals may act as sole proprietors. See §2.12. They may also provide professional services through the following entities:

- Professional corporations (see chap 10); and
- General partnerships (see chap 5).

Attorneys, accountants, and architects may also provide professional services through a limited liability partnership (LLP). See chap 7.

Professional services cannot be rendered in California through limited liability companies (LLCs), whether organized in California or elsewhere. Corp C §17375.

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**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.98 III. FACTORS IN SELECTING MOST APPROPRIATE FORM FOR DOING BUSINESS

**§2.98 III. FACTORS IN SELECTING MOST APPROPRIATE FORM FOR DOING BUSINESS**

A variety of factors should be considered in determining the most appropriate form for doing business. Some of the more significant factors are discussed below in §§2.99-2.199, but their relative importance can and should be weighed only in the context of a client's particular circumstances.

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**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.99 A. Costs and Ease of Formation; Agreements Among Owners

**§2.99            A. Costs and Ease of Formation; Agreements Among Owners**

The costs and ease of forming a business enterprise depend more on the scope and complexity of the specific business venture than on the chosen form of entity. For example, a limited liability company (LLC) formed to engage in a complex transaction, with detailed allocations of profits and losses and sophisticated management controls, may be much more complicated and costly to form than a one-shareholder corporation engaging in a simple business. For a list of filing fees associated with formation of various business entities, see the form in §2.209.

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**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.100 1. Sole Proprietorships

**§2.100 1. Sole Proprietorships**

A sole proprietorship is the simplest form of business organization, in which an individual engages in business personally, without co-owners and without the use of an entity such as a corporation. A sole proprietorship avoids many of the formalities and reporting requirements of business entities. Creation of a sole proprietorship does not involve registration with any governmental agency, except possible filing to obtain a local or municipal government business license and a fictitious business name (also called colloquially a "DBA," for "doing business as"). If a fictitious business name is used, the owner must file a DBA with the county recorder in the county where the proprietorship's principal place of business is located, and may also file in any other county. Bus & P C §17915. The filing fee is usually modest. Periodic renewals of registrations are required.

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## **2. Corporations**

### **§2.101 a. C Corporations**

Among all the limited liability entities available to a business, a corporation may be the simplest and least expensive to form and set up, due to long usage and commonly agreed provisions for the operative documents. Creation of a new corporation includes the following:

- Preparing and filing articles of incorporation with the Secretary of State (current filing fee: \$100; Govt C §12186(c)). See §§8.13-8.20.
- Preparing and adopting bylaws. See §§8.22-8.27.
- Selecting and recruiting a board of directors. See Comments to forms in §§8.43, 8.44.
- Holding and documenting an initial meeting (or preparing a unanimous written consent of the board) to complete organization of the corporation, including appointing officers, issuing stock to shareholders, establishing a fiscal year, adopting forms of stock certificate and corporate seal, and related matters (although an incorporator may take some of these actions (Corp C §210)). See §8.28.

No standard form for articles of incorporation is offered on the Secretary of State's website, because of the variations and optional provisions which can be included. However, a basic form suitable for tailoring is posted on the Secretary of State's website. For the website address, see the Directory. See also the form in §9.35. For attorney-drafted clauses for the articles of incorporation, see §§8.38-8.57.

Within 90 days after filing the articles of incorporation and annually thereafter, a Statement of Information (Domestic Stock Corporation) (Form SI 200 C) must be filed with the Secretary of State (current filing fee: \$25; Govt C §12186(g)), giving the names and addresses of current officers and directors and other basic information. For the website where this form may be obtained, see the Directory. See also the form in §8.125.

Before incorporation, federal and state securities law should be reviewed to determine whether registration or qualification of the offering or the shares of stock must be made with the appropriate regulatory authorities. Exemptions from registration and qualification may be available.

The corporation and its shareholders need not negotiate a detailed agreement governing the structure and operation of the corporation, but may instead rely on the provisions of the General Corporation Law (Corp C §§100-2319). A detailed shareholder "buy-sell" agreement or specially drafted articles of incorporation may be advisable or necessary, however, if the parties want to restrict the transferability or voting rights of corporate stock or provide for different classes of stock. The cost of negotiating and drafting a shareholder "buy-sell" agreement varies according to the complexity of the agreement and the shareholders' goals and desires.

Among the points which may be addressed in a shareholder "buy-sell" agreement are:

- A right of first refusal for the corporation and other shareholders to buy back shares a shareholder wishes to sell;
- The mandatory or optional repurchase of shares on a shareholder's death, disability, or termination of employment;
- The formula for determining the purchase price for shares in the future;
- The terms of payment on shares repurchased;
- A "come along, bring along" clause in which minority shareholders agree to participate in a sale of the corporation to a third party, as long as the minority receive the same consideration for their shares as the majority;
- The percentage vote needed to issue additional shares and to amend or terminate the shareholder "buy-sell" agreement; and
- Dispute resolution and controlling law provisions, along with other effectuating provisions.

A corporation is taxed under IRC subchapter C unless it elects to be taxed as an S corporation (see §2.102). A corporation not electing S corporation status is sometimes referred to as a C corporation.

For a comprehensive discussion of corporations, see chap 8; see also Organizing Corporations in California (3d ed Cal CEB 2001).

**§2.102      b. S Corporations**

Shareholders of a corporation formed as described in §2.101 may approve a resolution to be taxed under IRC subchapter S by executing and filing Form 2353 with the Internal Revenue Service. There is currently no filing fee.

To qualify for S corporation status, a corporation may have only one class of stock and have no more than 100 shareholders, including only individuals who are United States citizens or legal United States residents, as well as certain trusts and estates. When a qualified trust is a shareholder of an S corporation, each potential current beneficiary of the trust is treated as a separate shareholder. Treas Reg 1.1361-1(e)(1). Related shareholders, whether owning shares directly or by deemed ownership as a beneficiary of a trust, may be treated as a single shareholder pursuant to family attribution rules. Treas Reg 1.1361-1(e)(3).

For restrictions on a corporation's ability to qualify as an S corporation, see §2.129; see generally §§2.128-2.134. For tax implications of S corporation status, see §8.5.

**§2.103 c. Close Corporations**

Formalities of creation for a close corporation are the same as for a C corporation (see §2.101), but with additional specific wording required in the articles of incorporation regarding election of close corporation status, as well as a legend placed on the stock certificates to that effect. Corp C §418(c).

A close corporation (also called a statutory close corporation) is a corporation with no more than 35 shareholders, who usually agree among themselves to relax various corporate control and operating requirements otherwise required under the General Corporation Law. Corporations Code §300(c) specifies which provisions of the Code cannot be relaxed or varied. See §9.14.

In forming a close corporation, a separate written agreement should be entered into among the shareholders specifying which corporate control and operating requirements are affected. The cost of negotiating and preparing the agreement varies according to the complexity of the agreement and the shareholders' goals and desires.

See generally Corp C §300. For further discussion of close corporations, see chap 9.

**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.104 d. Professional Corporations

**§2.104 d. Professional Corporations**

Attorneys, accountants, architects, medical professionals, and members of other specified professions are permitted to practice through professional corporations. A professional corporation is formed as a C corporation (see §2.101) and includes additional restrictive language in its articles of incorporation, limiting ownership to licensed professionals. The professional corporation may, if it otherwise qualifies, also be structured as a close corporation (see §2.103) or elect to be taxed as an S corporation (see §2.117). Attorneys forming a professional corporation must also register it with the State Bar of California and, as with accountants, meet certain security requirements. For the website address where the forms are available, see the Directory. See also the forms in §§10.76-10.78.

Individuals providing professional services "pursuant to a license, certification or registration authorized by the Business and Professions Code, the Chiropractic Act, or the Osteopathic Act" and providing any services as licensed yacht and ship brokers may do so through a corporation designated in its articles of incorporation as a professional corporation. Corp C §§13401(a), 13401.3. Professionals permitted to form professional corporations are attorneys, accountants, and architects, as well as dentists, nurses, chiropractors, psychologists, clinical social workers, and certain others. "Professional services" do not include services provided by businesses which require only a nonprofessional, occupational license under the Business and Professions Code. See 87 Ops Cal Atty Gen 109 (2004). See also chap 10.

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**§2.105 3. General Partnerships**

A general partnership is an association formed by two or more consenting parties to carry on as co-owners a business for profit. The partners themselves may be individuals, partnerships, corporations, limited liability companies (LLCs), and other legal or commercial entities. Corp C §16101(13).

The partnership agreement between or among the partners may be oral or implied, but a written agreement is advisable for certainty of the terms agreed. Corp C §16101(8). The scope of and limitations to the partnership agreement are described in Corp C §16103. The cost of negotiating and preparing the agreement depends on the structure of the partnership, the nature of its business, and the shareholders' goals and desires.

No filing is required with the Secretary of State or any other governmental authority. However, a general partnership may file a Statement of Partnership Authority (Form GP-1) (see Corp C §16303(a)) with the Secretary of State's office, accompanied by a filing fee, which is currently \$70. Corp C §16113(a); Govt C §12187(a). For the website address of the form, see the Directory. See also the form in §5.48. In addition, a general partnership may record its partnership agreement with the county recorder's office where the general partnership is located. The requirements for statements filed by the partners are addressed in Corp C §16105.

Interests in general partnerships are generally not characterized as securities because all general partners are deemed personally involved in the management and control of the business. Corp C §§25000-25707; 10 Cal Code Regs §§250.9-260.617.

For discussion of general partnerships, see chap 5; see also *Advising California Partnerships*, chap 5 (3d ed Cal CEB 1999).

## **§2.106 4. Limited Partnerships**

**NOTE:** As of January 1, 2010, the Uniform Limited Partnership Act of 2008 (Re-RULPA) (Corp C §§15900-15912.07) became applicable to all California limited partnerships, with a few exceptional transition provisions described in Corp C §§15912.01-15912.07. As of January 1, 2008, Re-RULPA governs foreign limited partnerships whenever formed (Corp C §15912.04). The Corporations Code sections cited below refer to Re-RULPA.

A limited partnership is a partnership formed by two or more persons or entities and having (a) one or more *general partners*, who engage actively in the management and control of the business and have unlimited personal liability for the partnership's debts and obligations, *and* (b) one or more *limited partners*, who are not personally liable for the partnership's debts and obligations unless they participate in the control of the business. Corp C §15901.02(m), (p), (y). Persons who may serve as general or limited partners are individuals, partnerships, limited partnerships (domestic or foreign), trusts, estates, associations, corporations, limited liability companies, or other entities. See Corp C §15901.02(y) (Re-RULPA).

A limited partnership is formed by filing a Certificate of Limited Partnership (Form LP-1), recording it with the Secretary of State, and paying a filing fee (currently \$70; see Govt C §12188(b)). For the website of the form, see the Directory. See also the form in §6.38.

An oral partnership agreement among the partners is legally sufficient, but a written partnership agreement is recommended for certainty of the terms intended. Corp C §15901.02(x).

Before formation of the limited partnership and the offering of partnership interests, federal and state securities law should be reviewed to determine whether registration or qualification of the offering or the limited partnership interests must be made with the appropriate regulatory authorities. Exemptions from registration and qualification may be available. See §6.8.

For discussion of limited partnerships, see chap 7; see also *Advising California Partnerships*, chap 7 (3d ed Cal CEB 1999).

**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.107 5. Limited Liability Partnerships (LLPs)

## **§2.107 5. Limited Liability Partnerships (LLPs)**

A limited liability partnership (LLP) is a general partnership which executes and files the Registered Limited Liability Partnership Registration (Form LLP-1) with the Secretary of State (current filing fee: \$70; see Govt C §12189(a)) and whose partners are only those licensed to practice law, public accountancy, or architecture. For the website address of forms necessary to register an LLP with the Secretary of State and with the State Bar of California, see the Directory.

An LLP must maintain one or more types of security in the required amounts for claims based on acts, errors, or omissions arising from the practice of the profession concerned. Corp C §16956(a)(1). See §7.26. This security may be provided by obtaining professional liability insurance, by escrowing cash or cash equivalents, or by certifying that the LLP has at least the required minimum net worth. Corp C §16956. Each partner in an LLP is deemed to guarantee the difference between the amount of security required by statute and the amount of security actually provided by the LLP. Corp C §16956(a)(1)-(3). If the LLP relies on certification of its net worth, then at the time Form LLP-1 is filed with the Secretary of State to register the LLP, an additional form entitled Alternative Security Provision (Secretary of State Form LLP-3) concerning the security provisions must also be filed. An annual update must be filed each year thereafter; the filing fee is currently \$30. See Govt C §12189(f). For the website address of Form LLP-3, see the Directory.

An LLP must comply with all registration and filing requirements of the state board, commission, or other agency that prescribes the rules and regulations governing the particular profession. Corp C §16953(h). For example, State Bar rules require execution and filing of an Application for Issuance of Certificate of Registration as a Limited Liability Partnership. A copy of this form may be obtained from the State Bar Office of Certification; for the website address, see the Directory. See also the form in §7.39.

Because LLPs are a relatively recent concept, some risk exists in their use because statutory interpretation and case law are not yet as extensive as that for more established entity forms such as corporations and general and limited partnerships.

For further discussion of LLPs, see chap 7; see also *Advising California Partnerships*, chap 9 (3d ed Cal CEB 1999).

**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.108 6. Limited Liability Companies (LLCs)

## **§2.108 6. Limited Liability Companies (LLCs)**

A limited liability company (LLC) is formed by filing the Articles of Organization (Form LLC-1) with the Secretary of State, together with a filing fee, which is currently \$70. Corp C §17050(a); Govt C §12190(b). For the website address of the form, see the Directory. See also the form in §11.39. The articles must be signed and filed by the organizer of the LLC, who need not be or become a member or manager of the LLC. Corp C §17050(a).

Within 90 days after filing the articles of organization and biennially thereafter, a Statement of Information (Secretary of State Form LLC-12) must be filed with the Secretary of State (current filing fee: \$20; Govt C §12190(k)), giving the names and addresses of the LLC managers and the chief executive officer, if any, or if there are no managers, of each member, and other basic information. For the website address where the form may be obtained, see the Directory.

Before or after filing the articles of organization, all members of the LLC must enter into an operating agreement. Corp C §17050(a). Although the operating agreement may be oral (Corp C §17001(ab)), it is advisable that the agreement be written for certainty of the terms intended. The cost of negotiating and preparing an operating agreement depends on the complexity of the business contemplated and the variations on financial and other terms desired by the members of the LLC. The flexibility which makes LLCs so attractive to its owners can also impede negotiations among the members as to the financial and other terms of the operating agreement, delaying its completion. The failure to complete and execute an operating agreement does not invalidate the LLC's formation, but makes uncertain the terms governing the relationship among the members.

Because LLCs are a relatively recent concept, some risk exists in their use because statutory interpretation and case law are not yet as extensive as that for more established entity forms such as corporations and general and limited partnerships.

For detailed information on formation, see chap 11; see also Forming and Operating California Limited Liability Companies, chap 7 (2d ed Cal CEB 2007).

**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.109 B. Ability to Raise Capital; Securities Law Aspects

**§2.109 B. Ability to Raise Capital; Securities Law Aspects**

All offers and sales of securities in California require qualification with the Commissioner of Corporations, unless either the transaction or the security itself is, under the law or a rule of the Commissioner, exempted from qualification. Corp C §§25000-25707; 10 Cal Code Regs §§250.9-260.617. Generally speaking, a *security* is found to exist when a person has invested value in a common enterprise with an expectation of profit to be derived substantially from the efforts of others. See, e.g., *SEC v W. J. Howey Co.* (1946) 328 US 293, 90 L Ed 1244, 66 S Ct 1100. Shares of stock in a corporation and limited partnership interests are generally characterized as securities. See, e.g., Corp C §25019; 10 Cal Code Regs §260.000.

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**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.110 1. Sole Proprietorships

**§2.110 1. Sole Proprietorships**

Sole proprietorships are funded by the owner, through either personal funds or personal borrowing. Because there are no investors and no stock or other securities are issued, no securities issues arise.

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**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.111 2. Corporations, Including S Corporations and Close Corporations

## **§2.111 2. Corporations, Including S Corporations and Close Corporations**

A corporation is funded through:

- Its shareholders' equity capital contributions (either cash or in kind) in exchange for issuance of shares of stock;
- Funds loaned to the corporation by its shareholders; and/or
- Borrowing from third parties.

Borrowing from third parties can be secured by liens on corporate assets or by guaranties provided by individual shareholders.

Corporations may be more attractive to so-called "risk capital" from passive investors such as venture capitalists because (a) corporations offer limited liability and the relatively free transferability of corporate shares, and (b) the consequences and mechanisms of investing in corporate stock may be more widely understood than investing in partnerships or LLCs.

All offers and sales of securities in California, including shares of stock in a corporation, require qualification with the Commissioner of Corporations unless either the transaction or the security itself is exempted from qualification. The securities laws of other states (so-called "blue sky" laws) may also apply to offers or sales outside California. Federal securities laws should also be considered. Regulatory filings may be required either to qualify an offering and sale or to receive an exemption. Corp C §§25000-25707; 10 Cal Code Reg §§250.9-260.617. See §8.7; see also Organizing Corporations in California, chap 4 (3d ed Cal CEB 2001); Marsh & Volk, Practice Under the California Securities Laws (rev ed 1973). For federal securities law practice, see Loss & Seligman, Fundamentals of Securities Regulation (5th ed 2004).

**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.112 3. General Partnerships

**§2.112 3. General Partnerships**

A general partnership's capital usually comes from the partners' capital contributions and from secured or unsecured loans from partners or third parties. A partnership's ability to borrow may depend on the creditworthiness of the individual partners and the value of partnership assets that can be offered as collateral for a secured loan. General partnerships are usually not attractive to passive investors, because of the risk of personal liability for partnership debts and the lack of free transferability of partnership interests.

Interests in a general partnership are ordinarily not considered to be securities subject to federal and California securities law, due to the personal involvement of all partners in the management of the business.

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**§2.113 4. Limited Partnerships**

A limited partnership's sources of capital include those available to a general partnership, plus the capital contributions of limited partners. Because of limited liability and pass-through tax treatment, limited partnership interests are attractive to certain passive investors, especially in connection with real estate ventures and tax-advantaged investments. However, limited partnership interests are generally unattractive to venture capitalists because limited partners cannot participate in management without the risk of incurring general partner liability.

All offers and sales of securities in California, including limited partnership interests, require qualification with the Commissioner of Corporations unless either the transaction or the security itself is exempted from qualification. The securities laws of other states (so-called "blue sky" laws) may also apply to offers or sales outside California. Federal securities laws should also be considered. Regulatory filings may be required either to qualify an offering and sale or to receive an exemption. Corp C §§25000-25707; 10 Cal Code Reg §§250.9-260.617. See §6.8; see also *Advising California Partnerships* (3d ed Cal CEB 1999); Marsh & Volk, *Practice Under the California Securities Laws* (rev ed 1973). On federal securities law practice, see Loss & Seligman, *Fundamentals of Securities Regulation* (5th ed 2004).

**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.114 5. Limited Liability Partnerships (LLPs)

**§2.114 5. Limited Liability Partnerships (LLPs)**

In California, limited liability partnerships may provide only legal services, public accountancy services, and architectural services, and (except for related entities; see §7.3) may have only licensed persons as members. Funding options for an LLP are the same as for a general partnership. See §2.112.

Because California LLPs are governed by California's general partnership statute (Corp C §§16100-16962), partnership interests are unlikely to be treated as securities for purposes of federal and state securities laws.

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**§2.115 6. Limited Liability Companies (LLCs)**

An LLC is funded through:

- Its members' equity capital contributions (either cash or in kind) in exchange for membership interests;
- Funds loaned to the LLC by its members; and/or
- Borrowing from third parties.

Borrowing from third parties can be secured by liens on corporate assets or by personal guaranties provided by members.

Because of (a) the organizational and structural flexibility of LLCs; (b) the ability to engage actively in management without concern for personal liability; and (c) the ability to make special allocations and deduct losses, LLCs may become attractive to venture capitalists and passive investors.

Whether membership interests in a particular LLC constitute securities under the federal securities laws is determined on a case-by-case basis. An interest in an LLC will constitute a security under the California Corporate Securities Law of 1968 (Corp C §§25000-25707) unless all the members actually actively engage in the management of the LLC. Corp C §25019. See §11.9. See also Forming and Operating California Limited Liability Companies, chap 12 (2d ed Cal CEB 2007); Marsh & Volk, Practice Under the California Securities Laws (rev ed 1973). For federal securities law practice, see Loss & Seligman, Fundamentals of Securities Regulation (5th ed 2004).

**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.116 C. Income Tax Considerations

**§2.116 C. Income Tax Considerations**

Sections 2.117-2.154 provide a general overview of the federal income tax rules applicable to various entities.

For a comprehensive discussion of taxation of LLCs, see *Forming and Operating California Limited Liability Companies*, chap 5 (2d ed Cal CEB 2007).

For detailed discussion of taxation of partnerships, see *Advising California Partnerships* (3d ed Cal CEB 1999). See also Bonn, *Taxation of Partnerships* (1987); 1 McKee, Nelson & Whitmire, *Federal Taxation of Partnerships and Partners* (4th ed 2007); Willis, Pennell & Postlewaite, *Partnership Taxation* (6th ed 1997).

For an in-depth analysis of the taxations of corporations, see Bittker & Eustice, *Federal Income Taxation of Corporations and Shareholders* (7th ed 2000). For a brief review of corporate income tax issues, see *Organizing Corporations in California* (3d ed Cal CEB 2001). For a discussion of tax issues related to S corporations, see Eustice & Kuntz, *Federal Income Taxation of S Corporations* (4th ed 2001).

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**§2.117 1. Classification of Entities for Tax Purposes**

A corporation (other than an S corporation) is a tax-paying entity that must pay income tax on its taxable income. An S corporation is a "flow-through" or "pass-through" entity that reports items of income, loss, deduction, gain, and credit, to be allocated to—and the tax paid by—the individual shareholders based on their percentage of ownership. Other entities, such as general partnerships, limited partnerships, LLPs, or LLCs, may elect to be taxed either as a corporation or as a flow-through entity.

Whether an organization is an entity separate from its owners—and eligible to elect tax treatment either as a corporation or as a flow-through entity—is determined under federal tax law and does not depend on whether the organization is recognized as a separate entity under state law. Once the existence of an entity separate from its owners is established, an election to be treated either as a corporation or a flow-through entity is made under the Internal Revenue Code check-the-box regulations. Treas Reg §§301.7701-1—301.7701-3. The federal check-the-box election also governs for California tax purposes. 18 Cal Code Regs §23038(b)-1—23038(b)-3.

Under the check-the-box regulations, entities classified as trusts, or those formed as a corporation under state law, as well as joint stock companies, insurance companies, or banking institutions, and any organizations that are taxable as corporations under any other provision of the IRC are taxable as a corporation. Treas Reg §§301.7701-1(b), 301.7701-2(b).

Entities that are not required to be classified as corporations or trusts can elect to be taxed either as a corporation or as a flow-through entity. Treas Reg §301.7701-3(a). An entity with two or more members will be taxed either as a corporation or a partnership. An entity with only one member will either be taxed as a corporation or be disregarded (*i.e.*, reported as Schedule C income if the owner is an individual, or reported as branch or division income if the owner is another entity). Treas Reg §301.7701-2(a).

An entity having the right to elect its tax status will be treated as a partnership (or as a disregarded entity if it has a single owner) if no affirmative steps are made to elect otherwise. Treas Reg §301.7701-3(b). The election to be taxed as a corporation can be made using IRS Form 8832 and will be effective on the date specified by the taxpayer as long as the date selected is not more than 75 days before the election is filed and not more than 12 months after it is filed. Treas Reg §301.7701-3(c).

If an entity makes an election to be taxed as a corporation, the entity cannot change its tax classification for 60 months thereafter, unless more than 50 percent of the then-current owners were not owners at the time the election was made and the IRS consents to the change in classification. Treas Reg §301.7701-3(c)(1)(iv). The 60-month waiting period does not apply following an election that is made effective at the time of formation of the business entity. Treas Reg §301.7701-3(c)(1)(iv).

**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.118 2. Tax Considerations on Formation

**§2.118 2. Tax Considerations on Formation**

Ordinarily, business entities are not taxed on the receipt of capital contributions by their shareholders, partners, or members, irrespective of whether the contributions are cash, property, or services. IRC §721 (partnership, LLP, and LLC), IRC §1032 (corporation).

Contributing shareholders, partners, or members are not taxed when they contribute cash in exchange for an interest in the business entity. However, depending on the nature of the contribution, a shareholder, partner, or member may be taxed when he or she receives an interest in the entity in exchange for a contribution of property or services. See §§2.119-2.120.

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**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.119 a. Contributions of Property

**§2.119 a. Contributions of Property**

Contribution of property to a corporation (including an S corporation) in exchange for corporate stock is a taxable event for the contributing party unless the transaction constitutes a transfer to a controlled corporation within the meaning of IRC §351. When the contribution of property to a corporation is taxable, the shareholder will recognize gain on a "deemed sale" of the property for the fair market value of the shares received. Consequently, the shareholder will recognize taxable income in an amount equal to the difference between the fair market value of the shares received and the shareholder's adjusted tax basis in the property contributed to the corporation. IRC §1001.

The contribution of property to a partnership (including LLPs or LLCs that are treated as partnerships for tax purposes) does not usually trigger tax liability for the contributing partner. IRC §721(a). However, if the contributed property is subject to a liability, the contributing partner or member will recognize gain to the extent that the liability exceeds the partner's or member's adjusted tax basis in the partnership (LLP or LLC) after the contribution, including the tax basis of the contributed property and the partner's or member's share of the partnership's liabilities after the contribution.

"Disguised sale" rules may require the transaction to be taxed as a sale of the property to the partnership when the contributing partner receives a direct or indirect distribution from the partnership (other than the partnership interest) in exchange for a contribution of property. IRC §707(a)(2)(B). In addition, contribution of marketable securities to a partnership may result in recognition of gain if diversification results. See IRC §721(b).

**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.120 b. Contribution of Services

**§2.120      b. Contribution of Services**

Contribution of services to a corporation (including an S corporation) in return for stock is generally taxed to the contributing party as ordinary income equal to the fair market value of the stock received. See IRC §61. Placement of certain restrictions on the transferability or vesting of the shares may enable the shareholder to defer the recognition of the taxable income. IRC §83.

Subject to certain exceptions, contribution of services to a partnership (or LLP or LLC taxed as a partnership) in return for an interest solely in the profits of the partnership, but not an interest in the underlying capital, is not a taxable event for the contributing partner. Rev Proc 93-27, 1993-2 Cum Bull 343, clarified by Rev Proc 2001-43, 2001-2 Cum Bull 191; *Campbell v Commissioner* (8th Cir 1991) 943 F2d 815. However, receipt of a capital interest in the entity in exchange for services results in taxable income to the contributing partner. Treas Reg §1.721-1(b)(1).

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### 3. Tax Considerations During Operation

#### a. C Corporations

#### §2.121 (1) Entity Level Tax; Double Taxation

The net income of a C corporation (as opposed to an S corporation; see §2.127) is subject to taxation at the corporate level at rates up to 35 percent federal and 8.84 percent California. See IRC §11(a); Rev & T C §23153(e). Dividends paid to shareholders are not deductible to the corporation and are taxable to the receiving shareholder at the federal income tax rate applicable on the individual's tax return (limited to capital gains rates of 15 percent until Dec. 31, 2010, and potentially as high as 35 percent beginning Jan. 1, 2011) and California ordinary income rates of up to 9.55 percent (10.55 percent in the case of millionaires). IRC §1; Rev & T C §17041(a)(2). Consequently, income distributed to shareholders is subject to double taxation at an effective tax rate in excess of 50.7 percent. On a sale of the assets and the liquidation of the corporation, there will be a similar potential for double taxation. See §2.150.

Double taxation may be avoided on dividends paid by a C corporation to a shareholder that is also a C corporation. IRC §§561-565; Rev & T C §24402. The California income tax deduction pursuant to Rev & T C §24402 is permitted whether or not the dividend relates to income that was included in a taxpayer-corporation's California taxable income. See *Farmer Bros. v Franchise Tax Bd.* (2003) 108 CA4th 976, 134 CR2d 390. However, the deduction for a dividend paid to a C corporation will not avoid the double-taxation issue if the dividend received is then paid to the shareholders of the receiving corporation.

Double taxation can be avoided or reduced by paying reasonable wages to shareholder employees, or by paying interest on debt owed to the shareholders, or paying rents or royalties on property leased or licensed from the shareholders. The payment of reasonable salaries, interest, rents, or royalties will be deductible to the corporation and recognized as ordinary income to the receiving shareholder. These transactions, however, are subject to close scrutiny by the IRS. Therefore, they should be carefully documented and steps taken to ensure that the amounts paid are reasonable. See, e.g., *O.S.C. & Assocs. v Commissioner* (9th Cir 1999) 187 F3d 1116 (large salaries paid to shareholders roughly in proportion to ownership interests were disguised dividends); *Label/Graphics, Inc. v Commissioner* (9th Cir 2000) 221 F3d 1091 ("uncharacteristically large bonus" deemed to be disguised dividend).

Double taxation may become a non-issue for corporations that reinvest their income (rather than pay dividends), since the tax payable at the corporate level may be at a lower rate than if taxed to the individual shareholder. The corporate federal tax rates are as follows (IRC §11):

TAXABLE INCOME	TAX RATE
First \$50,000	15 percent
Between \$50,000 and \$75,000	25 percent
Over \$75,000 and less than \$10 million	34 percent
Over \$10 million	35 percent

The maximum individual federal tax rate is 39.6 percent. See IRC §1.

While retention of corporate earnings for necessary capital investment in the business is beneficial, accumulation of earnings inside the corporation without a reasonable business purpose, or simply to avoid the additional tax resulting from dividend distribution, is dangerous. Retention of earnings in excess of the corporation's anticipated needs can subject the corporation to an accumulated earnings tax (IRC §§531-537) or treatment as a personal holding company (IRC §§541-547). For a discussion of the accumulated earnings tax, see *Advanced Delivery & Chem. Sys. Nevada, Inc.* (2003) TC Memo 2003-250.

**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.122 (2) Tax Effect of Asset Distribution

**§2.122 (2) Tax Effect of Asset Distribution**

Distribution of assets owned by the corporation as dividends results in recognition of taxable income by the corporation in an amount equal to the current value of any built-up appreciation in the asset. IRC §311(b). At the same time, if the current fair market value of the asset is less than the corporation's adjusted tax basis, the accrued loss can only be recognized if the distribution to the shareholder is in liquidation of the corporation. IRC §336(d).

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**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.123 (3) Inability to Use Losses

**§2.123 (3) Inability to Use Losses**

If a corporation loses money during the taxable year, the loss will be trapped in the corporation and cannot be deducted by the shareholders. The net operating loss deduction can be carried back 2 years and carried over for 20 years as a deduction against the corporation's future income. IRC §172(b)(1)(A).

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**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.124 (4) At-Risk Rules; Passive Loss Rules

**§2.124 (4) At-Risk Rules; Passive Loss Rules**

Corporate deductions may be limited by the at-risk rules (IRC §465) and the passive loss rules (IRC §469) if five or fewer shareholders collectively own 50 percent or more of the corporation's stock, and by the passive loss rules in the case of personal service corporations. IRC §§465(a)(1)(B); 469(a)(2)(B)(j)(1), (a)(8)(c); 542(a)(2). Under the passive loss rules the corporation's passive losses can be deducted against "net active income" but not against portfolio income. IRC §469(e)(2).

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**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.125 (5) Method of Accounting

**§2.125 (5) Method of Accounting**

A C corporation must generally report its taxable income on an accrual basis. IRC §448(a)(1). However, corporations with annual gross receipts of less than \$5 million dollars, and qualified personal service corporations, are permitted to report their taxable income on a cash basis. IRC §§448(b)(2)-(b)(3).

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**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.126 (6) Taxable Year

**§2.126 (6) Taxable Year**

A C corporation (other than a personal service corporation) may adopt a taxable year without regard to the taxable year of its shareholders. IRC §441.

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**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.127 b. S Corporations

**§2.127      b. S Corporations**

The net income of an S corporation is not taxable at the corporate level. Instead, it flows through to the individual shareholders. A corporation becomes an S corporation by filing an election with the IRS pursuant to IRC §1362. The tax election does not change the nature of the entity as a corporation, nor alter its impact as a liability shield.

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**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.128 (1) Flow-Through Entity

**§2.128 (1) Flow-Through Entity**

An S corporation, as a general rule, does not pay federal income tax. Instead, the corporation's items of income and deductions are allocated to the individual shareholders in proportion to their stock ownership. The items of income and deduction retain the character that each had in relation to the S corporation.

The shareholder's adjusted tax basis in his or her stock is increased by the share of income recognized, and decreased by the share of deductions taken. IRC §1367. The shareholder's loss deduction is limited to the basis that he or she has in the stock, plus the basis of any debt owed by the corporation to the shareholder. IRC §1366; *Diane S. Blodgett* (2003) TC Memo 2003-212.

A filing of bankruptcy by the S corporation does not terminate the S election. Consequently, any gain recognized on liquidation of assets during the bankruptcy proceeding flows through to the individual shareholders. *Alphonse Mourad* (2003) 121 TC 1.

In addition to the individual shareholders paying California income tax based on the income and deductions flowing through from the S corporation, the S corporation itself pays California income tax equal to 1.5 percent of the S corporation's taxable income. Rev & T C §§23151, 23501, 23802(b)(1).

**§2.129 (2) Qualifying for S Corporation Status**

In order to qualify as an S corporation, the corporation must meet the requirements of IRC §1361(b). Specifically, the corporation cannot:

- Have more than 100 shareholders;
- Have a shareholder other than an individual, an estate, a tax exempt organization, or certain qualified trusts (*i.e.*, corporate and partnership shareholders are not permitted);
- Have a shareholder who is a non-resident alien;
- Have more than one class of stock (however, differences solely in voting rights are permitted);
- Be an insurance company;
- Be a foreign corporation;
- Be a domestic international sales corporation; or
- Have an IRC §936 election in effect (involving Puerto Rico and possession tax credit).

The corporation's S corporation status may be inadvertently terminated at any time should it fail to meet any of the above requirements. IRC §1362(d)(2). Once the S election is terminated, whether inadvertently or intentionally, the corporation may not normally make another S election for 5 years. IRC §1362(g).

**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.130 (3) Distributions to Shareholders

**§2.130 (3) Distributions to Shareholders**

An S corporation shareholder is taxed on his or her share of the corporation's income, regardless of whether or not the income is distributed to the shareholder.

Distributions received by the shareholder are not taxable to the shareholder, except to the extent that the money (and the fair market value of property) distributed exceeds the shareholder's basis in his or her stock plus the basis of debt owed by the corporation to the shareholder. IRC §1368. The shareholder's basis in his or her shares is reduced by the amount of money (and fair market value of property) which is received in the distribution. IRC §1367.

As with a C corporation, distribution by an S corporation of property (rather than cash) is deemed to be a sale of the property at its then fair market value. Consequently, the corporation will recognize any accumulated capital gain in the property, but not recognize any loss except on a liquidating distribution. IRC §311(b). On receipt of property as a distribution, the shareholder takes a fair market value adjusted tax basis in the distributed property. IRC §301(d).

**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.131 (4) At-Risk Rules; Passive Loss Rules

**§2.131 (4) At-Risk Rules; Passive Loss Rules**

The corporation's items of income and deduction flow through to each individual shareholder without reference to the at-risk rules or passive loss rules. Instead, the at-risk rules (IRC §465) and the passive loss rules (IRC §469) apply at the shareholder level.

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**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.132 (5) Method of Accounting

**§2.132 (5) Method of Accounting**

Unlike C corporations, S corporations may generally report their taxable income using the cash method of accounting. IRC §446(a). The cash method may not be used, however, if the S corporation comes within the technical definition of a "tax shelter" within the meaning of IRC §448(a)(3). The accrual method of accounting will be required by the tax shelter definitions whenever more than 35 percent of the corporation's losses are allocated to shareholders who do not actively participate in the corporation's management. IRC §§448(d)(3), 461(i)(3), 464(e)(2), 1256(e)(3).

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**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.133 (6) Taxable Year

**§2.133 (6) Taxable Year**

S corporations are generally required to use a calendar year for tax purposes. IRC §441.

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**§2.134 (7) Difference in Tax Treatment Between Partnerships and S Corporations**

S corporations, like partnerships (and LLCs electing partnership taxation), are flow-through entities for tax purposes. However, there are several significant distinctions between the tax treatment of S corporations and other flow-through entities that should be considered during the formation stage of the business entity. The specific differences are as follows:

- S corporation distributions must be in proportion to each shareholder's ownership of stock. Unlike a partnership or an LLC, an S corporation may not specially allocate profits or losses. Income and loss allocations must be based exclusively on stock holdings. IRC §1366. Further, allocations cannot be adjusted through use of different classes of stock, since an S corporation may have only one class of stock (allowing only differences as to voting rights). IRC §§1361(b)(1)(D), (c)(4).
- Corporate debt does not increase the shareholder's adjusted tax basis in his or her stock (compare with partnerships and LLCs; see §§2.138, 2.147).
- An S corporation cannot increase its adjusted tax basis in assets owned inside the corporation on death of a shareholder or sale of shares of the corporation. Pursuant to IRC §754, a partnership (or LLC electing partnership tax treatment) may elect to increase its inside tax basis on assets held by the partnership to match a new partner's outside basis in his or her partnership interest (resulting from the stepped-up basis on the death of a partner, pursuant to IRC §1014, or as a result of the new basis resulting from the purchase of an existing partner's interest in the partnership). Because there is no equivalent of the §754 election for S corporations, if the corporation's assets are later sold, the corporation will recognize income equal to the full amount of its gain, including any pre-death or pre-purchase appreciation that could have been avoided if an equivalent to the §754 election were available.
- Gain is normally recognized by the shareholder on contribution of appreciated property. Unless the transaction is structured to constitute a tax-free exchange under IRC §351 (transfers to controlled corporations), on contribution of appreciated property to an S corporation in exchange for S corporation stock the shareholder will be taxed as if he or she had sold the property to the corporation, and would be liable for tax on the difference between the property's then fair market value and the shareholder's adjusted tax basis in the contributed property. IRC §1001. In contrast, contribution of property to a partnership in exchange for an interest in the partnership will not ordinarily trigger tax liability. IRC §721(a).
- An S corporation ordinarily recognizes gain on distribution of appreciated property, and the recognized gain flows through to the individual shareholders in proportion to their interests in the corporation. IRC §§311, 336. However, no loss is recognized on the distribution of depreciated property unless the distribution is in liquidation of the shareholder's interest in the corporation. In a partnership or an LLC, neither gain nor loss is normally recognized on distribution of property. See §§2.136, 2.146.
- S corporation income and loss is not included in the shareholder's self-employment earnings total. Items of income and loss that pass through from an S corporation to its shareholder are treated as distributions based on ownership, and not included in determining the shareholder's self-employment tax liability. Therefore, the shareholder does not pay self-employment tax on the distribution and cannot reduce his or her self-employment tax liability on other income by virtue of losses flowing through from the corporation. Further, the shareholder cannot make retirement plan contributions that are based on having self-employment income. See *Ding v Commissioner* (9th Cir 1999) 200 F3d 587; *Durando v U.S.* (9th Cir 1995) 70 F3d 548.

**c. Partnerships**

**§2.135 (1) Flow-Through Entity**

Partnerships do not pay federal income tax. IRC §701. Instead, the partnership's income and deductions flow through to, and are taxed to or deducted by, the partners. Income and deductions normally retain the character they had in the partnership. IRC §702(b). Consequently, partnership income is not subject to potential double taxation, and partnership losses can be fully deductible by the individual partners, but not in excess of their adjusted tax basis in the partnership interest (IRC §704(d)) and subject to the at-risk and passive loss rules (IRC §§465, 469).

Such flow-through treatment can be a disadvantage for the owners of a profitable partnership that reinvests a significant portion of its profits since the partners would be taxed on their allocable share of the profits without receiving cash distributions from which to pay the tax.

**§2.136 (2) Distributions**

Distributions of cash or property by a partnership to its partners are not normally taxable events, either to the partnership or the individual partners. IRC §731. However, distributions of cash or property, including deemed distributions resulting from the reduction in a partner's share of partnership debt, will be taxable if and to the extent that the value of the distribution exceeds the partner's adjusted tax basis in his or her partnership interest immediately before the distribution. IRC §731(a)(1).

A partner who previously contributed property with unrecognized, taxable gain may be required to recognize the gain that was not recognized at the time of contribution if, within 7 years of the contribution, either (a) the partnership distributes the previously contributed property to another partner (IRC §704(c)), or (b) the partnership distributes different property to the contributing partner (IRC §737(d)(1)).

Gain may also be recognized by a partner when the partnership distributes marketable securities, or when a partnership owning unrealized receivables (including depreciation recapture) or appreciated inventory makes distributions that alter the partners' proportionate interests in each property. IRC §§731(c), 751(b).

A partner's basis in his or her partnership interest is reduced by the amount of distributions made to the partner. IRC §705(a)(2). Generally, a partner takes an adjusted tax basis in any property distributed to him or her by the partnership equal to the partnership's adjusted tax basis in the property immediately prior to the distribution. IRC §732.

**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.137 (3) Special Allocations

**§2.137 (3) Special Allocations**

"Special allocations" of profits, losses, deductions, and credits (*i.e.*, allocations not in proportion to percentage ownership) may be made among the partners, as long as they have "substantial economic effect." IRC §§704(a), 704(b)(2); Treas Reg §1.752-3. The substantial economic effect test applicable to special allocations is set forth in Treas Reg §1.704-1(b)(2).

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**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.138 (4) Debt Increases Basis

**§2.138 (4) Debt Increases Basis**

A partner's share of partnership debt is deemed to be a contribution of money by the partner to the partnership, and the partner's basis in his or her partnership interest is increased accordingly. IRC §§705, 752(a). Conversely, decreases in a partner's share of partnership debt are deemed to be a distribution of money to the partner, and the partner's basis in his or her partnership interest is decreased. IRC §§705, 752(b).

Allocation of partnership debt among partners depends on whether the debt is recourse or nonrecourse. Recourse partnership debt is shared among the partners in the same manner as they share the "economic risk of loss" with regard to the debt. Treas Reg §1.752-2. Detailed analysis of the sharing of economic risk of loss is complex; however, the allocation of recourse debt will most typically follow each partner's ultimate responsibility for the payment of the recourse debt. Allocation of nonrecourse partnership debt is more complicated, but often results in allocating the nonrecourse debt among partners in the same manner in which the partners share profits. Treas Reg §1.752-3.

An individual partner's increase in adjusted tax basis resulting from the partnership debt can result in the individual partner being allowed to take greater loss deductions (compared to an S corporation).

**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.139 (5) Section 754 Election

**§2.139 (5) Section 754 Election**

A partnership can elect to adjust the partnership's adjusted tax basis in the assets owned by the partnership to match any increase or decrease in an individual partner's adjusted tax basis in his or her partnership interest occurring either because of the death of a partner or because of the sale of any partnership interest. IRC §§734, 743, 754-755. As a result, a purchasing or inheriting partner will not be taxed on the built-in gain inherent in the partnership's asset at the time of inheritance or purchase, when the partnership subsequently sells the underlying assets or distributes them to a partner.

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**§2.140 (6) At-Risk Rules**

A partner may deduct his or her allocable share of partnership losses only to the extent of his or her amount "at risk." IRC §465. A partner's at-risk amount equals his or her capital investment, plus his or her allocable share of the partnership debt for which he or she is personally liable. Generally, partnership nonrecourse debt is not included in the at-risk computation, except to the extent that it is "qualified nonrecourse financing" (most commonly nonrecourse debt secured by real property). IRC §465(b)(6).

**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.141 (7) Passive Loss Rules

**§2.141 (7) Passive Loss Rules**

A partner may deduct passive losses only against passive income, and not against active or portfolio income. IRC §469. A partner who does not "materially" participate in the partnership business activity is deemed to have passive income or losses from the partnership.

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**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.142 (8) Deemed Termination of Partnership

**§2.142 (8) Deemed Termination of Partnership**

A partnership is deemed to have terminated for tax purposes if 50 percent or more of the interests in a partnership are sold or exchanged within 12 months. IRC §708(b)(1)(B). On deemed termination, the partnership assets are deemed to be distributed proportionally to the partners and then recontributed back to the partnership. Any partner whose deemed distribution exceeds his or her adjusted tax basis in the partnership interest will recognize gain to the extent of that excess. IRC §731(a)(1).

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**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.143 (9) Method of Accounting

**§2.143 (9) Method of Accounting**

Partnerships generally may use the cash method of accounting for reporting taxable income. IRC §§446(a)-(c). A partnership must use the accrual method of accounting, however, if any partner is a C corporation and the partnership has average annual gross receipts over the past 3 years in excess of \$5 million dollars. IRC §§448(a)(2), (b)(3), (c). Finally, a partnership must use the accrual method of accounting if it is a "tax shelter" within the meaning of IRC §448(a)(3) (including a limited partnership that allocates over 35 percent of the partnership's losses to limited partners). IRC §§448(d)(3), 461(i)(3), 1256(e)(3).

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**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.144 (10) Taxable Year

**§2.144 (10) Taxable Year**

A partnership must adopt a taxable year corresponding to that used by its majority or principal partners. IRC §706(b). If the majority or principal partners do not all have the same fiscal year, the partnership is generally required to adopt a calendar year for tax purposes.

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**d. Limited Liability Companies**

**§2.145 (1) Flow-Through Entity; Election of Corporate Treatment**

Pursuant to IRS and California check-the-box regulations, an LLC is treated as a partnership for income tax purposes unless it elects to be treated as a corporation. See §2.117.

As a flow-through entity (partnership tax characteristics), the income and losses of the LLC flow through to, and are taxed to or deducted by, the individual members. Income and losses normally retain the character they had in the LLC. Thus, an LLC choosing partnership characteristics can avoid double taxation, and losses may be fully deductible by the individual members (but not in excess of the individual member's adjusted tax basis in the LLC). IRC §§702, 704(d).

As with a partnership, flow-through tax treatment can be disadvantageous to the owners of a profitable LLC that reinvests a significant portion of its profits, since the members will be taxed on their allocable share of the profits without receiving cash distributions from which to pay the tax.

An LLC that elects corporate tax characteristics may be subject to double taxation and other tax characteristics of a corporation. See §§2.121-2.126.

**§2.146 (2) Distributions**

An LLC's distributions to its members generally are not taxable either to the LLC or the individual members. IRC §731. However, if the value of the distribution by the LLC exceeds the individual member's adjusted tax basis in his or her LLC interest, gain is recognized by the individual member to the extent of the excess. IRC §731(a)(1).

As with a partnership, a member who contributes property with built-in gain may be required to recognize all or part of that gain if, within 5 years of the initial contribution, either (a) the LLC distributes the contributed property to another member (IRC §704(c)) or (b) the LLC distributes different property to the contributing member (IRC §737).

In addition, gain may be recognized to the individual partner when an LLC distributes marketable securities or certain unrealized receivables or appreciated inventory. IRC §§731(c), 751(b).

A member's adjusted tax basis in his or her LLC interest is reduced by the distributions made to the member. IRC §705. Generally, a member will take an adjusted tax basis in any property distributed by the LLC to the member equal to the LLC's adjusted tax basis in the property immediately prior to the distribution. IRC §732.

**§2.147 (3) Application of Partnership Tax Rules to LLCs**

Most commonly, LLCs are treated as partnerships for federal income tax purposes (and single-member LLCs, including LLCs owned solely by a husband and wife as community property, at their election are treated as sole proprietorships or partnerships for tax purposes). See Rev Proc 2002-69, 2002-2 Cum Bull 831. Unless an election is made to treat the LLC as a corporation for tax purposes, the partnership tax discussion in §§2.135-2.144 will apply to LLCs. Briefly, the partnership tax principles applicable to LLCs are as follows:

- An LLC may make special allocations of profit, loss, deductions, and credits (rather than in proportion to ownership) as long as the allocations have "substantial economic effect."
- Debt incurred by the LLC should increase the individual member's adjusted tax basis in his or her LLC interest. Because the individual members may not be personally liable for the LLC's debt, the allocation for purposes of each individual member's adjusted tax basis will likely be made as if the debt is nonrecourse.
- An LLC may make the IRC §754 election to adjust the inside basis of LLC-owned assets to reflect change in the outside basis of an individual member resulting from the death of a member or the sale of a member's interest.
- Each individual member's ability to deduct losses of the LLC is subject to the at-risk rules limitations set forth in IRC §465.
- Each individual member of the LLC is subject to the passive loss rule of IRC §469. However, it is unclear whether members who participate in management of the LLC will be deemed to "materially participate" in the LLC's business. Therefore, it is unclear whether a managing member's losses will be characterized as active or passive under the passive loss rules.
- An LLC will be deemed to terminate for tax purposes if 50 percent or more of the membership interests in the LLC are sold or exchanged within 12 months. IRC §708(b)(1)(B).
- An LLC's method of accounting for tax purposes is determined under the same general criteria used by partnerships, except that a single-member LLC must use the accounting method of its member.
- LLCs are generally subject to the same limitations as partnerships in adopting a taxable year, except that single-member LLCs must use the same taxable year as its member.

For a comprehensive discussion of the taxation of LLCs, see *Forming and Operating California Limited Liability Companies*, chap 5 (2d ed Cal CEB 2007).

**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.148 (4) Election to Apply Corporate Tax Rules to LLCs

**§2.148 (4) Election to Apply Corporate Tax Rules to LLCs**

Although LLCs usually elect to be treated as partnerships for tax purposes, under the check-the-box regulations an LLC may elect to be treated as a corporation for tax purposes. For a discussion of the tax rules applicable to corporations, see §§2.121-2.126.

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**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/ 4. Taxation on Disposition and Liquidation/ a. Corporations/§2.149 (1) Dispositions of Shares

#### **4. Taxation on Disposition and Liquidation**

##### **a. Corporations**

##### **§2.149 (1) Dispositions of Shares**

A shareholder's disposition of shares of corporate stock generally constitutes a taxable event. Gain or loss is recognized equal to the difference between the value of the money and property received for the stock and the shareholder's adjusted tax basis in the stock. IRC §1001. The gain or loss will generally be treated as resulting from the disposition of a capital asset. IRC §1221. Consequently, gain on the sale of stock held for at least 12 months will be subject to a maximum federal income tax rate of 15 percent, as compared to the top marginal rate of 39.6 percent on ordinary income. Losses recognized on the sale of stock may be subject to the capital loss limitations, potentially resulting in the deduction being spread out over several years (if the shareholder does not have sufficient offsetting capital gains). IRC §§1211-1212.

The sale of an individual shareholder's stock in the corporation is not a taxable event to the corporation.

**§2.150 (2) Liquidation of Corporation**

On liquidation of the entire corporation, or on a distribution to one or more shareholders (but not all shareholders) in complete liquidation of their shares in the corporation, each shareholder whose shares are being liquidated will recognize capital gain or capital loss equal to the difference between the fair market value of cash and property received and the shareholder's adjusted tax basis in the shares. IRC §§302, 331, 1001.

At the same time, to the extent that the distribution to the shareholder is made in property (rather than in cash), the corporation must recognize gain on an amount equal to the fair market value of the property being distributed less the corporation's adjusted tax basis in the property. IRC §336. Consequently, the liquidating distribution may result in double taxation.

Double taxation cannot be reduced or avoided simply by transferring appreciated property from the corporation to an LLC or a limited partnership, and then distributing membership or limited partnership interests to the corporation's shareholders. In *Pope & Talbot, Inc. v Commissioner* (9th Cir 1999) 162 F3d 1236, the liquidating corporation tried to minimize double taxation by arguing that its distribution of limited partnership interests to the shareholders resulted in a distribution of property to the shareholders having a lower fair market value than if the original corporate property had been distributed directly to the shareholders. The court rejected this argument and determined the taxable gain based on a deemed sale of the corporation's underlying assets (without taking into account the restrictions imposed by creation of the limited partnership interest).

**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.151 (3) Merger of Corporation

**§2.151 (3) Merger of Corporation**

Merger of a corporation into another entity may result in a tax-free reorganization under IRC §368. Consequently, it may be advantageous to structure a business as a corporation if the owners believe the company may be acquired by another entity sometime in the future.

It may be possible to convert an LLC or a partnership into a corporation without triggering tax. IRC §351. However, the IRS may not treat the conversion as tax-free if it is immediately followed by a reorganization. Rev Rul 70-140, 1970-1 Cum Bull 73; *West Coast Mktg. Corp.* (1966) 46 TC 32.

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**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/ b. Partnerships/§2.152 (1)  
Disposition of Partnership Interest

**b. Partnerships**

**§2.152 (1) Disposition of Partnership Interest**

A partner's disposition of all or any portion of his or her partnership interest is generally a taxable event. IRC §741. Gain or loss is recognized in an amount equal to the difference between the value of money and property received for the partnership interest and the partner's adjusted tax basis in the partnership interest. The gain or loss (except to the extent that it is attributable to unrealized receivables—including recapture—or inventory) is treated as resulting from the disposition of a capital asset. IRC §§741, 751(a). Consequently, gain on the sale of a partnership interest held for at least 12 months will be subject to the lower maximum rate for federal income tax purposes, and losses may be subject to the capital loss limitations.

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**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.153 (2) Liquidation of Partnerships

### **§2.153 (2) Liquidation of Partnerships**

On liquidation, a partnership does not ordinarily experience a tax recognition event (IRC §731(b)), and the partners are generally taxed only to the extent that the value of the money and property received in liquidation of their partnership interest exceeds the partners' adjusted tax basis (unless the distributions are disproportionate with respect to unrealized receivables or inventory). IRC §§731(a), 751(b). Thus, partnerships generally do not experience double taxation on liquidation. The individual partner's recognition of gain or loss on liquidation of the partnership interest is generally treated as a capital gain or loss. Therefore, the gain on liquidation of a partnership interest held for at least 12 months may be subject to the lower maximum rate for federal income tax purposes, and any loss may be subject to the capital loss deduction limitations.

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**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.154 c. Limited Liability Companies

**§2.154 c. Limited Liability Companies**

LLCs are taxed as partnerships unless they elect to be taxed as corporations. Consequently, the consequence of disposition or liquidation of an interest in an LLC is as set forth with respect to partnerships (See §§2.152-2.153) or with respect to corporations (See §§2.149-2.151), depending on whether or not the election is made.

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**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/ D. State Taxation/§2.155  
1. Corporations

**D. State Taxation**

**§2.155 1. Corporations**

Corporations are subject to the California franchise tax on principles similar to the federal corporate income tax. The maximum rate of tax is 8.84 percent. Rev & T C §23151(d). After the corporation's first taxable year, the minimum franchise tax is \$800 each year. Rev & T C §23151(d)(1).

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**§2.156      2. S Corporations**

An S corporation is subject to California franchise tax on roughly the same principles as the federal corporate income tax rules applicable to S corporations, unless the corporation is an ineligible corporation within the meaning of Rev & T C §§23800.5 and 23801. However, an S corporation is required to pay California franchise tax in an amount equal to 1.5 percent of the corporation's net income (Rev & T C §23802(b)(1)), and after the corporation's first taxable year is subject to the \$800 minimum annual franchise tax. Rev & T C §§23153(d)(1), 23802(c).

**§2.157 3. Partnerships**

California's tax treatment of partnerships generally corresponds to the federal tax treatment of partnerships. Rev & T C §17851. Consequently, California does not tax partnership income at the entity level, but instead partnership income and loss flows through to, and are taxed to or deducted by, the individual partners.

Limited partnerships and limited liability partnerships are subject to the \$800 minimum annual franchise tax, but general partnerships do not pay the \$800 minimum annual franchise tax. Rev & T C §§17935(a), 17948, 23153(d)(1), (e)(4).

**§2.158 4. Limited Liability Companies**

LLCs are subject to the California rules applicable to partnerships, unless they elect to be taxed as corporations (in which event they are subject to the California rules applicable to corporations).

In addition, LLCs are subject to the \$800 minimum annual franchise tax (Rev & T C §§17941(a), 23153(d)(1)) and also must pay an additional annual fee if the LLC's total revenue (gross receipts) from all sources derived from or attributable to California is at least \$250,000. Rev & T C §17942. The attorney should keep in mind that "gross revenue" includes any proceeds of liquidating assets or selling real estate, so that an LLC holding real estate, for example, may incur the maximum annual fee of \$11,790 in a year that the real estate is sold, even if the rental revenue is only enough to trigger the \$900 annual fee. The annual fee (over and above the \$800 minimum annual franchise tax) is determined as follows:

TOTAL INCOME	ANNUAL FEE
Less than \$250,000	\$0
\$250,000 to less than \$500,000	\$900
\$500,000 to less than \$1,000,000	\$2500
\$1,000,000 to less than \$5,000,000	\$6000
\$5,000,000 or more	\$11,790

**NOTE:** An appellate court has held that the California annual fee paid by LLCs (based on worldwide gross receipts) is unconstitutional under the commerce clause of the United States Constitution when paid by a foreign (non-California) LLC that did not conduct any business in California. *Northwest Energetic Servs., LLC v California Franchise Tax Bd.* (2008) 159 CA4th 841, 71 CR3d 642.

The California Franchise Tax Board has established a procedure for submitting protective claims for the refund of previously paid fees. See §11.7.

## **E. Other Tax Considerations**

### **§2.159 1. Self-Employment Income**

Self-employment income is subject to a 15.3-percent federal tax (12.4 percent for "old-age, survivors, and disability insurance" (Social Security) applicable to the first \$106,800 of self-employment income (for 2010, and adjusting each year thereafter for inflation); and 2.9 percent for "hospital insurance" (Medicare) applicable to all self-employment income). See IRC §1401. Generally, "net earnings from self-employment" include gross income derived from any trade or business carried on as an individual, plus a partner's share of income or loss carried on by a partnership of which he or she is a member. IRC §1402(a). For application of the self-employment tax rules to each type of entity, see §§2.160-2.162, below.

**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.160 a. Corporations

**§2.160 a. Corporations**

Wages paid to a shareholder are not subject to self-employment tax, but are subject to Social Security and Medicare taxes in an equal amount that are imposed one-half on the employer and one-half on the employee. Any profits of the corporation that are paid as dividends to the corporation's shareholders are exempt from self-employment tax. IRC §1402(a)(2).

A shareholder's share of income received from an S Corporation is not taxable as self-employment income. *Ding v Commissioner* (9th Cir 1999) 200 F3d 587.

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**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.161 b. Partnerships

**§2.161      b. Partnerships**

Generally, a general partner's allocable share of partnership income is treated as self-employment income and is subject to self-employment tax. IRC §1401-1402.

A limited partner's allocable share of partnership income, however, is not ordinarily treated as self-employment income, unless it is paid to the limited partner as a "guaranteed payment" for services rendered, within the meaning of IRC §707. IRC §1402(a)(13). But see discussion of Prop Treas Reg §1.1402(a)-2 in §2.162, below.

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**§2.162 c. Limited Liability Companies**

Treatment of income or loss from an LLC will depend on whether the LLC has elected to be treated as a partnership or corporation for federal tax purposes. See the rules applicable to each entity in §§2.160-2.161, above.

Treatment of members of an LLC who do not participate in the management of the LLC is uncertain. Under former proposed regulations, non-managing members were treated similarly to limited partners, and the allocable share of LLC income was not treated as self-employment income. Former Prop Treas Reg §1.1402(a)-2. The current proposed regulations that define limited partner would require a managing member or a member who materially participated in the company's trade or business to include his or her distributive share of partnership income in the computation of self-employment income. Prop Treas Reg §1.1402(a)-2. This is inconsistent with the express language of IRC §1402(a) that excludes the distributive share of a limited partner (unless it is a guaranteed payment), but may be given effect if it applies to LLCs.

**§2.163      2. Fringe Benefits**

Fringe benefits, such as health insurance and other items, can be deductible to the business entity and excluded from the employee's taxable income. IRC §§106, 162. The ability of an owner-employee to exclude the cost of the fringe benefit from taxable income on the owner's personal tax return is dependent on the type of business entity selected. The specifics follow.

**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.164 a. Corporations

**§2.164 a. Corporations**

A corporation may deduct the cost of fringe benefits, and an owner-shareholder may exclude the value of the fringe benefit from taxable income, so long as the benefit plan does not improperly discriminate in favor of highly compensated employees (including owners). IRC §§105, 106.

An S corporation shareholder-employee who owns more than 2 percent of the outstanding shares of the corporation, however, must include the value of any medical insurance received in his or her taxable income. IRC §1372; Rev Rul 91-26, 1991-1 Cum Bull 184.

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**§2.165      b. Partnerships**

A partnership may treat the cost of medical insurance as a "guaranteed payment" within the meaning of IRC §707(c) and deduct the cost (thereby reducing the income that will flow through to the individual partners). In that situation, the value of the insurance received will be treated as taxable income to the partner receiving the benefit, deductible by the partner to the extent allowed under IRC §162(a).

Alternatively, the partnership may elect not to deduct the cost of the insurance. In that event, the partnership's income will be greater to the extent of the premium paid but not deducted, and the increased income will be allocated to the individual partners in accordance with their respective ownership interests in the partnership. They may deduct the cost to the extent allowed under IRC §162(a). Rev Rul 91-26.

**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.166 c. Limited Liability Companies

**§2.166 c. Limited Liability Companies**

Treatment of fringe benefits paid by an LLC will depend on whether the LLC has elected to be treated as a partnership or corporation for federal tax purposes. See the rules applicable to each entity in §§2.164-2.165, above.

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**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/ F. Anonymity of Owners/  
§2.167 1. Sole Proprietorships

## **F. Anonymity of Owners**

### **§2.167 1. Sole Proprietorships**

Sole proprietorships are operated either under the owner's own name or under another fictitious business name (also colloquially called a "DBA," for "doing business as"). A DBA is obtained by registration with the county recorder of the proprietorship's principal place of business, and other business licenses may be required by local government. In either event, the owner's name is public or readily available by a search of local fictitious name and licensing records.

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**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.168 2. Corporations, Including S Corporations and Close Corporations

**§2.168      2. Corporations, Including S Corporations and Close Corporations**

The names of corporate shareholders are not a matter of public record, but the names and addresses of officers and directors must be listed in the annual Statement of Information (Domestic Stock Corporation) (Form SI 200 C) filed with the Secretary of State. Corp C §1502(a). Shareholders may obtain the names and addresses of fellow shareholders from corporate records.

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**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.169 3. General Partnerships

**§2.169 3. General Partnerships**

The names of partners in a general partnership need not be public record unless

- A statement of partnership is recorded (see Corp C §16105);
- The partnership uses a fictitious business name; or
- A statement of partnership authority is filed (see Corp C §16303).

If the partnership uses a name that does not include the surname of each general partner or if the name suggests the existence of additional owners, the partnership must file and publish a fictitious business name statement. Bus & P C §§17900(b)(2), 17917. The fictitious business name statement must contain the full name and residence address of each general partner. Bus & P C §17913(b). See §§3.8-3.12.

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**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.170 4. Limited Partnerships

**§2.170 4. Limited Partnerships**

The names of limited partners are not public record; only the names and addresses of the general partner(s) must be shown on the Certificate of Limited Partnership (Secretary of State Form LP-1).

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**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.171 5. Limited Liability Partnerships (LLPs)

**§2.171 5. Limited Liability Partnerships (LLPs)**

Registered LLPs are exempt from the fictitious business name requirements. Corp C §16961. However, the names and addresses of all licensed persons must be disclosed in the application for certification required to be filed with the State Bar by legal services LLPs. State Bar LLP R 4.0. Information provided to the State Bar under the LLP rules is not confidential and will be disclosed on request of any interested person, except as prohibited by law. State Bar LLP R 12.0. Any partnership agreement provided to the State Bar is confidential.

The State Bar, Board of Accountancy, and California Architects Board may not disclose any information they receive in the course of evaluating an LLP's compliance with applicable statutory and administrative registration or filing requirements, unless compelled by a subpoena or other order of a court of competent jurisdiction. Corp C §16953(h). The State Bar, Board of Accountancy, and California Architects Board are not prohibited from disclosing the manner in which the LLP has satisfied any requirements of financial security for claims arising from the practice of law, public accountancy, or architecture. Corp C §16953(h).

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**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.172 6. Limited Liability Companies (LLCs)

**§2.172 6. Limited Liability Companies (LLCs)**

In an LLC managed not by its members but by a non-member manager, the names and addresses of the members are not a matter of public record, but the names and addresses of the managers must be listed in the initial Limited Liability Company Statement of Information (Secretary of State Form LLC-12) and in annual renewals. In a member-managed LLC, however, the names of the member-managers will be public record because their names and addresses must be listed in the Form LLC-12 filed annually by the LLC.

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**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/ G. Owners' Personal Liability for Business Debts and Obligations/§2.173 1. Sole Proprietorships

## **G. Owners' Personal Liability for Business Debts and Obligations**

### **§2.173 1. Sole Proprietorships**

A sole proprietor's personal liability for the debts and obligations of the business is not limited to the assets of the business, and liability insurance should be considered. In addition, a sole proprietor may consider forming a corporation or an LLC, although creditors may nevertheless require personal guarantees from the owner for obligations of the business.

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**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.174 2. Corporations, Including S Corporations and Close Corporations

## **§2.174 2. Corporations, Including S Corporations and Close Corporations**

Corporate shareholders, directors, and officers are ordinarily not liable for the debts and other obligations of a corporation, although business creditors may require personal guarantees from shareholders of a thinly capitalized or new corporation. As a separate legal entity, the corporation itself is liable for such debts and obligations. Individuals, however, may be held liable:

- To the extent that they have personally guaranteed corporate debts;
- To the extent that they have received improper distributions (see Corp C §§506(a), 2009(a));
- If a court "pierces the corporate veil" of a corporation to impose personal liability on the shareholders (see *Stodd v Goldberger* (1977) 73 CA3d 827, 141 CR 67);
- If a director, officer, or controlling shareholder breaches a duty to the other shareholders of the corporation (Corp C §§204(a)(10), 309; see *Jones v H. F. Ahmanson & Co.* (1969) 1 C3d 93, 81 CR 592); or
- If a director, officer, or shareholder participates in tortious conduct (see *PMC, Inc. v Kadisha* (2000) 78 CA4th 1368, 93 CR2d 663).

**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.175 3. General Partnerships

**§2.175 3. General Partnerships**

The partners of a general partnership are (a) jointly and severally liable for the wrongful acts or omissions of any partner acting in the ordinary course of partnership business or with authority of the partners, and (b) jointly liable for all other debts and obligations of the partnership. Corp C §16306(a). Each partner is an agent of the partnership, with authority to bind the partnership by his or her unilateral actions. See §2.181.

A partnership may obtain insurance against some potential liabilities and may be able to negotiate the terms of indebtedness to limit a creditor's recourse against specific partners. Nevertheless, each partner's personal assets ordinarily remain subject to the risks of the partnership business.

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**§2.176 4. Limited Partnerships**

The general partner of a limited partnership is liable for partnership debts and obligations to the same extent as the partners of a general partnership. Corp C §15904.04(a). Like shareholders in a corporation, limited partners are not normally liable for debts of the partnership. Corp C §15903.03(a). The liability of a limited partner is usually limited to the amount of his or her agreed capital contribution and any distributions received by the limited partner from the partnership at a time when the partnership's assets were insufficient to satisfy its liabilities. Corp C §15902.02.

Limited partners may become liable as though they are general partners if they participate in the control of the partnership business. Corp C §15903.03(a). A limited partner may, however, be a director, an officer, or an employee of a corporate general partner without adversely affecting his or her status as a limited partner. See Corp C §15903.03(b).

**§2.177 5. Limited Liability Partnerships (LLPs)**

The defining characteristic of an LLP is its elimination of the vicarious liability of partners for partnership debts, with certain specified exceptions. Generally speaking, a partner is liable jointly and severally for all obligations of the partnership unless otherwise agreed by the claimant or provided by law (Corp C §16306(a)), except that

- A partner is not personally liable for any partnership obligation incurred before admission as a partner (Corp C §16306(b)), and
- A partner is not liable for debts or obligations of the partnership or another partner, whether in tort or in contract (Corp C §16306(c)), that are incurred while the partnership is a registered limited liability partnership.

Despite these exceptions, the partners may agree by majority vote (or a different vote required in the partnership agreement) to be liable as partners for specified debts and obligations of the partnership (Corp C §16306(d)).

A partner nevertheless remains liable for his or her own tortious conduct, but not that of the other partners (noting that, for such protection to apply, a legal services LLP must be currently registered as such with the State Bar of California). Corp C §16306(e)-(f). A partner may guarantee or provide collateral for obligations of an LLP. Corp C §16306(h). See §2.79. For further discussion of LLP partner liability, see §§7.4-7.6.

Other than for changes to its partnership agreement and compliance with filing, registration, and financial security requirements, a California LLP is governed by California's general partnership statute. Corp C §§16100-16962.

**§2.178 6. Limited Liability Companies (LLCs)**

The owners of an LLC (called *members*) are not personally liable for the debts, obligations, or liabilities of the LLC solely by reason of membership in the LLC, whether the debts, obligations, or liabilities arise in contract, tort, or otherwise (Corp C §17101(a)), with the following exceptions:

- A member may be liable to third parties for the member's participation in tortious conduct and to the extent that he or she personally guarantees debts of the LLC either through a written guarantee or in the articles of organization or a written operating agreement (Corp C §17101(c), (e));
- A member may be obligated to return (or to face personal liability for) improper distributions from the LLC (Corp C §§17254(e), 17255); and
- A member may be liable if a court "pierces the veil" of an LLC to impose personal liability on the member as an "alter ego" of the LLC, in the same way that a shareholder of a corporation could be liable under similar circumstances (Corp C §17101(b)).

**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/ H. Management and Control; Fiduciary Duties/§2.179 1. Sole Proprietorships

## **H. Management and Control; Fiduciary Duties**

### **§2.179 1. Sole Proprietorships**

A sole proprietor has full management and control of the business. Employees may be hired to assist in running the business, but the sole proprietor has no partner-like fiduciary duty to those employees.

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## §2.180 2. Corporations

Shareholders elect directors initially on formation (unless the initial directors are appointed by the incorporator; see Corp C §210) and thereafter elect a board of directors annually. Corp C §301. The directors in turn appoint officers, including at a minimum a president, secretary, and chief financial officer/treasurer. Corp C §312.

In a corporation, shareholders may serve as officers and directors without sacrificing limited liability protection, as long as corporate formalities are respected. See *Organizing Corporations in California*, chaps 1, 1A (3d ed Cal CEB 2001). See also chap 9 of this book.

The board of directors determines corporate policy and authorizes corporate actions outside the ordinary course of business, for example, raising capital, borrowing money, and acquiring or disposing of significant assets. Corp C §300(a). The officers, elected annually by the board of directors, carry out policies established by the board and manage the day-to-day affairs of the corporation. Shareholders, in the capacity of shareholders, cannot bind the corporation and, except for close corporations, have no right to participate in the management and control of the business unless elected as directors or officers.

In a corporation, management and control is vested in the officers and directors while ownership and voting powers reside in the shareholders. This balance can be altered by creating voting and nonvoting classes of stock, entering into voting trusts, creating committees of the board, drafting management agreements or shareholder agreements, or including provisions in the articles of incorporation requiring supermajority votes for specified corporate actions.

When the number of shareholders is substantial, a corporation's directors and officers are more likely to operate without input from shareholders except at annual shareholder meetings. If a corporation has only a few shareholders who are also directors and officers, however, management of the corporation may not differ significantly in substance from that of a partnership, although corporate formalities must be observed to avoid "alter ego" liability. A corporation may formally vest management and control in the shareholders and avoid corporate formalities by electing to be a close corporation and entering into a shareholder agreement. Corp C §§158, 186, 300(b). See §8.5, chap 9.

Members of a corporation's board of directors have a duty to act in good faith and in a manner the directors believe to be in the best interests of the corporation and its shareholders and to exercise such care as an ordinarily prudent person would in a similar situation. Corp C §309. The articles of incorporation may eliminate or limit the personal liability of directors for monetary damages for breach of these duties, subject to exceptions for intentional misconduct or violations of law. Corp C §204(a)(10). Officers are obligated not to engage in self-dealing, in which their personal interests in transactions overrides the interests of the corporation and its shareholders. Corp C §310. The General Corporation Law is silent regarding the fiduciary duties of shareholders; however, majority shareholders of the corporation may owe certain fiduciary duties to minority shareholders. See *Jones v H. F. Ahmanson & Co.* (1969) 1 C3d 93, 81 CR 592.

**§2.181 3. General Partnerships**

Unless the general partnership agreement provides otherwise, all partners have equal rights to manage and conduct partnership business. Corp C §16401(f). Each partner is an agent of the partnership for the purpose of carrying on its business, and the act of any partner for apparently carrying on the partnership's business in the usual manner binds the partnership. Corp C §16301(1). The general partnership agreement may restrict the authority of a particular partner to bind the partnership; however, a restriction on authority will not be effective against third parties who have no knowledge of the restriction. Corp C §16301(1).

The fiduciary duties of general partners to the partnership and to each other are governed by Corp C §16404, which establishes a duty of loyalty (Corp C §16404(b)) and a duty of care (Corp C §16404(c)), and specifies that partners discharge their duties and exercise their rights consistently with the obligation of good faith and fair dealing (Corp C §16404(d)). See §5.11-5.14.

**§2.182 4. Limited Partnerships**

Limited partnerships are managed by the general partners. Limited partners may not participate in the control of the business without risking loss of their limited liability protection. Corp C §§15901.13, 15903.03, 15904.08. General partners may simultaneously hold interests as limited partners. Corp C §15901.13.

The fiduciary duties of general partners in a limited partnership are the same as those in a general partnership: the duties of loyalty and of care, exercised consistent with the obligations of good faith and fair dealing. See §6.10. General partners in a limited partnership have the following additional obligations (Corp C §§15901.10(b)(5)-(7), 15904.08):

- The general partner's duty of loyalty cannot be eliminated, but the limited partnership agreement may set definitions of activities which do not unreasonably violate that duty and may establish the number or percentage of partners who may authorize or ratify acts by the general partner(s) which would otherwise violate the duty of loyalty;
- The general partner's duty of care may be reduced, but not unreasonably; and
- The general partner's obligations of good faith and fair dealing may not be eliminated, but reasonable standards may be set by which to judge the general partner's performance in this regard.

A limited partner has no fiduciary duty to the limited partnership or the other partners solely by reason of being a limited partner. Corp C §15903.05(a). Although a limited partner is required to discharge its duties and exercise its rights consistent with the obligations of good faith and fair dealing toward the partnership and the other partners, the limited partner does not violate such a duty or obligation merely because the conduct furthers the partner's own interest. Corp C §15903.05(b)-(c).

**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.183 5. Limited Liability Partnerships (LLPs)

**§2.183 5. Limited Liability Partnerships (LLPs)**

An LLP formed under California law is subject to the same principles of management as a general partnership, with the following principal differences: (a) the partners' liability is limited, and (b) the partnership agreement may provide, on a specified vote of the partners, that particular partners will be personally liable for certain debts, obligations, or liabilities of the partnership. Corp C §16306(d).

The members of an LLP are governed by California's general partnership statute and, accordingly, owe each other the fiduciary duties of general partners to each other: the duties of loyalty and care, and the obligations of good faith and fair dealing. Corp C §16404.

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**§2.184 6. Limited Liability Companies (LLCs)**

Unless an LLC's articles of organization state that it will be managed by managers, the LLC's business and affairs are managed by its members. Corp C §17150. If an LLC is member-managed, the members have all the rights and are subject to all the duties of managers set forth in the Corporations Code. Corp C §17150.

If an LLC is managed by managers, then the members do not participate in the management of the LLC's business, are not agents of the LLC, and cannot bind it. Corp C §17157(b)(1). A written operating agreement may eliminate the right of members to remove managers. Corp C §§17005(b), 17152(b).

If authorized in a written operating agreement, an LLC may have officers, including a chairman, president, vice president, secretary, and chief financial officer. Corp C §17154. Officers have the powers and duties specified in the operating agreement and determined from time to time by the members or managers. Either a member-managed or a manager-managed LLC may have officers. See Corp C §17154(b).

In a member-managed LLC (Corp C §17157(a)):

- Every member is an agent of the LLC for the purpose of carrying on its business or affairs, and
- The act of any member for apparently carrying on the business or affairs of the LLC in the usual way binds the LLC.

In a manager-managed LLC (Corp C §17157(b)):

- Every manager is an agent of the LLC for the purpose of its business affairs, and the act of any manager for apparently carrying on in the usual way the business or affairs of the LLC binds the LLC; and
- Members are not agents of the LLC and cannot bind it.

The articles of organization or the operating agreement may include limitations on the authority of members (in a member-managed LLC) or managers (in a manager-managed LLC) to bind the LLC. Such provisions will not be effective, however, against third parties who do not have actual knowledge of the restrictions. Corp C §17157(a), (b)(2), (d).

An LLC provides management flexibility. If the LLC is managed by its members, the management can be as decentralized and informal as that of a general partnership. Alternatively, (a) a corporate-style management structure may be adopted, complete with officers and managers acting as would a board of directors (with the caveat that managers, unlike directors, have agency power to bind the LLC); or (b) the LLC may adopt a centralized structure analogous to a limited partnership, with a manager acting as would a general partner.

The fiduciary duties owed to the LLC and its members by the managers of the LLC are the same as those of a partner to a partnership and to the partners of the partnership. Corp C §§17150, 17153. This is true whether the managers are members who manage ("member-managers") or outsiders who manage ("non-member-managers"). The fiduciary duties of a manager (whether a member-manager or a non-member-manager) may be modified only in a written operating agreement and with the informed consent of the members. In some situations, a lower standard of duty may be appropriate. Corp C §17005(d).

For further discussion, see Forming and Operating California Limited Liability Companies §§6.35-6.40 (2d ed Cal CEB 2007).

**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.185 I. Transferability of Interests; Liquidity

**§2.185 I. Transferability of Interests; Liquidity**

Although the ability to transfer ownership interests freely is an important planning consideration, it is usually not the determining factor in the choice of entity. Generally, the fewer the number of owners, the less weight is given to this factor. In a venture with only a few participants, the parties will generally want to restrict the transferability of ownership interests. Furthermore, in most closely held businesses, there is no ready market for the ownership interests in the business, regardless of the degree of transferability inherent in the form of business selected.

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**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.186 1. Sole Proprietorships

**§2.186 1. Sole Proprietorships**

A sole proprietorship has no divisible ownership interests. If the business is sold or transferred, the owner sells the assets and assigns the liabilities of the business directly to the purchaser.

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**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.187 2. Corporations, Including S Corporations

**§2.187 2. Corporations, Including S Corporations**

Other than limitations imposed by securities laws (see §8.7), there are no statutory limits on a shareholder's right to transfer shares of stock and the consent of other shareholders to the transfer need not be obtained by law. In addition, a transfer of shares does not terminate a corporation. In corporations with few shareholders or in close corporations, however, the transfer or sale of shares is often restricted by a shareholder "buy-sell" agreement or by provision in the articles of incorporation or bylaws. See Corp C §§204(a)(3), (b), 212(b)(1). Conversely, a ready market may not exist for shares in a small, closely held corporation, resulting in difficulty in finding a buyer and in determining an appropriate price for the shares.

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**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.188 3. General Partnerships

**§2.188 3. General Partnerships**

Interests in general partnerships are not easily transferred. Unless otherwise provided by specific agreement, partners in a general partnership cannot convey their rights as a partner to another person, because the admission of a new partner requires the consent of the other partners. Corp C §16401(i). A partner may assign his or her economic interest in the partnership to a third party, but this transfers only the right to share in distributions and profit and loss allocations and does not transfer voting rights, the right to participate in the management of the partnership business, or the right to require accountings or inspect partnership records. Corp C §§16502-16503.

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**§2.189 4. Limited Partnerships**

The economic interest of a limited partner in a limited partnership is assignable without the other partners' consent, but, as with general partnerships, this assignment transfers only the limited partner's economic interest (that is, the right to share in distributions and profit and loss allocations) and does not transfer the limited partner's voting rights. Corp C §§15907.01, 15907.02. Unless the partnership agreement provides otherwise, the assignee of an economic interest cannot be admitted as a substitute limited partner (thereby acquiring all rights of a limited partner, including voting rights) without the consent of all general partners and a majority in interest of the limited partners. Corp C §15907.02(h). Limited partnership agreements often provide, however, that an assignee will be admitted as a substitute limited partner with the consent of only the general partners, eliminating the requirement of limited partner consent, which is advantageous in limited partnerships with many limited partners.

The transfer of the general partner's interest in a limited partnership is subject to the same rules as transfers of interests in general partnerships discussed above. The limited partners must approve the addition or substitution of a new general partner. Corp C §15904.01.

**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.190 5. Limited Liability Partnerships (LLPs)

**§2.190 5. Limited Liability Partnerships (LLPs)**

An LLP is treated in the same manner as a California general partnership with respect to transferability of interests. See §2.188.

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**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.191 6. Limited Liability Companies (LLCs)

**§2.191 6. Limited Liability Companies (LLCs)**

The economic interest of an LLC member is assignable without the other members' consent, but transfer of an economic interest transfers only the member's right to share in distributions and profit and loss allocations and does not assign the member's voting and management rights. Corp C §17301(a). Unless the operating agreement provides otherwise, the assignee of an economic interest cannot be admitted as a substitute member (thereby acquiring all the rights of a member, including voting rights) without the consent of a majority in interest of the members who are not transferring their interests. Corp C §§17301(a)(1), 17303.

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**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.192 J. Continuity of Business

**§2.192 J. Continuity of Business**

The loss of an owner through disability, death, withdrawal, expulsion, or bankruptcy is of greatest concern when the individual plays a significant role in management of a business. If the departing owner holds only a relatively small ownership interest and does not have a significant management role, the departure may be of less concern in its effect on the continuation and success of the business.

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**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.193 1. Sole Proprietorships

**§2.193 1. Sole Proprietorships**

A sole proprietorship has no continuity of business issues to address. If the owner is unable to continue the business or decides to terminate it, then the assets are sold, the liabilities are paid by the owner or assumed by an acquiror, and the business ceases.

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**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.194 2. Corporations, Including S Corporations

**§2.194 2. Corporations, Including S Corporations**

A corporation has an existence independent of its owners and is not terminated by death, withdrawal, or other events affecting its shareholders, officers, or directors. The departure of a significant shareholder or officer can nevertheless damage a corporation's viability. Unless its articles of incorporation provide otherwise, a corporation continues in existence indefinitely until terminated by the affirmative act of its shareholders or by judicial decree.

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**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.195 3. General Partnerships

**§2.195 3. General Partnerships**

A general partnership formed for a definite term or undertaking is dissolved and wound up on the wrongful withdrawal, death, bankruptcy, or termination of a partner, unless a majority in interest of the remaining partners (including partners who have rightfully withdrawn after the first withdrawal) vote to continue the partnership. A general partnership without a definite term or undertaking (that is, "at will") is dissolved and wound up only on the affirmative vote of at least half the partners, except as provided in the partnership agreement. On dissolution, the partners may agree to reconstitute into a new partnership to carry on the business of the dissolved partnership. Corp C §16801(1)-(2). These rules may be varied in the partnership agreement.

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**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.196 4. Limited Partnerships

#### **§2.196 4. Limited Partnerships**

Neither the assignment of a limited partnership interest nor the departure of a limited partner causes the dissolution of a limited partnership. Corp C §§15906.02, 15907.02(a)(2). However, the death, bankruptcy, withdrawal, removal, or incompetence of a general partner will cause the dissolution of a limited partnership unless (Corp C §15908.01):

- The partnership agreement permits the remaining general partners to continue the business, and a remaining general partner or partners elect to do so; or
- A majority in interest of the remaining partners agree to continue the business of the partnership and elect one or more successor general partners if no general partner remains.

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**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.197 5. Limited Liability Partnerships (LLPs)

**§2.197 5. Limited Liability Partnerships (LLPs)**

An LLP is governed by California's general partnership statute (Corp C §§16100-16962) and is accordingly treated in the same fashion with respect to causes of dissolution. On the dissolution of general partnerships, see §2.56.

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**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.198 6. Limited Liability Companies (LLCs)

**§2.198 6. Limited Liability Companies (LLCs)**

An LLC is not dissolved on the death, retirement, resignation, expulsion, bankruptcy, or dissolution of one or more of its members. Corp C §17350.

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**§2.199 K. Estate Planning for Families**

Limited partnerships and LLCs can be used to provide centralized management and control of a closely held business, so that ownership (and the related right to receive income) can be widely distributed among family members of the next generation, while allowing management to be centralized in the hands of one or more family members who are best suited to operate the business (or investments, such as rental real estate). As a result, the "restricted" interests may be discounted for lack of marketability or lack of control, resulting in a lower valuation in the decedent's estate and lower estate taxes. Consideration should be given to the pros and cons of using an LLC (with its additional annual fees) or a limited partnership with a corporate general partner (with its additional maintenance and accounting fees). For further discussion of family limited partnerships (FLPs) and family limited liability companies (FLLCs), see §2.96A.

**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/ IV. NOTIFYING TAX AUTHORITIES ON FORMATION OF ENTITY/§2.200 A. Notifying IRS; Obtaining Federal Employer Tax Identification Number

#### IV. NOTIFYING TAX AUTHORITIES ON FORMATION OF ENTITY

##### §2.200 A. Notifying IRS; Obtaining Federal Employer Tax Identification Number

All entities, except certain sole proprietorships, must obtain a federal employer identification number (FEIN) for tax filing and reporting purposes. If the start-up business is conducted as a sole proprietorship, the sole proprietor does not need to obtain a separate FEIN and may report the affairs of the business using his or her own social security number. However, a sole proprietor must obtain a separate FEIN if he or she pays wages to one or more employees, or files pension or excise tax returns.

A FEIN is obtained by filing IRS Form SS-4, Application for Employer Identification Number. See form in §2.207.

**PRACTICE TIP:** Form SS-4 should be filed as soon as possible so that the number may be obtained before the deadline for filing a return or an information statement, or making a tax deposit.

**NOTE:** Form SS-4 includes a third party designee section in which the client may authorize another individual to receive the client's FEIN. If the third party designee section is completed and Form SS-4 is properly signed by the client, the third party designee may obtain the client's FEIN directly from the IRS without first having to file an IRS Form 2848 (Power of Attorney).

There are several ways to file Form SS-4. They include any of the following methods:

- **Online application.** An application for an FEIN may be completed and filed online. Receipt of the FEIN is immediate, and can be used to file a return or make a payment.
- **Fax.** Complete and fax Form SS-4 to the IRS, using the IRS Fax-TIN number.
- **Telephone.** Complete Form SS-4 and then call the IRS to obtain the number over the telephone. Receipt of the FEIN is immediate, and can be used to file a return or make a payment. If requested by the IRS representative, mail or fax the completed, signed Form SS-4 (including any third party designation) within 24 hours. The person making the call must be authorized to sign the form or be an authorized designee. The practitioner must accompany his or her request with a power of attorney signed by the client.
- **Mail.** Complete and mail Form SS-4 to the appropriate IRS office at least 4 to 5 weeks before the FEIN is needed. The IRS will send the FEIN by mail within about 4 weeks.

For the website address of Form SS-4 and the address and phone numbers of relevant IRS offices, see the Directory.

In the event that a return, filing, or payment becomes due before a FEIN has been assigned to the business, the form requiring the FEIN should be completed by inserting "applied for" in the appropriate space along with the date. Any payments should be mailed to the IRS Service Center responsible for the area where the principal place of business is located. On the check or money order, the business proprietor should write his or her name (exactly as shown on Form SS-4), address, kind of tax, period covered, and the date he or she applied for the FEIN.

For LLCs, the bottom of the Form SS-4, signed by the LLC, should designate the practitioner to receive the FEIN on behalf of the LLC. If the attorney signs the Form SS-4 on behalf of the LLC, the attorney must accompany the Form SS-4 with a power of attorney (IRS Form 2848) signed by the LLC.

**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.201 B. Registering With California Employment Development Department

## **§2.201 B. Registering With California Employment Development Department**

A business that has California employees must also register with the California Employment Development Department (EDD) using EDD Form DE 1. See form in §2.208. This form must be filed within 15 calendar days following the date aggregate wages paid to employees exceed \$100, or following a change in ownership of the business.

The completed form may be submitted to the EDD by mail or fax, or by calling the EDD's "Tele-Reg" number and submitting the information verbally. The EDD advises against using e-mail or other unsecured methods of communication, as the form contains the owner's confidential information. Once the registration form is processed, a separate EDD Employer Account Number will be assigned to the business for use in all future communications with the EDD. For additional information regarding the tax obligations of California employers, see EDD Publication DE 44, California Employer's Guide. An online version of EDD Form DE 44 is available on the EDD website. For completed samples of most EDD forms, see the Sample Forms Guide (DE 45). For information about where to submit the completed form and for website addresses, see the Directory.

**NOTE:** New businesses are not required to notify the California Franchise Tax Board (FTB) to obtain a tax identification number. Businesses use the federal employer identification number (FEIN). The California Secretary of State assigns an identification (file) number when a corporation files its articles of incorporation. The FTB may require this number for compliance, such as for the election of S corporation status. See §8.5.

**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.202 C. Notifying California State Board of Equalization

**§2.202 C. Notifying California State Board of Equalization**

The California State Board of Equalization (SBE) administers the state sales and use tax. If a California business intends to sell or lease tangible or personal property that would ordinarily be subject to sales tax if sold at retail, the business must obtain a seller's permit from the local SBE office. Seller's permit applications are available for downloading and printing at the SBE website. See Directory.

Any person who engages in business as a seller without a required seller's permit (or after a permit has been suspended or revoked), as well as each corporate officer that engages in the sales, is guilty of a criminal misdemeanor punishable by fine, imprisonment, or both. Rev & T C §§6071, 7153.

**PRACTICE TIP:** Counsel should advise clients to contact the local SBE office to determine whether telephone registration is possible under the "Express Registration" program or, if not, then the best time to visit the local field office and the paperwork requirements.

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**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.203 D. Notifying Local Taxing Authorities

### **§2.203 D. Notifying Local Taxing Authorities**

Start-up businesses should contact local government authorities to determine whether any local business taxes apply to the business and, if so, how to comply. Many larger cities have local tax ordinances requiring businesses to obtain licenses and pay taxes based on gross receipts or payroll.

The practitioner should carefully review the client's proposed business activities to determine the applicable licenses and permits particular to the business, including city and local permits. Information is available through these resources; for their websites, see the Directory:

- The California Business Portal sponsored by the California Economic Development Partnership;
- The Small Business Assistance Center of the California Tax Service Center; and
- The CalGOLD website, sponsored by the California Environmental Protection Agency.

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**V. CHARTS**

**§2.204 A. Business Aspects of Commonly Used Entities**

	<b>General Partnership (GP)</b>	<b>Limited partnership (LP)</b>	<b>Corporation (C corp, S corp, and close corp)</b>	<b>Limited Liability Company (LLC)</b>
1. Number of owners	Two general partners minimum.	Two partners minimum ( <i>i.e.</i> , one general partner and one limited partner).	One shareholder minimum. An S corp can have no more than 100 shareholders, and a close corporation no more than 35.	One member minimum.
2. Formation of the entity	No filing required to form the entity, but an optional filing (Statement of Partnership Authority (Secretary of State Form GP-1)) can be made with the Secretary of State or the county recorder. See form in §5.48.	Formed by executing and filing a Certificate of Limited Partnership (Secretary of State Form LP-1) with the Secretary of State. See form in §6.38.	Formed by executing and filing articles of incorporation with the Secretary of State. An S corp also files Form 2553 with the IRS. See sample form of articles of incorporation in §9.35.	Formed by executing and filing Limited Liability Company Articles of Organization (Secretary of State Form LLC-1)) with the Secretary of State. See form in §11.39.
	The filing fee is currently \$70.	The filing fee is currently \$70.	The filing fee is currently \$100.	The filing fee is currently \$70.
3. Anonymity of owners	Names of general partners are public record only if a Form GP-1 or a fictitious business name (or "DBA" or "doing business as") application is filed.	Names of general partners are public record.  Names of limited partners are not public record.	Names of shareholders are not public record, but can be obtained by other shareholders.  Names of officers and directors are public record.	Names of managers are public record.  Names of members are not public record unless they serve as managers.
4. Owners' agreement on the terms of their business relationship  (Cost and complexity of a written agreement depend on the structure and business of the entity, the goals of the various owners, and other factors.)	Although an oral agreement is permitted regarding the terms of the partnership, a written partnership agreement is strongly recommended for certainty.	Although an oral agreement is permitted regarding the terms of the partnership, a written agreement is strongly recommended for certainty.	A corporation must adopt written bylaws to govern its internal housekeeping such as election of directors and officers.  In addition, shareholders may negotiate and enter into an optional, separate shareholder "buy-sell" agreement including restrictions on the sale or transfer of	Although the terms of an LLC may be oral among the members, a written agreement is strongly recommended for certainty.

			shares, a formula for valuation on a transfer, supermajority voting provisions, and other clauses.	
5. Management and control	<p>All general partners have equal rights in management of the partnership unless the partnership agreement provides otherwise.</p> <p>GPs are flexible, and a wide variety of control and management structures are available by agreement.</p>	<p>General partner(s) manage the business of an LP.</p> <p>Limited partner(s) engaging in management of the partnership risk losing the protection of limited liability.</p>	<p>A corporation's goals and policies are established by its board of directors, who are elected by the shareholders. The board of directors appoints officers (president, secretary, treasurer/CFO) to implement the policies and run the corporation day to day.</p> <p>Shareholders (except those in close corporations) have no right to participate in day-to-day management of the corporation, but shareholders can also be directors and officers without losing the protection of limited liability.</p>	<p>An LLC can be managed by its members or by non-member managers, depending on the LLC operating agreement.</p> <p>If an LLC is managed by non-member managers, then members do not participate in management.</p> <p>An LLC's managers (whether members or non-members) may for convenience in dealing with third parties have officer titles such as president, secretary and CFO/treasurer, if permitted by the operating agreement.</p>
6. Agency authority of owners and management	<p>Each general partner is an agent of the partnership.</p> <p>General partners have apparent authority in carrying on the ordinary course of business, and their acts bind the partnership. Restrictions in the partnership agreement restricting the authority of a general partner will not be effective against third parties unless they have knowledge of the restriction.</p>	<p>General partner(s) are agents of the LP.</p> <p>Limited partner(s) do not have apparent agency authority to bind the partnership.</p>	<p>Officers are agents of the corporation. Neither directors nor shareholders have authority to bind the corporation.</p> <p>The corporation's bylaws or resolutions of the board of directors can restrict the ability of officers to act, for example, by requiring dual signatures on contracts or bank accounts, but the restrictions are not effective against third parties without actual knowledge of the restrictions.</p>	<p>Member-managers and non-member managers acting under the operating agreement have authority to act in the ordinary course of business of the LLC, and their acts bind the LLC.</p> <p>Any limitations on the authority of member-managers and non-member managers will not be effective against third parties without actual knowledge of restrictions.</p>
7. Owners' personal liability for business	General partners are jointly and severally liable for	General partner(s) of an LP are personally liable	Shareholders are not personally liable for corporate	Members of an LLC are not personally liable

debts and obligations	<p>(1) the acts or omissions of any general partner acting in the ordinary course of partnership business or with the authority of the general partners and (2) partnership debts and obligations.</p> <p>General partners also have fiduciary duties of confidentiality, loyalty, and care to each other.</p>	<p>for partnership obligations to the same extent as a general partner of a general partnership.</p> <p>Limited partner(s) are not personally liable for partnership debts and obligations, unless they participate in control of the partnership business.</p> <p>If the LP operates outside California, the laws of other states may apply in determining a limited partner's liability.</p>	<p>debts and obligations unless shareholders (1) personally guarantee corporate debts; (2) receive improper distributions; (3) engage in tortious conduct; (4) are subject to "alter ego" claims for commingling personal and corporate matters; or (5) breach duties to other shareholders or the corporation.</p> <p>Shareholders who also serve as officers and directors may have additional liability due to the additional control they have over corporate matters.</p>	<p>for debts and obligations of the LLC, unless members (1) personally guarantee debts of the LLC; (2) receive improper distributions; (3) fail to pay taxes; (4) engage in tortious conduct; or (5) are subject to "alter ego" claims for commingling personal and LLC matters.</p> <p>Members who also serve as managers may have additional liability due to the additional control they have over LLC matters.</p>
8. Obtaining working capital and investors	<p>A GP's working capital usually comes from partners' contributions of cash and property, as well as from secured or unsecured loans from partners or third parties.</p> <p>GPs are usually not attractive investments to passive investors because of personal liability for partnership debts and obligations and the lack of easy transferability of partnership interests.</p>	<p>An LP's sources of working capital include those available to a general partnership.</p> <p>Because of limited liability and pass-through tax treatment, LPs are attractive to certain passive investors, especially in connection with real estate ventures and tax-advantaged investments.</p> <p>However, limited partners cannot participate in management without the risk of incurring general partner liability, making investment as limited partners generally unattractive to venture capitalists.</p>	<p>A corporation is funded through its shareholders' capital contributions of cash and property and from loans from shareholders and third parties.</p> <p>Different classes and series of stock with varying rights can alter control of the corporation as well as distributions.</p> <p>Because of limited liability, relatively easy transferability of corporate shares under law (excluding restrictions in a shareholder "buy-sell agreement") and extensive case law interpreting corporate law, corporations may be more attractive as an investment vehicle to venture capitalists than other entity structures.</p>	<p>An LLC is funded through its members' capital contributions of cash and property and from loans from its members and third parties.</p> <p>Because of the organizational and structural flexibility of LLCs, the ability to engage actively in management without risk of liability, and the ability to receive special allocations and deduct losses, LLCs may be attractive to venture capitalists and investors in real estate ventures and tax-advantaged investments.</p>

<p>9. Must ownership interests be registered or qualified with state and/or federal regulators as "securities"?</p>	<p>No. Interests in GPs are generally not characterized as securities because all general partners are deemed personally involved in the management and control of the business.</p>	<p>Yes, absent an exemption. An exemption from securities qualification may be available for offers and sales of LP interests, depending on the facts and circumstances of the offering.</p>	<p>Yes, absent an exemption. An exemption from securities qualification may be available for offers and sales of stock in a corporation, depending on the facts and circumstances of the offering.</p>	<p>Possibly. A membership interest in an LLC constitutes a security unless all the members actually actively engage in the management of the LLC. An exemption may nevertheless be available.</p>
<p>10. Continuity of business: departure of an owner</p>	<p>Dissociation of a partner (whether through withdrawal, retirement, or death) does not necessarily result in dissolution and winding up of a GP.  A GP formed for a definite term or undertaking is dissolved and wound up on wrongful withdrawal, death, bankruptcy, or termination of a partner unless majority in interest of remaining partners vote to continue the partnership.  A GP at will is dissolved and wound up only on the vote of at least half the partners, except as provided in the partnership agreement.  On dissolution, the partners may agree to reconstitute into a new partnership to carry on the business of the dissolved partnership.</p>	<p>Departure of general partner: Generally, an LP dissolves and must wind up on departure of a general partner unless a remaining general partner continues or a new general partner is admitted.  Departure of a limited partner: A limited partner can withdraw, but only on a date or events specified in the LP agreement.</p>	<p>A corporation has an independent existence and is not terminated by the withdrawal, death, or other event affecting its shareholders, directors, or officers.</p>	<p>An LLC member may withdraw at any time on notice to other members, but if the withdrawal is not permitted by the articles or the operating agreement, then the withdrawing member becomes holder of an economic interest only and is liable for damages to the LLC.  The operating agreement may separately specify that the LLC can terminate a member's membership or economic interests.</p>
<p>11. Continuity of business: arrival of a new or additional owner</p>	<p>The consent of all the general partners is required to admit a new partner, unless the GP agreement</p>	<p>Arrival of a general partner: A new general partner is admitted as provided in the LP agreement and/or</p>	<p>A corporation has an independent existence and is not terminated by the withdrawal, death, or other event affecting its</p>	<p>New members may acquire LLC interests (1) from the LLC as provided in the articles of organization or the</p>

	<p>provides otherwise.</p> <p>A general partner may assign his or her economic interest in the GP, but the assignee is entitled only to an economic interest in distributions and not to voting or management rights, unless the partnership agreement provides otherwise.</p>	<p>by consent of the partners.</p> <p>Arrival of a limited partner: An LP interest is personal property and is usually assignable, but assignment does not dissolve the LP or entitle the assignee to rights as a partner. A new limited partner is admitted on compliance with the LP agreement or by consent of the partners.</p>	<p>shareholders, directors, or officers.</p> <p>Stock owned in a corporation may be transferred more easily than LP or LLC interests.</p> <p>There are generally no statutory limits on the right of a shareholder to transfer stock, and the consent of other shareholders to the transfer is not required, unless restricted by bylaw or in a shareholder "buy-sell" agreement.</p>	<p>operating agreement or by majority vote of the members, or (2) from other members on consent of all members except as otherwise provided in the articles of organization or the operating agreement.</p>
12. Termination	GP is subject to dissolution and winding up on certain occurrences, including departure of a partner.	LP is subject to dissolution and winding up on certain occurrences.	No fixed termination date unless stated in the articles of incorporation.	LLC is subject to dissolution and winding up on certain occurrences.
13. Available to attorneys, accountants, and architects?	Yes, but liability is joint and several, so a professional corporation (PC) or LLP may be preferable.	No.	Yes, attorneys, accountants, and architects may incorporate as professional corporations (PCs).	No, but attorneys, accountants, and architects are permitted to use limited liability partnerships (LLPs).
14. Advantageous for estate planning purposes?	No tax advantages for estate planning.	Potential tax advantages for estate planning.	Potential tax advantages for estate planning.	Potential tax advantages for estate planning.

*Comment:* The brief summaries in this chart should not be relied on without further investigation of applicable law.

**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/§2.205 B. Tax Aspects of Commonly Used Entities

**§2.205 B. Tax Aspects of Commonly Used Entities**

	<b>C Corporation</b>	<b>S Corporation</b>	<b>Partnership (general partnership, LP, LLP)</b>	<b>Limited Liability Companies</b>
1. Flow-through tax treatment? (avoidance of double tax)	No	Yes	Yes	Yes
2. Ability to elect either flow-through or corporate taxation?	No, corporate only	No, flow-through only	Yes	Yes
3. Ownership Characteristics				
a. More than 100 owners?	Yes	No	Yes	Yes
b. Owners other than individuals, estates and trusts?	Yes	No	Yes	Yes
c. Non-resident alien owners permitted?	Yes	No	Yes	Yes
d. More than one class of stock/interest permitted?	Yes	No, except differences as to voting rights	Yes	Yes
e. Permitted to be member of affiliated group?	Yes	No	Yes	Yes
4. Are contributions to capital taxed?				
a. To the entity?	No	No	No	No
b. To contributing party?				
(1) Property?	Yes, unless to a controlled corporation (IRC §351)	Yes, unless to a controlled corporation (IRC §351)	Generally no	Generally no
(2) Services?	Yes (IRC §83)	Yes (IRC §83)	No, if only profits interest	No, if only profits interest

			received; Yes, if capital interest received	received; Yes, if capital interest received
5. Accounting Method	Accrual, unless gross receipts do not exceed \$5 million or corp is qualified personal service corporation	Cash, unless tax shelter	Cash, unless C corporation is one of the partners and gross receipts exceed \$5 million or tax shelter	Cash, unless C corporation is one of the partners and gross receipts exceed \$5 million or tax shelter
6. Taxable Year	Fiscal year selected by corporation, except for personal service corporations	Usually calendar year	Same tax year as majority or principal partners, or Calendar Year	Same tax year as majority or principal members, or Calendar Year
7. Double tax on liquidation?	Yes	No	No	No
8. Partnership tax features.				
a. Special allocations?	Yes, but only through preferred stock	No	Yes, if substantial economic effect	Yes, if substantial economic effect
b. Flow-through losses?	No	Yes, subject to basis limitation and at risk and passive loss rules	Yes, subject to basis limitation and at risk and passive loss rules	Yes, subject to basis limitation and at risk and passive loss rules
c. IRC §754 adjustment of entity's inside basis in assets to match owner's adjusted basis on death or transfer of assets?	No	No	Yes	Yes
d. Owner's tax basis increased by owner's share of entity debt?	No	No	Yes	Yes
9. California tax treatment	\$800 minimum franchise tax	Flow-through taxation; \$800 minimum franchise tax, plus 1.5-percent income tax	Flow-through taxation; \$800 minimum franchise tax (except general partnership	Flow-through taxation; \$800 minimum franchise tax, plus additional annual fee

			does not pay \$800 minimum)	of \$900 or more if gross revenue exceeds \$250,000
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§2.206 C. Client Interview Sheet

▶ To download **Word** version,  
right click and choose  
*Save Target As*

▶ To download **WordPerfect** version,  
right click and choose  
*Save Target As*

**INITIAL PARTICIPANTS**

**1. Who will initially participate in the business?**

As owner(s): \_\_\_\_\_

Name: \_\_\_\_\_

Address: \_\_\_\_\_

Telephone: \_\_\_\_\_

Social Security /Taxpayer I.D. number: \_\_\_\_\_

Family and/or prior business relationship to other participants:  
\_\_\_\_\_

Contribution: \_\_\_\_\_

Cash: \_\_\_\_\_

Property and its value: \_\_\_\_\_

Other: \_\_\_\_\_

Precontribution payments (if any): \_\_\_\_\_

Percentage interest to be held in the business: \_\_\_\_\_

Percentage voting interest (if different): \_\_\_\_\_

Percentage of time to be devoted to business: \_\_\_\_\_

Management function: \_\_\_\_\_

Anticipated salary from business: \_\_\_\_\_

Taxable year, if different from calendar: \_\_\_\_\_

Guaranteed minimum return (if any): \_\_\_\_\_

As creditor(s): \_\_\_\_\_

Name: \_\_\_\_\_

Address: \_\_\_\_\_

Telephone: \_\_\_\_\_

Investment in business: \_\_\_\_\_

Credit extended: \_\_\_\_\_

Other investment: \_\_\_\_\_

Conditions: \_\_\_\_\_

Management function (if any): \_\_\_\_\_

Other pertinent information: \_\_\_\_\_

2. What is the maximum number of persons expected to participate? \_\_\_\_\_

**LENDERS TO BUSINESS**

3. List all persons (participants or outsiders) who have made, or are expected to make, loans to the business.

Name(s) of lender(s): \_\_\_\_\_

Address(es): \_\_\_\_\_

Amount of loan: \_\_\_\_\_

Date of loan: \_\_\_\_\_

Interest rate on loan: \_\_\_\_\_

Form of loan, term: \_\_\_\_\_

Security or guaranties, if any:

4. List any additional lenders who are expected to provide financing after the business gets started.

Name(s) of lender(s): \_\_\_\_\_

Address(es): \_\_\_\_\_

Amount of loan: \_\_\_\_\_

Date of loan: \_\_\_\_\_

Interest rate on loan: \_\_\_\_\_

Form of loan, term: \_\_\_\_\_

Security or guaranties, if any: \_\_\_\_\_

**CONTROL ISSUES**

5. Is the business expected to remain in the control of a closed group within the foreseeable future?

\_\_\_\_\_  
\_\_\_\_\_

6. Are additional participants expected to join in the near future?

\_\_\_\_\_  
\_\_\_\_\_

**INFORMATION ABOUT THE BUSINESS**

7. What is the type or nature of the business, and, if appropriate, in what form (e.g., sole proprietorship) is it now operating?

\_\_\_\_\_

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8. Is incorporation required, regulated, or prohibited by statute? \_\_\_\_\_

9. Does the particular business require special permits or licenses? If so, in what name(s) will they be issued?

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10. Do the regulatory provisions applicable to the business either restrict who may be shareholders (e.g., alcoholic beverage licensees) or require consent to issue shares (e.g., employment agencies)?\_

11. What is the preferred name for the business? Alternatives?

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12. Is the business expected to operate at a loss for an initial period?\_\_\_\_\_

#### DURATION OF THE BUSINESS

13. What is the expected duration of the business?\_\_\_\_\_

14. Is it desired that the business survive the death, retirement, or other withdrawal of any participant?

15. Is any participant's departure from the business within the foreseeable future a reasonable probability?

*Comment:* The information collected using this interview sheet will be useful in organizing any type of business entity. At the initial interview, it is important to advise the client of securities laws restrictions applicable to both the offering and later transfer of shares and to the solicitation of investment capital, including loans.

Question 2, concerning the number of persons expected to participate in the business, is significant in several respects. If there are no more than 35 shareholders, a corporation may be eligible for close corporation status. Corp C §158. See §2.31. An S corporation is limited to 100 shareholders. IRC §1361(b). See §2.27. In addition, some exemptions from qualification under the securities laws also impose maximum number requirements. A husband and wife are ordinarily counted as one person. See Corp C §§158(d) (close corporation), 25102(f)(4) (limited offering exemption), 25102(h)(5) (small offering exemption); IRC §1361(c)(1) (S corporation).

Concerning Questions 5 and 6, which address control issues, if control is expected to remain with a closed group, a limited liability company or general or limited partnership may be indicated. See §§2.36-2.47, 2.60-2.71. If additional parties are expected to join in the near future, then before the initial issuance of shares is made, the parties should anticipate whether the additional participants will receive newly issued shares or shares transferred to them from the original participants.

Concerning Questions 7 through 12, the nature of the business will influence the type of entity that should be formed. Most banks and savings and loan associations organized under California law must be corporations. See Fin C §102. Incorporation by professionals, permitted under California law, is subject to additional regulations. See generally chap 10. However, if the venture is of a highly speculative nature and there is a significant risk of ultimate insolvency, and if the owner could offset the loss against other income, the best vehicle may be a corporation that complies with IRC §1244. See §8.121. If losses are expected initially, and profits are anticipated after a year or two of operations, it may be better from a tax standpoint to set up a limited liability company, limited partnership, or an S corporation or to delay incorporation until the business begins to show a profit. The tax advantages of delaying formation of an entity must, however, be weighed against delaying the advantages of limited liability protection afforded owners of an entity.

Concerning Questions 13 through 15 on duration of the business, perpetual existence is an advantage of the corporate form. See §2.194. However, the operations of limited liability companies, general partnerships, and limited partnerships may continue indefinitely, despite deaths or withdrawals, by advance agreement of the partners or members. See §§2.195-2.196, 2.198.



**Source:** Business Law/Selecting and Forming Business Entities/2 Evaluating Entity Choices/ VI. FORMS/§2.207 A.  
Form: Application for Employer Identification Number (IRS Form SS-4)

**VI. FORMS**

**§2.207 A. Form: Application for Employer Identification Number (IRS Form SS-4)**



# Application for Employer Identification Number

(For use by employers, corporations, partnerships, trusts, estates, churches, government agencies, Indian tribal entities, certain individuals, and others.)

OMB No. 1545-0003

EIN

▶ See separate instructions for each line. ▶ Keep a copy for your records.

Type or print clearly.

<b>1</b> Legal name of entity (or individual) for whom the EIN is being requested			
<b>2</b> Trade name of business (if different from name on line 1)	<b>3</b> Executor, administrator, trustee, "care of" name		
<b>4a</b> Mailing address (room, apt., suite no. and street, or P.O. box)	<b>5a</b> Street address (if different) (Do not enter a P.O. box.)		
<b>4b</b> City, state, and ZIP code (if foreign, see instructions)	<b>5b</b> City, state, and ZIP code (if foreign, see instructions)		
<b>6</b> County and state where principal business is located			
<b>7a</b> Name of responsible party	<b>7b</b> SSN, ITIN, or EIN		
<b>8a</b> Is this application for a limited liability company (LLC) (or a foreign equivalent)? <input type="checkbox"/> Yes <input type="checkbox"/> No	<b>8b</b> If 8a is "Yes," enter the number of LLC members ▶		
<b>8c</b> If 8a is "Yes," was the LLC organized in the United States? <input type="checkbox"/> Yes <input type="checkbox"/> No			
<b>9a</b> Type of entity (check only one box). <b>Caution.</b> If 8a is "Yes," see the instructions for the correct box to check.			
<input type="checkbox"/> Sole proprietor (SSN) _____ <input type="checkbox"/> Partnership <input type="checkbox"/> Corporation (enter form number to be filed) ▶ _____ <input type="checkbox"/> Personal service corporation <input type="checkbox"/> Church or church-controlled organization <input type="checkbox"/> Other nonprofit organization (specify) ▶ _____ <input type="checkbox"/> Other (specify) ▶ _____			
<input type="checkbox"/> Estate (SSN of decedent) _____ <input type="checkbox"/> Plan administrator (TIN) _____ <input type="checkbox"/> Trust (TIN of grantor) _____ <input type="checkbox"/> National Guard <input type="checkbox"/> State/local government <input type="checkbox"/> Farmers' cooperative <input type="checkbox"/> Federal government/military <input type="checkbox"/> REMIC <input type="checkbox"/> Indian tribal governments/enterprises <input type="checkbox"/> Group Exemption Number (GEN) if any ▶ _____			
<b>9b</b> If a corporation, name the state or foreign country (if applicable) where incorporated	State _____ Foreign country _____		
<b>10</b> Reason for applying (check only one box)			
<input type="checkbox"/> Started new business (specify type) ▶ _____ <input type="checkbox"/> Hired employees (Check the box and see line 13.) <input type="checkbox"/> Compliance with IRS withholding regulations <input type="checkbox"/> Other (specify) ▶ _____			
<input type="checkbox"/> Banking purpose (specify purpose) ▶ _____ <input type="checkbox"/> Changed type of organization (specify new type) ▶ _____ <input type="checkbox"/> Purchased going business <input type="checkbox"/> Created a trust (specify type) ▶ _____ <input type="checkbox"/> Created a pension plan (specify type) ▶ _____			
<b>11</b> Date business started or acquired (month, day, year). See instructions.	<b>12</b> Closing month of accounting year		
<b>13</b> Highest number of employees expected in the next 12 months (enter -0- if none). If no employees expected, skip line 14.	<b>14</b> If you expect your employment tax liability to be \$1,000 or less in a full calendar year and want to file Form 944 annually instead of Forms 941 quarterly, check here. (Your employment tax liability generally will be \$1,000 or less if you expect to pay \$4,000 or less in total wages.) If you do not check this box, you must file Form 941 for every quarter. <input type="checkbox"/>		
<table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 33%;">Agricultural</td> <td style="width: 33%;">Household</td> <td style="width: 33%;">Other</td> </tr> </table>		Agricultural	Household
Agricultural	Household	Other	
<b>15</b> First date wages or annuities were paid (month, day, year). <b>Note.</b> If applicant is a withholding agent, enter date income will first be paid to nonresident alien (month, day, year) ▶			
<b>16</b> Check one box that best describes the principal activity of your business.			
<input type="checkbox"/> Construction <input type="checkbox"/> Rental & leasing <input type="checkbox"/> Transportation & warehousing <input type="checkbox"/> Accommodation & food service <input type="checkbox"/> Wholesale-other <input type="checkbox"/> Retail <input type="checkbox"/> Real estate <input type="checkbox"/> Manufacturing <input type="checkbox"/> Finance & insurance <input type="checkbox"/> Other (specify) _____			
<b>17</b> Indicate principal line of merchandise sold, specific construction work done, products produced, or services provided.			

**18** Has the applicant entity shown on line 1 ever applied for and received an EIN?  Yes  No  
If "Yes," write previous EIN here ▶

<b>Third Party Designee</b>	Complete this section <b>only</b> if you want to authorize the named individual to receive the entity's EIN and answer questions about the completion of this form.	
	Designee's name	Designee's telephone number (include area code) ( )
	Address and ZIP code	Designee's fax number (include area code) ( )
Under penalties of perjury, I declare that I have examined this application, and to the best of my knowledge and belief it is true, correct, and complete.		Applicant's telephone number (include area code) ( )
Name and title (type or print clearly) ▶		Applicant's fax number (include area code) ( )
Signature ▶		Date ▶



## Do I Need an EIN?

File Form SS-4 if the applicant entity does not already have an EIN but is required to show an EIN on any return, statement, or other document.<sup>1</sup> See also the separate instructions for each line on Form SS-4.

IF the applicant...	AND...	THEN...
Started a new business	Does not currently have (nor expect to have) employees	Complete lines 1, 2, 4a-8a, 8b-c (if applicable), 9a, 9b (if applicable), and 10-14 and 16-18.
Hired (or will hire) employees, including household employees	Does not already have an EIN	Complete lines 1, 2, 4a-6, 7a-b (if applicable), 8a, 8b-c (if applicable), 9a, 9b (if applicable), 10-18.
Opened a bank account	Needs an EIN for banking purposes only	Complete lines 1-5b, 7a-b (if applicable), 8a, 8b-c (if applicable), 9a, 9b (if applicable), 10, and 18.
Changed type of organization	Either the legal character of the organization or its ownership changed (for example, you incorporate a sole proprietorship or form a partnership) <sup>2</sup>	Complete lines 1-18 (as applicable).
Purchased a going business <sup>3</sup>	Does not already have an EIN	Complete lines 1-18 (as applicable).
Created a trust	The trust is other than a grantor trust or an IRA trust <sup>4</sup>	Complete lines 1-18 (as applicable).
Created a pension plan as a plan administrator <sup>5</sup>	Needs an EIN for reporting purposes	Complete lines 1, 3, 4a-5b, 9a, 10, and 18.
Is a foreign person needing an EIN to comply with IRS withholding regulations	Needs an EIN to complete a Form W-8 (other than Form W-8EC), avoid withholding on portfolio assets, or claim tax treaty benefits <sup>6</sup>	Complete lines 1-5b, 7a-b (SSN or ITIN optional), 8a, 8b-c (if applicable), 9a, 9b (if applicable), 10, and 18.
Is administering an estate	Needs an EIN to report estate income on Form 1041	Complete lines 1-5, 9a, 10-12, 13-17 (if applicable), and 18.
Is a withholding agent for taxes on non-wage income paid to an alien (i.e., individual, corporation, or partnership, etc.)	Is an agent, broker, fiduciary, manager, tenant, or spouse who is required to file Form 1042, Annual Withholding Tax Return for U.S. Source Income of Foreign Persons	Complete lines 1, 2, 3 (if applicable), 4a-5b, 7a-b (if applicable), 8a, 8b-c (if applicable), 9a, 9b (if applicable), 10, and 18.
Is a state or local agency	Serves as a tax reporting agent for public assistance recipients under Rev. Proc. 80-4, 1980-1 C.B. 561 <sup>7</sup>	Complete lines 1, 2, 4a-5b, 9a, 10, and 18.
Is a single-member LLC	Needs an EIN to file Form 8832, Classification Election, for filing employment tax returns and excise tax returns, or for state reporting purposes <sup>8</sup>	Complete lines 1-18 (as applicable).
Is an S corporation	Needs an EIN to file Form 2553, Election by a Small Business Corporation <sup>9</sup>	Complete lines 1-18 (as applicable).

<sup>1</sup> For example, a sole proprietorship or self-employed farmer who establishes a qualified retirement plan, or is required to file excise, employment, alcohol, tobacco, or firearms returns, must have an EIN. A partnership, corporation, REMIC (real estate mortgage investment conduit), nonprofit organization (church, club, etc.), or farmers' cooperative must use an EIN for any tax-related purpose even if the entity does not have employees.

<sup>2</sup> However, do not apply for a new EIN if the existing entity only (a) changed its business name, (b) elected on Form 8832 to change the way it is taxed (or is covered by the default rules), or (c) terminated its partnership status because at least 50% of the total interests in partnership capital and profits were sold or exchanged within a 12-month period. The EIN of the terminated partnership should continue to be used. See Regulations section 301.6109-1(d)(2)(iii).

<sup>3</sup> Do not use the EIN of the prior business unless you became the "owner" of a corporation by acquiring its stock.

<sup>4</sup> However, grantor trusts that do not file using Optional Method 1 and IRA trusts that are required to file Form 990-T, Exempt Organization Business Income Tax Return, must have an EIN. For more information on grantor trusts, see the instructions for Form 1041.

<sup>5</sup> A plan administrator is the person or group of persons specified as the administrator by the instrument under which the plan is operated.

<sup>6</sup> Entities applying to be a Qualified Intermediary (QI) need a QI-EIN even if they already have an EIN. See Rev. Proc. 2000-12.

<sup>7</sup> See also *Household employer* on page 4 of the instructions. **Note.** State or local agencies may need an EIN for other reasons, for example, hired employees.

<sup>8</sup> See *Disregarded entities* on page 4 of the instructions for details on completing Form SS-4 for an LLC.

<sup>9</sup> An existing corporation that is electing or revoking S corporation status should use its previously-assigned EIN.

# Instructions for Form SS-4



Department of the Treasury  
Internal Revenue Service

(Rev. January 2010)

## Application for Employer Identification Number

Section references are to the Internal Revenue Code unless otherwise noted.

### What's New

**Name of responsible party.** The instructions for Line 7a–b have been changed to request the name of the responsible party. See *Lines 7a–b, Name of responsible party* on page 3 for details.

**Election to file Form 944.** Eligible employers may now elect to file Form 944 annually instead of Forms 941 quarterly. See *Line 14, Do you want to file Form 944?* on page 5 for details.

### General Instructions

Use these instructions to complete Form SS-4, Application for Employer Identification Number. Also see *Do I Need an EIN?* on page 2 of Form SS-4.

### Purpose of Form

Use Form SS-4 to apply for an employer identification number (EIN). An EIN is a nine-digit number (for example, 12-3456789) assigned to sole proprietors, corporations, partnerships, estates, trusts, and other entities for tax filing and reporting purposes. The information you provide on this form will establish your business tax account.



**An EIN is for use in connection with your business activities only. Do not use your EIN in place of your social security number (SSN).**

### Reminders

**Apply online.** Generally, you can apply for and receive an EIN online using the Internet. See *How To Apply* later.



**This is a free service offered by the Internal Revenue Service at [www.irs.gov](http://www.irs.gov). Beware of websites on the Internet that charge for this free service.**

**File only one Form SS-4.** Generally, a sole proprietor should file only one Form SS-4 and needs only one EIN, regardless of the number of businesses operated as a sole proprietorship or trade names under which a business operates. However, if the proprietorship incorporates or enters into a partnership, a new EIN is required. Also, each corporation in an affiliated group must have its own EIN.

**EIN applied for, but not received.** If you do not have an EIN by the time a return is due, write "Applied For" and the date you applied in the space shown for the number. Do not show your SSN as an EIN on returns.

If you do not have an EIN by the time a tax deposit is due, send your payment to the Internal Revenue Service Center for your filing area as shown in the instructions for the form that you are filing. Make your check or money order payable to the "United States Treasury" and show your name (as shown on Form SS-4), address, type of tax, period covered, and date you applied for an EIN.

**Electronic filing and payment.** Now, more than ever before, businesses can enjoy the benefits of filing and

paying their federal taxes electronically. Whether you rely on a tax professional or handle your own taxes, IRS offers you convenient programs to make filing and paying easier. Spend less time and worry on taxes and more time running your business. Use e-file and the Electronic Federal Tax Payment System (EFTPS) to your benefit.

- For e-file, visit [www.irs.gov](http://www.irs.gov) for additional information.
- For EFTPS, visit [www.eftps.gov](http://www.eftps.gov) or call EFTPS Customer Service at 1-800-555-4477, 1-800-733-4829 (TDD), or 1-800-244-4829 (Spanish).

**Federal tax deposits.** New employers that have a federal tax obligation will be pre-enrolled in the Electronic Federal Tax Payment System (EFTPS). EFTPS allows you to make all of your federal tax payments online at [www.eftps.gov](http://www.eftps.gov) or by telephone. Shortly after we have assigned you your EIN, you will receive instructions by mail for activating your EFTPS enrollment. You will also receive an EFTPS Personal Identification Number (PIN) that you will use to make your payments, as well as instructions for obtaining an Internet password you will need to make payments online.

If you are not required to make deposits by EFTPS, you can use Form 8109, Federal Tax Deposit (FTD) Coupon, to make deposits at an authorized depository. If you would like to receive Form 8109, call 1-800-829-4933. Allow 5 to 6 weeks for delivery. For more information on federal tax deposits, see Pub. 15 (Circular E), Employer's Tax Guide.

### How To Apply

You can apply for an EIN online, by telephone, by fax, or by mail depending on how soon you need to use the EIN. Use only one method for each entity so you do not receive more than one EIN for an entity.

**Online.** Taxpayers and authorized third party designees located within the United States and U.S. possessions can receive an EIN online and use it immediately to file a return or make a payment. Go to the IRS website at [www.irs.gov/businesses](http://www.irs.gov/businesses) and click on *Employer ID Numbers*.



**Taxpayers who apply online have an option to view, print, and save their EIN assignment notice at the end of the session. (Authorized third party designees will receive the EIN but the notice will be mailed to the applicant.)**



**Applicants who are not located within the United States or U.S. possessions cannot use the online application to obtain an EIN. Please use one of the other methods to apply.**

**Telephone.** You can receive your EIN by telephone and use it immediately to file a return or make a payment. Call the IRS at 1-800-829-4933. The hours of operation are 7:00 a.m. to 10:00 p.m. local time (Pacific time for Alaska and Hawaii). The person making the call must be authorized to sign the form or be an authorized designee. See *Third Party Designee and Signature* on page 6. Also see the *TIP* on page 2.

**Note.** International applicants must call 215-516-6999.

If you are applying by telephone, it will be helpful to complete Form SS-4 before contacting the IRS. An IRS representative will use the information from the Form SS-4 to establish your account and assign you an EIN. Write the

Cat. No. 62736F



number you are given on the upper right corner of the form and sign and date it. Keep this copy for your records.

If requested by an IRS representative, mail or fax the signed Form SS-4 (including any Third Party Designee authorization) within 24 hours to the IRS address provided by the IRS representative.

**TIP** Taxpayer representatives can apply for an EIN on behalf of their client and request that the EIN be faxed to their client on the same day. **Note.** By using this procedure, you are authorizing the IRS to fax the EIN without a cover sheet.

**Fax.** Under the Fax-TIN program, you can receive your EIN by fax within 4 business days. Complete and fax Form SS-4 to the IRS using the appropriate Fax-TIN number listed below. A long-distance charge to callers outside of the local calling area will apply. Fax-TIN numbers can only be used to apply for an EIN. The numbers may change without notice. Fax-TIN is available 24 hours a day, 7 days a week.

Be sure to provide your fax number so the IRS can fax the EIN back to you.

**Note.** By using this procedure, you are authorizing the IRS to fax the EIN without a cover sheet.

**Mail.** Complete Form SS-4 at least 4 to 5 weeks before you will need an EIN. Sign and date the application and mail it to the service center address for your state. You will receive your EIN in the mail in approximately 4 weeks. See also *Third Party Designee* on page 6.

Call 1-800-829-4933 to verify a number or to ask about the status of an application by mail.

#### Where to File or Fax

<b>If your principal business, office or agency, or legal residence in the case of an individual, is located in:</b>	<b>File or fax with the "Internal Revenue Service Center" at:</b>
One of the 50 states or the District of Columbia	Attn: EIN Operation Cincinnati, OH 45999  Fax-TIN: 859-669-5760
<b>If you have no legal residence, principal place of business, or principal office or agency in any state:</b>	Attn: EIN Operation Philadelphia, PA 19255  Fax-TIN: 215-516-1040

## How To Get Forms and Publications

**Internet.** You can access the IRS website 24 hours a day, 7 days a week at [www.irs.gov](http://www.irs.gov) to download forms, instructions, and publications.

**Phone.** Call 1-800-TAX-FORM (1-800-829-3676) to order forms, instructions, and publications. You should receive your order or notification of its status within 10 workdays.

**DVD for Tax Products.** For small businesses, return preparers, or others who may frequently need tax forms or publications, a DVD containing over 2,000 tax products (including many prior year forms) can be purchased from the National Technical Information Service (NTIS).

To order Pub.1796, IRS Tax Products CD, call 1-877-233-6767 or connect to [www.irs.gov/cdorders](http://www.irs.gov/cdorders).

## Tax Help for Your Business

IRS-sponsored Small Business Workshops provide information about your federal and state tax obligations. For

information about workshops in your area, call 1-800-829-4933.

## Related Forms and Publications

The following forms and instructions may be useful to filers of Form SS-4.

- Form 990-T, Exempt Organization Business Income Tax Return.
- Instructions for Form 990-T.
- Schedule C (Form 1040), Profit or Loss From Business.
- Schedule F (Form 1040), Profit or Loss From Farming.
- Instructions for Form 1041 and Schedules A, B, D, G, I, J, and K-1, U.S. Income Tax Return for Estates and Trusts.
- Form 1042, Annual Withholding Tax Return for U.S. Source Income of Foreign Persons.
- Instructions for Form 1065, U.S. Return of Partnership Income.
- Instructions for Form 1066, U.S. Real Estate Mortgage Investment Conduit (REMIC) Income Tax Return.
- Instructions for Forms 1120.
- Form 2553, Election by a Small Business Corporation.
- Form 2848, Power of Attorney and Declaration of Representative.
- Form 8821, Tax Information Authorization.
- Form 8832, Entity Classification Election.

For more information about filing Form SS-4 and related issues, see:

- Pub. 51 (Circular A), Agricultural Employer's Tax Guide;
- Pub. 15 (Circular E), Employer's Tax Guide;
- Pub. 538, Accounting Periods and Methods;
- Pub. 542, Corporations;
- Pub. 557, Tax-Exempt Status for Your Organization;
- Pub. 583, Starting a Business and Keeping Records;
- Pub. 966, The Secure Way to Pay Your Federal Taxes for Business and Individual Taxpayers;
- Pub. 1635, Understanding Your EIN;
- Package 1023, Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code; and
- Package 1024, Application for Recognition of Exemption Under Section 501(a).

## Specific Instructions

Print or type all entries on Form SS-4. Follow the instructions for each line to expedite processing and to avoid unnecessary IRS requests for additional information. Enter "N/A" (nonapplicable) on the lines that do not apply.

**Line 1. Legal name of entity (or individual) for whom the EIN is being requested.** Enter the legal name of the entity (or individual) applying for the EIN exactly as it appears on the social security card, charter, or other applicable legal document. An entry is required.

**Individuals.** Enter your first name, middle initial, and last name. If you are a sole proprietor, enter your individual name, not your business name. Enter your business name on line 2. Do not use abbreviations or nicknames on line 1.

**Trusts.** Enter the name of the trust as it appears on the trust instrument.

**Estate of a decedent.** Enter the name of the estate. For an estate that has no legal name, enter the name of the decedent followed by "Estate."

**Partnerships.** Enter the legal name of the partnership as it appears in the partnership agreement.

**Corporations.** Enter the corporate name as it appears in the corporate charter or other legal document creating it.

**Plan administrators.** Enter the name of the plan administrator. A plan administrator who already has an EIN should use that number.

**Line 2. Trade name of business.** Enter the trade name of the business if different from the legal name. The trade name is the "doing business as" (DBA) name.



*Use the full legal name shown on line 1 on all tax returns filed for the entity. (However, if you enter a trade name on line 2 and choose to use the trade name instead of the legal name, enter the trade name on all returns you file.) To prevent processing delays and errors, always use the legal name only (or the trade name only) on all tax returns.*

**Line 3. Executor, administrator, trustee, "care of" name.** Trusts enter the name of the trustee. Estates enter the name of the executor, administrator, or other fiduciary. If the entity applying has a designated person to receive tax information, enter that person's name as the "care of" person. Enter the individual's first name, middle initial, and last name.

**Lines 4a–b. Mailing address.** Enter the mailing address for the entity's correspondence. If the entity's address is outside the United States or its possessions, you must enter the city, province or state, postal code, and the name of the country. Do not abbreviate the country name. If line 3 is completed, enter the address for the executor, trustee or "care of" person. Generally, this address will be used on all tax returns.

If the entity is filing the Form SS-4 only to obtain an EIN for the Form 8832, use the same address where you would like to have the acceptance or nonacceptance letter sent.



*File Form 8822, Change of Address, to report any subsequent changes to the entity's mailing address.*

**Lines 5a–b. Street address.** Provide the entity's physical address only if different from its mailing address shown in lines 4a–b. Do not enter a P.O. box number here. If the entity's address is outside the United States or its possessions, you must enter the city, province or state, postal code, and the name of the country. Do not abbreviate the country name.

**Line 6. County and state where principal business is located.** Enter the entity's primary physical location.

**Lines 7a–b. Name of responsible party.** Enter the full name (first name, middle initial, last name, if applicable) and SSN, ITIN, or EIN of the entity's responsible party as defined below.

**Responsible party defined.** For entities with shares or interests traded on a public exchange, or which are registered with the Securities and Exchange Commission, "responsible party" is (a) the principal officer, if the business is a corporation, (b) a general partner, if a partnership, (c) the owner of an entity that is disregarded as separate from its owner (disregarded entities owned by a corporation enter the corporation's name and EIN), or (d) a grantor, owner, or trustor, if a trust.

For all other entities, "responsible party" is the person who has a level of control over, or entitlement to, the funds or assets in the entity that, as a practical matter, enables the individual, directly or indirectly, to control, manage, or direct the entity and the disposition of its funds and assets. The ability to fund the entity or the entitlement to the property of the entity alone, however, without any corresponding authority to control, manage, or direct the entity (such as in the case of a minor child beneficiary), does not cause the individual to be a responsible party.

If the person in question is an alien individual with a previously assigned individual taxpayer identification number (ITIN), enter the ITIN in the space provided and submit a copy of an official identifying document. If necessary, complete Form W-7, Application for IRS Individual Taxpayer Identification Number, to obtain an ITIN.

You must enter an SSN, ITIN, or EIN on line 7b unless the only reason you are applying for an EIN is to make an entity classification election (see Regulations sections 301.7701-1 through 301.7701-3) and you are a nonresident alien or other foreign entity with no effectively connected income from sources within the United States.

**Lines 8a–c. Limited liability company (LLC) information.**

An LLC is an entity organized under the laws of a state or foreign country as a limited liability company. For federal tax purposes, an LLC may be treated as a partnership or corporation or be disregarded as an entity separate from its owner.

By default, a domestic LLC with only one member is disregarded as an entity separate from its owner and must include all of its income and expenses on the owner's tax return (for example, Schedule C (Form 1040)). Also by default, a domestic LLC with two or more members is treated as a partnership. A domestic LLC may file Form 8832 to avoid either default classification and elect to be classified as an association taxable as a corporation. For more information on entity classifications (including the rules for foreign entities), see the instructions for Form 8832.

If the answer to line 8a is "Yes," enter the number of LLC members. If the LLC is owned solely by a husband and wife in a community property state and the husband and wife choose to treat the entity as a disregarded entity, enter "1" on line 8b.



*Do not file Form 8832 if the LLC accepts the default classifications above. If the LLC is eligible to be treated as a corporation that meets certain tests and it will be electing S corporation status, it must timely file Form 2553. The LLC will be treated as a corporation as of the effective date of the S corporation election and does not need to file Form 8832. See the Instructions for Form 2553.*

**Line 9a. Type of entity.** Check the box that best describes the type of entity applying for the EIN. If you are an alien individual with an ITIN previously assigned to you, enter the ITIN in place of a requested SSN.



*This is not an election for a tax classification of an entity. See Disregarded entities on page 4.*

**Sole proprietor.** Check this box if you file Schedule C, C-EZ, or F (Form 1040) and have a qualified plan, or are required to file excise, employment, alcohol, tobacco, or firearms returns, or are a payer of gambling winnings. Enter your SSN (or ITIN) in the space provided. If you are a nonresident alien with no effectively connected income from sources within the United States, you do not need to enter an SSN or ITIN.

**Corporation.** This box is for any corporation other than a personal service corporation. If you check this box, enter the income tax form number to be filed by the entity in the space provided.



*If you entered "1120S" after the "Corporation" checkbox, the corporation must file Form 2553 no later than the 15th day of the 3rd month of the tax year the election is to take effect. Until Form 2553 has been received and approved, you will be considered a Form 1120 filer. See the Instructions for Form 2553.*

**Personal service corporation.** Check this box if the entity is a personal service corporation. An entity is a personal service corporation for a tax year only if:

- The principal activity of the entity during the testing period (prior tax year) for the tax year is the performance of personal services substantially by employee-owners, and
- The employee-owners own at least 10% of the fair market value of the outstanding stock in the entity on the last day of the testing period.

Personal services include performance of services in such fields as health, law, accounting, or consulting. For more information about personal service corporations, see the Instructions for Form 1120 and Pub. 542.



*If the corporation is recently formed, the testing period begins on the first day of its tax year and ends on the earlier of the last day of its tax year, or the last day of the calendar year in which its tax year begins.*

**Other nonprofit organization.** Check this box if the nonprofit organization is other than a church or church-controlled organization and specify the type of nonprofit organization (for example, an educational organization).



*If the organization also seeks tax-exempt status, you must file either Package 1023 or Package 1024. See Pub. 557 for more information.*

If the organization is covered by a group exemption letter, enter the four-digit group exemption number (GEN) in the last entry. (Do not confuse the GEN with the nine-digit EIN.) If you do not know the GEN, contact the parent organization. Get Pub. 557 for more information about group exemption numbers.

If the organization is a section 527 political organization, check the box for *Other nonprofit organization* and specify "section 527 organization" in the space to the right. To be recognized as exempt from tax, a section 527 political organization must electronically file Form 8871, Political Organization Notice of Section 527 Status, within 24 hours of the date on which the organization was established. The organization may also have to file Form 8872, Political Organization Report of Contributions and Expenditures. See [www.irs.gov/polorgs](http://www.irs.gov/polorgs) for more information.

**Plan administrator.** If the plan administrator is an individual, enter the plan administrator's taxpayer identification number (TIN) in the space provided.

**REMIC.** Check this box if the entity has elected to be treated as a real estate mortgage investment conduit (REMIC). See the Instructions for Form 1066 for more information.

**State/local government.** If you are a government employer and you are not sure of your social security and Medicare coverage options, go to [www.ncsssa.org/ssafames.html](http://www.ncsssa.org/ssafames.html) to obtain the contact information for your state's Social Security Administrator.

**Other.** If not specifically listed, check the "Other" box, enter the type of entity and the type of return, if any, that will be filed (for example, "Common Trust Fund, Form 1065" or "Created a Pension Plan"). Do not enter "N/A." If you are an alien individual applying for an EIN, see the *Lines 7a–b* instructions on page 3.

• **Household employer.** If you are an individual that will employ someone to provide services in your household, check the "Other" box and enter "Household Employer" and your SSN. If you are a trust that qualifies as a household employer, you do not need a separate EIN for reporting tax information relating to household employees; use the EIN of the trust.

• **Household employer agent.** If you are an agent of a household employer that is a disabled individual or other welfare recipient receiving home care services through a state or local program, check the "Other" box and enter "Household Employer Agent." (See Rev. Proc. 80-4, 1980-1 C.B. 581 and Notice 2003-70, 2003-43 I.R.B. 916.) If you are a state or local government also check the box for state/local government.

• **QSub.** For a qualified subchapter S subsidiary (QSub) check the "Other" box and specify "QSub."

• **Withholding agent.** If you are a withholding agent required to file Form 1042, check the "Other" box and enter "Withholding Agent."

**Disregarded entities.** A disregarded entity is an eligible entity that is disregarded as separate from its owner for federal income tax purposes. Disregarded entities include single-member limited liability companies (LLCs) that are disregarded as separate from their owners, qualified subchapter S subsidiaries (qualified subsidiaries of an S corporation), and certain qualified foreign entities. See the instructions for Form 8832 and Regulations section 301.7701-3 for more information on domestic and foreign disregarded entities.

A disregarded entity must have an EIN if it is subject to employment taxes or certain excise taxes. For wages paid during 2008 and in prior years, the reporting and payment of employment taxes for employees could be made using the name and EIN of either the owner or the disregarded entity (as explained in Notice 99-6, 1999-3 I.R.B. 12).

For wages paid on or after January 1, 2009, the disregarded entity is required to use its name and EIN for reporting and payment of employment taxes. A disregarded entity is also required to use its name and EIN to register for excise tax activities on Form 637, pay and report excise taxes reported on Forms 720, 730, 2290, and 11-C, and claim any refunds, credits, and payments on Form 8849. This requirement for reporting and paying excise taxes became effective after December 31, 2007. See the instructions for the employment and excise tax returns for more information.

Complete Form SS-4 for disregarded entities as follows.

- If a disregarded entity is filing Form SS-4 to obtain an EIN because it is required to report and pay employment and excise taxes (see above) or for non-federal purposes such as a state requirement, check the "Other" box for line 9a and write "disregarded entity" (or "disregarded entity-sole proprietorship" if the owner of the disregarded entity is an individual).
- If the disregarded entity is requesting an EIN for purposes of filing Form 8832 to elect classification as an association taxable as a corporation, or Form 2553 to elect S corporation status, check the "Corporation" box for line 9a and write "single-member" and the form number of the return that will be filed (Form 1120 or 1120S).
- If the disregarded entity is requesting an EIN because it has acquired one or more additional owners and its classification has changed to partnership under the default rules of Regulations section 301.7701-3(f), check the "Partnership" box for line 9a.

**Line 10. Reason for applying.** Check only one box. Do not enter "N/A." A selection is required.

**Started new business.** Check this box if you are starting a new business that requires an EIN. If you check this box, enter the type of business being started. Do not apply if you already have an EIN and are only adding another place of business.

**Hired employees.** Check this box if the existing business is requesting an EIN because it has hired or is hiring employees and is therefore required to file employment tax returns. Do not apply if you already have an EIN and are only hiring employees. For information on employment taxes (for example, for family members), see Pub. 15 (Circular E).



*You may have to make electronic deposits of all depository taxes (such as employment tax, excise tax, and corporate income tax) using the Electronic Federal Tax Payment System (EFTPS). See Federal tax deposits on page 1; section 11, Depositing Taxes, of Pub. 15 (Circular E); and Pub. 966.*

**Banking purpose.** Check this box if you are requesting an EIN for banking purposes only, and enter the banking purpose (for example, a bowling league for depositing dues or an investment club for dividend and interest reporting).

**Changed type of organization.** Check this box if the business is changing its type of organization. For example, the business was a sole proprietorship and has been incorporated or has become a partnership. If you check this box, specify in the space provided (including available space immediately below) the type of change made. For example, "From Sole Proprietorship to Partnership."

**Purchased going business.** Check this box if you purchased an existing business. Do not use the former owner's EIN unless you became the "owner" of a corporation by acquiring its stock.

**Created a trust.** Check this box if you created a trust, and enter the type of trust created. For example, indicate if the trust is a nonexempt charitable trust or a split-interest trust.

**Exception.** Do not file this form for certain grantor-type trusts. The trustee does not need an EIN for the trust if the trustee furnishes the name and TIN of the grantor/owner and the address of the trust to all payers. However, grantor trusts that do not file using Optional Method 1 and IRA trusts that are required to file Form 990-T, Exempt Organization Business Income Tax Return, must have an EIN. For more information on grantor trusts, see the Instructions for Form 1041.

**TIP** Do not check this box if you are applying for a trust EIN when a new pension plan is established. Check "Created a pension plan."

**Created a pension plan.** Check this box if you have created a pension plan and need an EIN for reporting purposes. Also, enter the type of plan in the space provided.

**TIP** Check this box if you are applying for a trust EIN when a new pension plan is established. In addition, check the "Other" box on line 9a and write "Created a Pension Plan" in the space provided.

**Other.** Check this box if you are requesting an EIN for any other reason; and enter the reason. For example, a newly-formed state government entity should enter "Newly-Formed State Government Entity" in the space provided.

**Line 11. Date business started or acquired.** If you are starting a new business, enter the starting date of the business. If the business you acquired is already operating, enter the date you acquired the business. If you are changing the form of ownership of your business, enter the date the new ownership entity began. Trusts should enter the date the trust was funded. Estates should enter the date of death of the decedent whose name appears on line 1 or the date when the estate was legally funded.

**Line 12. Closing month of accounting year.** Enter the last month of your accounting year or tax year. An accounting or tax year is usually 12 consecutive months, either a calendar year or a fiscal year (including a period of 52 or 53 weeks). A calendar year is 12 consecutive months ending on December 31. A fiscal year is either 12 consecutive months ending on the last day of any month other than December or a 52-53 week year. For more information on accounting periods, see Pub. 538.

**Individuals.** Your tax year generally will be a calendar year.

**Partnerships.** Partnerships must adopt one of the following tax years.

- The tax year of the majority of its partners.
- The tax year common to all of its principal partners.

- The tax year that results in the least aggregate deferral of income.
- In certain cases, some other tax year.

See the Instructions for Form 1065 for more information.

**REMICs.** REMICs must have a calendar year as their tax year.

**Personal service corporations.** A personal service corporation generally must adopt a calendar year unless it meets one of the following requirements.

- It can establish a business purpose for having a different tax year.
- It elects under section 444 to have a tax year other than a calendar year.

**Trusts.** Generally, a trust must adopt a calendar year except for the following trusts.

- Tax-exempt trusts.
- Charitable trusts.
- Grantor-owned trusts.

**Line 13. Highest number of employees expected in the next 12 months.** Complete each box by entering the number (including zero ("0-")) of "Agricultural," "Household," or "Other" employees expected by the applicant in the next 12 months.

If no employees are expected, skip line 14.

**Line 14. Do you want to file Form 944?** If you expect your employment tax liability to be \$1,000 or less in a full calendar year, you are eligible to file Form 944 annually (once each year) instead of filing Form 941 quarterly (every three months). Your employment tax liability generally will be \$1,000 or less if you expect to pay \$4,000 or less in total wages subject to social security and Medicare taxes and federal income tax withholding. If you qualify and want to file Form 944 instead of Forms 941, check the box on line 14. If you do not check the box, then you must file Form 941 for every quarter.

**TIP** For employers in the U.S. possessions, generally, if you pay \$6,536 or less in wages subject to social security and Medicare taxes, you are likely to pay \$1,000 or less in employment taxes.

For more information on employment taxes, see Pub. 15 (Circular E); or Pub. 51 (Circular A) if you have agricultural employees (farmworkers).

**Line 15. First date wages or annuities were paid.** If the business has employees, enter the date on which the business began to pay wages. If the business does not plan to have employees, enter "N/A."

**Withholding agent.** Enter the date you began or will begin to pay income (including annuities) to a nonresident alien. This also applies to individuals who are required to file Form 1042 to report alimony paid to a nonresident alien.

**Line 16.** Check the one box on line 16 that best describes the principal activity of the applicant's business. Check the "Other" box (and specify the applicant's principal activity) if none of the listed boxes applies. You must check a box.

**Construction.** Check this box if the applicant is engaged in erecting buildings or engineering projects (for example, streets, highways, bridges, tunnels). The term "Construction" also includes special trade contractors (for example, plumbing, HVAC, electrical, carpentry, concrete, excavation, etc. contractors).

**Real estate.** Check this box if the applicant is engaged in renting or leasing real estate to others; managing, selling, buying, or renting real estate for others; or providing related real estate services (for example, appraisal services). Also check this box for mortgage real estate investment trusts (REITs). Mortgage REITs are engaged in issuing shares of funds consisting primarily of portfolios of real estate

mortgage assets with gross income of the trust solely derived from interest earned.

**Rental and leasing.** Check this box if the applicant is engaged in providing tangible goods such as autos, computers, consumer goods, or industrial machinery and equipment to customers in return for a periodic rental or lease payment. Also check this box for equity real estate investment trusts (REITS). Equity REITS are engaged in issuing shares of funds consisting primarily of portfolios of real estate assets with gross income of the trust derived from renting real property.

**Manufacturing.** Check this box if the applicant is engaged in the mechanical, physical, or chemical transformation of materials, substances, or components into new products. The assembling of component parts of manufactured products is also considered to be manufacturing.

**Transportation & warehousing.** Check this box if the applicant provides transportation of passengers or cargo; warehousing or storage of goods; scenic or sight-seeing transportation; or support activities related to transportation.

**Finance & insurance.** Check this box if the applicant is engaged in transactions involving the creation, liquidation, or change of ownership of financial assets and/or facilitating such financial transactions; underwriting annuities/insurance policies; facilitating such underwriting by selling insurance policies; or by providing other insurance or employee-benefit related services.

**Health care & social assistance.** Check this box if the applicant is engaged in providing physical, medical, or psychiatric care or providing social assistance activities such as youth centers, adoption agencies, individual/family services, temporary shelters, daycare, etc.

**Accommodation & food services.** Check this box if the applicant is engaged in providing customers with lodging, meal preparation, snacks, or beverages for immediate consumption.

**Wholesale-agent/broker.** Check this box if the applicant is engaged in arranging for the purchase or sale of goods owned by others or purchasing goods on a commission basis for goods traded in the wholesale market, usually between businesses.

**Wholesale-other.** Check this box if the applicant is engaged in selling goods in the wholesale market generally to other businesses for resale on their own account, goods used in production, or capital or durable nonconsumer goods.

**Retail.** Check this box if the applicant is engaged in selling merchandise to the general public from a fixed store; by direct, mail-order, or electronic sales; or by using vending machines.

**Other.** Check this box if the applicant is engaged in an activity not described above. Describe the applicant's principal business activity in the space provided.

**Line 17.** Use line 17 to describe the applicant's principal line of business in more detail. For example, if you checked the "Construction" box on line 16, enter additional detail such as "General contractor for residential buildings" on line 17. An entry is required. For mortgage REITS indicate mortgage REIT and for equity REITS indicate what type of real property is the principal type (residential REIT, nonresidential REIT, miniwarehouse REIT).

**Line 18.** Check the applicable box to indicate whether or not the applicant entity applying for an EIN was issued one previously.

**Third Party Designee.** Complete this section only if you want to authorize the named individual to receive the entity's EIN and answer questions about the completion of Form

SS-4. The designee's authority terminates at the time the EIN is assigned and released to the designee. You must complete the signature area for the authorization to be valid. **Signature.** When required, the application must be signed by (a) the individual, if the applicant is an individual, (b) the president, vice president, or other principal officer, if the applicant is a corporation, (c) a responsible and duly authorized member or officer having knowledge of its affairs, if the applicant is a partnership, government entity, or other unincorporated organization, or (d) the fiduciary, if the applicant is a trust or an estate. Foreign applicants may have any duly-authorized person (for example, division manager) sign Form SS-4.

**Privacy Act and Paperwork Reduction Act Notice.** We ask for the information on this form to carry out the Internal Revenue laws of the United States. We need it to comply with section 6109 and the regulations thereunder, which generally require the inclusion of an employer identification number (EIN) on certain returns, statements, or other documents filed with the Internal Revenue Service. If your entity is required to obtain an EIN, you are required to provide all of the information requested on this form. Information on this form may be used to determine which federal tax returns you are required to file and to provide you with related forms and publications.

We disclose this form to the Social Security Administration (SSA) for their use in determining compliance with applicable laws. We may give this information to the Department of Justice for use in civil and/or criminal litigation, and to cities, states, the District of Columbia, and U.S. commonwealths and possessions for use in administering their tax laws. We may also disclose this information to other countries under a tax treaty, to federal and state agencies to enforce federal nontax criminal laws, and to federal law enforcement and intelligence agencies to combat terrorism.

We will be unable to issue an EIN to you unless you provide all of the requested information that applies to your entity. Providing false information could subject you to penalties.

You are not required to provide the information requested on a form that is subject to the Paperwork Reduction Act unless the form displays a valid OMB control number. Books or records relating to a form or its instructions must be retained as long as their contents may become material in the administration of any Internal Revenue law. Generally, tax returns and return information are confidential, as required by section 6103. Section 6109 requires paid preparers to provide their identifying number.

The time needed to complete and file this form will vary depending on individual circumstances. The estimated average time is:

<b>Recordkeeping</b> .....	8 hrs., 36 min.
<b>Learning about the law or the form</b> .....	42 min.
<b>Preparing, copying, assembling, and sending the form to the IRS</b> .....	52 min.

If you have comments concerning the accuracy of these time estimates or suggestions for making this form simpler, we would be happy to hear from you. You can write to Internal Revenue Service, Tax Products Coordinating Committee, SE:W:CAR:MP:T:T:SP, IR-6526, 1111 Constitution Avenue, NW, Washington, DC 20224. Do not send the form to this address. Instead, see *Where to File or Fax* on page 2.

to the IRS by telephone, fax, or mail. To apply for an EIN online or by any other means, see "How to Apply" in the instructions to the form, available at <http://www.irs.gov/pub/irs-pdf/iss4.pdf>.

§2.208 B. Form: Registration Form for Commercial Employers (California EDD Form DE 1)



This form will be the basic record of YOUR Account. DO NOT FILE FORM UNTIL YOU HAVE PAID WAGES THAT EXCEED \$100.00 IN CALENDAR QUARTER. Please read INSTRUCTIONS on page 2 before completing form. PLEASE PRINT OR TYPE in BLUE OR BLACK INK ONLY. Return form to

EMPLOYMENT DEVELOPMENT DEPARTMENT  
ACCOUNT SERVICES GROUP, M/C 28  
P.O. BOX 826880  
SACRAMENTO CA 94280-0001  
(866) 745-3866 FAX (916) 664-9211  
www.edd.ca.gov

REGISTRATION FORM FOR COMMERCIAL EMPLOYERS See page 2 for registration instructions for other business types.

EDD ACCOUNT NUMBER		Dept. Use Only:	QUARTER	ONLINE PROCESS DATE	TAS CODE
- - - - -					
<b>A. LIST NAMES OF: OWNER(S), PARTNER(S) *, CORP OFFICERS, OR LLC/LLP Members/Managers/Officers</b>		TITLE	PERCENT OF OWNERSHIP	SOCIAL SECURITY #	CALIFORNIA DRIVER'S LIC #
<i>Note: If entity is a Limited Partnership, indicate General Partner with an (*). List additional partners, LLC/LLP members/officers/managers on a separate sheet.</i>					
<b>B. BUSINESS NAME:</b> (If none, enter N/A)			<b>C. DATE OWNERSHIP BEGAN OPERATING:</b> MM __ DD __ YYYY		<b>D. FEDERAL TAX ID #:</b>
<b>E. CORPORATION / LLC / LLP/LP NAME:</b> (If none, enter N/A)				<b>E1. SECRETARY OF STATE CORP / LLC / LLP ID #</b>	
<b>F. PHYSICAL BUSINESS LOCATION:</b> (Number and Street, not P.O. Box)		CITY	STATE	ZIP CODE	PHONE NUMBER
<b>G. MAILING ADDRESS:</b> (P.O. Box / Number and Street, only if different than F)		CITY	STATE	ZIP CODE	PHONE NUMBER
<i>Note: If you have multiple CA locations, please attach the physical business addresses on a separate sheet of paper.</i>					
<b>H. INDICATE FIRST QUARTER &amp; YEAR WAGES EXCEEDED \$100:</b> <input type="checkbox"/> Jan-Mar 20__ <input type="checkbox"/> Apr-Jun 20__ <input type="checkbox"/> Jul-Sept 20__ <input type="checkbox"/> Oct-Dec 20__					
<b>I. HAVE YOU EVER OWNED OR BEEN A PRINCIPAL OWNER IN A BUSINESS REGISTERED WITH EDD:</b> <input type="checkbox"/> No <input type="checkbox"/> Yes If Yes, complete J. →			<b>J. FORMER EDD ACCOUNT NUMBER(S):</b> _____ <b>BUSINESS NAME:</b> _____ <b>ADDRESS:</b> _____ <small>NOTE: If necessary, please provide additional information on a separate sheet.</small>		
<b>K. THIS IS A:</b> <input type="checkbox"/> New Business <input type="checkbox"/> Hired Employees <input type="checkbox"/> Purchased a Business ** <input type="checkbox"/> Other (Specify) _____ <small>** If business was purchased, mark appropriate box and complete the information below: <input type="checkbox"/> All <input type="checkbox"/> Part</small>					
1. Previous Owner		2. Previous Business Name		3. Previous EDD Account #	
				4. Purchase Price	
				5. Date of Transfer	
<small>Note: For all other changes in form/ownership to your account, please use the Change of Employer Account Information (DE 24).</small>					
<b>L. NUMBER OF CA EMPLOYEES:</b> _____ <small>See page 2 for information on CA employees.</small>			<b>M. EMPLOYEE IS:</b> <input type="checkbox"/> Spouse <input type="checkbox"/> Minor Child (Under 18) <input type="checkbox"/> Employer's Parent <small>If Yes to any of the above, please refer to instructions on page 2.</small>		
<b>N. ORGANIZATION TYPE:</b>					
<input type="checkbox"/> Individual Owner		<input type="checkbox"/> Limited Partnership		<input type="checkbox"/> Estate Administration	
<input type="checkbox"/> Co-Ownership		<input type="checkbox"/> Association		<input type="checkbox"/> Trusteeship	
<input type="checkbox"/> General Partnership		<input type="checkbox"/> Limited Liability Company		<input type="checkbox"/> Joint Venture	
<input type="checkbox"/> Corporation		<input type="checkbox"/> Limited Liability Partnership		<input type="checkbox"/> Receivership	
<input type="checkbox"/> Bankruptcy		<input type="checkbox"/> Liquidation			
<b>O. EMPLOYER TYPE:</b>		<b>P. INDUSTRY ACTIVITY:</b> Check the industry, product, or service that represents the greatest portion of your sales or revenue:			
<input type="checkbox"/> COMMERCIAL		<input type="checkbox"/> Services		<input type="checkbox"/> Retail	
<input type="checkbox"/> PACIFIC MARITIME		<input type="checkbox"/> Temp Services		<input type="checkbox"/> Wholesale	
<input type="checkbox"/> FISHING BOAT				<input type="checkbox"/> Manufacturing	
				<input type="checkbox"/> Professional Employer Organization	
				<input type="checkbox"/> Other (Specify) _____	
<b>Also, describe specific product and/or service in detail:</b> _____					
<b>Q. CONTACT PERSON FOR BUSINESS:</b>		TITLE/COMPANY NAME	ADDRESS	DAYTIME PHONE NUMBER	
<b>R. DECLARATION</b> I certify under penalty of perjury that the above information is true, correct and complete, and that these actions are not being taken to receive a more favorable Unemployment Insurance Rate. I further certify that I have the authority to sign on behalf of the above business. <b>Signature:</b> _____ <b>Title:</b> _____ (Owner, Corporate Officer, Partner, LLC/LLP Member/Manager, or authorized Agent) <b>Printed Name:</b> _____ <b>Phone Number:</b> _____ <b>Date:</b> _____					

**INSTRUCTIONS FOR REGISTRATION FORM FOR COMMERCIAL EMPLOYERS**

An employer is required by law to file a registration form with the Employment Development Department (EDD) within fifteen (15) days after paying over \$100 in wages for employment in a calendar quarter. Please complete the registration process by doing one of the following:

- Register online from EDD's e-Services at <https://eddservices.edd.ca.gov> or
- Mail your completed registration form to EDD, Account Services Group (ASG) MIC 28, P.O. Box 826880, Sacramento, CA 94280-0001 or
- Fax your completed registration form to EDD at (916) 654-9211 or
- Call for telephone registration at (916) 654-8706
- If you are already registered and have a change in form or ownership, please complete a *Change of Employer Account Information (DE 24)*.
- Attach additional sheets if your information will not fit in the space provided.

Industry specific registration forms for Agricultural, Government/Schools/Indian Tribes, Household Workers, Nonprofit, or Personal Income Tax Only, are available online at [www.edd.ca.gov/Payroll\\_Taxes/Forms\\_and\\_Publications.htm#Forms](http://www.edd.ca.gov/Payroll_Taxes/Forms_and_Publications.htm#Forms).

**NEED MORE HELP OR INFORMATION?**

- If you have questions regarding this form or the registration account number and assignment process and about whether your business entity is subject to reporting and paying State payroll taxes, you may visit our Web Site at [www.edd.ca.gov/Payroll\\_Taxes/Reporting\\_Requirements.htm](http://www.edd.ca.gov/Payroll_Taxes/Reporting_Requirements.htm). You may also call our Taxpayer Assistance Center at 888-745-3886. For TTY (nonverbal) access, call 800-547-9565. Outside U.S. or Canada, call (916) 464-3502.
  - EDD provides seminars and other educational opportunities for taxpayers to learn how to report employees' wages and pay taxes, pointing out the pitfalls that create errors and unnecessary billings. Visit our Web site at [www.edd.ca.gov/Payroll\\_Tax\\_Seminars/](http://www.edd.ca.gov/Payroll_Tax_Seminars/) or call us at 888-745-3886 for more information.
  - Access the EDD Web site at [www.edd.ca.gov](http://www.edd.ca.gov).
- A. **LIST INDIVIDUAL OWNER(S), PARTNER(S), CORPORATE OFFICER(S), OR LLC/LLP Members/Managers/Officers** – Enter name, title, percent of ownership, social security number, and California driver's license number of each individual.
- B. **BUSINESS NAME** – Enter name by which your business is known to the public. Enter "N/A" if business name is not different from Box A.
- C. **OWNERSHIP BEGAN** – Enter date the new ownership began operating.
- D. **FEDERAL TAX NUMBER** – Enter Federal Employer Identification Number. If not assigned, enter "Applied For."
- E. **CORPORATION/LLC/LLP/LP NAME** – Enter Corporation/LLC/LLP/LP name exactly as spelled and registered with the Secretary of State.  
E1. **SECRETARY OF STATE CORP/LLC/LLP ID NUMBER** – Enter the California Corporate/LLC/LLP/LP identification number.
- F. **PHYSICAL BUSINESS LOCATION** – Enter the California street address (not PO Box) and telephone number where business is physically conducted. If you have multiple California locations, please attach the physical business addresses on a separate sheet of paper.
- G. **MAILING ADDRESS** – Enter mailing address where EDD correspondence and forms should be sent. Provide daytime telephone number.
- H. **INDICATE FIRST QUARTER & YEAR WAGES EXCEEDED \$100** – Check the appropriate box for the quarter in which you first paid over \$100 in wages. These wages are subject to Unemployment Insurance, Employment Training Tax, and State Disability Insurance withholdings.
- I. **PRIOR REGISTRATION** - If any part of the ownership shown in items A, B, or E are operating or have ever operated a business at another location, check "Yes" and provide account number, business name, and address in box J.
- J. **FORMER BUSINESS INFORMATION** – If "Yes" is checked in box I, provide former EDD account number, business name, and address.
- K. **STATUS OF BUSINESS** – Check the box that best describes why you are completing this form. If the business was purchased, provide previous owner and business name, EDD account number, purchase price, and date ownership was transferred to this ownership.
- L. **NUMBER OF CALIFORNIA EMPLOYEES** – Enter the number of workers who are considered to be California employees. Refer to Information Sheet: *Employment (DE 231)* and Information Sheet: *Multi-State Employment (DE 231D)* on our Web site at [www.edd.ca.gov/Payroll\\_Taxes/Forms\\_and\\_Publications.htm#Publications](http://www.edd.ca.gov/Payroll_Taxes/Forms_and_Publications.htm#Publications) for additional information.
- M. **FAMILY EMPLOYEES** – Refer to Information Sheet: *Family Employment (DE 231FAM)* and Information Sheet: *Specialized Coverage (DE 231SC)* on our Web site at [www.edd.ca.gov/Payroll\\_Taxes/Forms\\_and\\_Publications.htm#Publications](http://www.edd.ca.gov/Payroll_Taxes/Forms_and_Publications.htm#Publications) for additional information.
- N. **ORGANIZATION TYPE** – Check box that best describes the legal form of the ownership shown in items A, B, or E. Co-ownership is defined as husband/wife, spouse, or registered domestic partners. If other, please specify.
- O. **EMPLOYER TYPE** – Check box that best describes your employer type.
- P. **INDUSTRY ACTIVITY** – Check box that best describes the industry activity of your business. Describe the particular product or service in detail. This information is used to assign an Industrial Classification Code to your business. If you would like more information on industry coding or the North American Industry Classification System (NAICS), you can visit the Web site at [www.census.gov/epcd/www/naics.html](http://www.census.gov/epcd/www/naics.html).
- Q. **CONTACT PERSON FOR BUSINESS** – Enter the name, title/company name, address, and daytime telephone number of the person authorized by the ownership shown in items A or B to provide EDD staff information needed to maintain the accuracy of your employer account.
- R. **DECLARATION** – This declaration must be signed by an individual having the authority to sign on behalf of the business.

We will notify you of your **EDD Account Number** by mail. To help you understand your tax withholding and filing responsibilities, you will be sent a **California Employer's Guide (DE 44)**. Please keep your account status current by completing a **Change of Employer Account Information (DE 24)** for all future changes to the original registration information. The DE 44 and DE 24 can be accessed through our Web site at [www.edd.ca.gov/Payroll\\_Taxes/Forms\\_and\\_Publications.htm](http://www.edd.ca.gov/Payroll_Taxes/Forms_and_Publications.htm).

*Comment:* This form may be completed online and downloaded at [http://www.edd.ca.gov/pdf\\_pub\\_ctr/de1.pdf](http://www.edd.ca.gov/pdf_pub_ctr/de1.pdf).

§2.209 C. Form: Business Entities Fee Schedule (Secretary of State)



Secretary of State  
Business Programs Division

1500 11<sup>th</sup> Street, 3<sup>rd</sup> Floor  
Sacramento, CA 95814

Business Entities  
(916) 657-5448

## Business Entities Fee Schedule

Statutory fees for the various business programs can generally be found in Article 2 (Section 12178.1) and Article 3 (commencing with Section 12180) of the California Government Code.

Article 3 provides that upon the filing of any document pursuant to any provision of the Corporations Code for which there is a filing fee of twenty-five dollars (\$25.00) or more, the Secretary of State shall compare and certify up to two copies without charge, **provided that the copies are submitted to the Secretary of State with the document to be filed.** Any additional copies submitted with the document will be certified upon request and payment of the \$8.00 per copy certification fee.

### Filing Fees

#### Domestic Corporations:

Articles of Incorporation (providing for shares).....	\$100.00
Articles of Incorporation (providing for shares <b>and</b> containing a statement of conversion): California stock corporation converted from a California limited liability company, California limited partnership, California general partnership or a foreign entity .....	\$150.00
Articles of Incorporation (not providing for shares).....	\$ 30.00
Certificate of Amendment.....	\$ 30.00
Certificate of Amendment (changing status of corporation from nonprofit to stock).....	\$ 70.00
Restated Articles of Incorporation .....	\$ 30.00
Restated Articles of Incorporation (changing status of corporation from nonprofit to stock) .....	\$ 70.00
Certificate Pursuant to California Corporations Code section 1505 .....	\$ 30.00
Certificate of Correction.....	\$ 30.00
Certificate of Election to Wind Up and Dissolve.....	NO FEE
Certificate of Revocation of Certificate of Election to Wind Up and Dissolve.....	\$ 30.00
Certificate of Dissolution.....	NO FEE
Short Form Certificate of Dissolution.....	NO FEE
Agreement of Merger/Certificate of Ownership .....	\$100.00
Interspecies Merger (between corporations and other business entities).....	\$150.00
Conversion: California stock corporation converting to a California limited liability company (Form LLC-1A), California limited partnership (Form LP-1A), registered (Form GP-1A) or a non-registered (Form CONV-1A) California general partnership .....	\$150.00

#### Statement of Information:

- Domestic Stock Corporation (Form SI-200 C or Form SI-200 N/C) - initial or annual statement:  
\$20.00 filing fee and a \$5.00 disclosure fee .....
- Domestic Nonprofit Corporation (Form SI-100) - initial or biennial statement .....
- Statement by Common Interest Development Association (Form SI-CID).....  
Note: Corporations formed to manage common interest development associations must initially and biennially file a Statement of Information (Form SI-100 – filing fee \$20.00) together with a Statement by Common Interest Development Association (Form SI-CID – filing fee \$15.00) for a total of \$35.00.
- Amended statement (Form SI-200 C, Form SI-100 or Form SI-CID):  
submission of a statement between applicable filing periods to report a change of information .....
- Corporate Disclosure Statement (Form SI-PT) – Publicly Traded Corporations .....

**Filing Fees (continued)**

**Foreign (out-of-state or out-of-country) Corporations:**

Statement and Designation by Foreign Corporation (qualification of a foreign stock corporation) .....	\$100.00
Statement and Designation by Foreign Corporation (qualification of a foreign nonstock, nonprofit corporation) .....	\$ 30.00
Amended Statement by Foreign Corporation.....	\$ 30.00
Certificate Pursuant to California Corporations Code section 1505.....	\$ 30.00
Interspecies Merger (between corporations and other business entities).....	\$150.00
Certificate of Surrender of Right to Transact Intrastate Business .....	NO FEE
Converting to a:	
California stock corporation (Articles of Incorporation containing a statement of conversion) .....	\$150.00
California limited liability company (Form LLC-1A), California limited partnership (Form LP-1A) or a registered California general partnership (Form GP-1A).....	\$ 70.00
Non-registered California general partnership (Form CONV-1A).....	\$ 30.00
Registering a corporate name of a foreign corporation <b>NOT</b> transacting intrastate business in California (for the calendar year - Corporations Code section 2101) .....	\$ 50.00
Statement of Information:	
• Foreign Corporation (Form SI-350) - annual statement.....	\$20.00 filing fee and a \$5.00 disclosure fee.....\$ 25.00
• Amended statement (Form SI-350): submission of a statement between applicable filing periods to report a change of information .....	NO FEE
Corporate Disclosure Statement (Form SI-PT) – Publicly Traded Corporations.....	NO FEE

**Domestic Limited Liability Companies:**

Articles of Organization (Form LLC-1).....	\$ 70.00
Articles of Organization - Conversion (Form LLC-1A): California limited liability company converted from a:	
California stock corporation .....	\$150.00
California limited partnership, California general partnership or a foreign entity .....	\$ 70.00
Amendment of Articles of Organization (Form LLC-2) .....	\$ 30.00
Restated Articles of Organization (Form LLC-10) .....	\$ 30.00
Certificate of Correction (Form LLC-11) .....	\$ 30.00
Certificate of Dissolution (Form LLC-3).....	NO FEE
Certificate of Cancellation (Form LLC-4/7).....	NO FEE
Short Form Certificate of Cancellation (Form LLC-4/8).....	NO FEE
Certificate of Continuation (Form LLC-8) .....	\$ 30.00
Certificate of Merger (Form OBE MERGER-1) between limited liability companies ONLY .....	\$ 70.00
Certificate of Merger (Form OBE MERGER-1) between limited liability companies and other business entities .....	\$150.00
Converting to a:	
California stock corporation (Articles of Incorporation containing a statement of conversion) .....	\$150.00
California limited partnership (Form LP-1A) or a registered California general partnership (Form GP-1A) .....	\$ 70.00
Non-registered California general partnership or a foreign entity (Form CONV-1A) .....	\$ 30.00
Statement of Information:	
• Domestic Limited Liability Company (Form LLC-12 or Form LLC-12R) – initial or biennial statement.....	\$ 20.00
• Amended statement (Form LLC-12): submission of a statement between applicable filing periods to report a change of information .....	NO FEE

**Filing Fees (continued)**

**Foreign (out-of-state or out-of-country) Limited Liability Companies:**

Application for Registration as a Foreign Limited Liability Company (Form LLC-5).....	\$ 70.00
Certificate of Amendment to Application for Registration (Form LLC-6) .....	\$ 30.00
Certificate of Correction (Form LLC-11) .....	\$ 30.00
Certificate of Cancellation (Form LLC-4/7).....	NO FEE
Certificate of Merger (Form OBE MERGER-1) between limited liability companies ONLY .....	\$ 70.00
Certificate of Merger (Form OBE MERGER-1) between limited liability companies and other business entities .....	\$150.00
Converting to a:	
California stock corporation (Articles of Incorporation containing a statement of conversion) .....	\$150.00
California limited liability company (Form LLC-1A), California limited partnership (Form LP-1A) or a registered California general partnership (Form GP-1A) .....	\$ 70.00
Non-registered California general partnership (Form CONV-1A) .....	\$ 30.00
Statement of Information:	
• Foreign Limited Liability Company (Form LLC-12 or LLC-12R) - initial or biennial statement.....	\$ 20.00
• Amended statement (Form LLC-12): submission of a statement between applicable filing periods to report a change of information .....	NO FEE

**Domestic Limited Partnerships:**

Certificate of Limited Partnership (Form LP-1).....	\$ 70.00
Certificate of Limited Partnership - Conversion (Form LP-1A): California limited partnership converted from a:	
California stock corporation .....	\$150.00
California limited liability company, California general partnership or a foreign entity .....	\$ 70.00
Amendment to Certificate of Limited Partnership (Form LP-2) .....	\$ 30.00
Restated Certificate of Limited Partnership (Form LP-10) .....	\$ 30.00
Certificate of Correction (Form LP-11) .....	\$ 30.00
Certificate of Cancellation (Form LP-4/7) .....	NO FEE
Certificate of Revival (Form LP-7) .....	\$ 30.00
Certificate of Dissociation (Form LP-101) by a general partner ONLY .....	\$ 30.00
Certificate of Withdrawal (Form LP-102) by a limited partner ONLY.....	\$ 30.00
Certificate of Merger (Form OBE MERGER-1) between limited partnerships ONLY.....	\$ 70.00
Certificate of Merger (Form OBE MERGER-1) between limited partnerships and other business entities.....	\$150.00
Converting to a:	
California stock corporation (Articles of Incorporation containing a statement of conversion) .....	\$150.00
California limited liability company (Form LLC-1A) or a registered general partnership (Form GP-1A) .....	\$ 70.00
Non-registered California general partnership or a foreign entity (Form CONV-1A) .....	\$ 30.00

**Foreign (out-of-state or out-of-country) Limited Partnerships:**

Application for Registration (Form LP-5).....	\$ 70.00
Amendment to Application for Registration (Form LP-6).....	\$ 30.00
Certificate of Correction (Form LP-11) .....	\$ 30.00
Certificate of Cancellation (Form LP-4/7) .....	NO FEE
Certificate of Merger (Form OBE MERGER-1) between limited partnerships ONLY.....	\$ 70.00
Certificate of Merger (Form OBE MERGER-1) between limited partnerships and other business entities.....	\$150.00
Converting to a:	
California stock corporation (Articles of Incorporation containing a statement of conversion) .....	\$150.00
California limited liability company (Form LLC-1A), California limited partnership (Form LP-1A) or a registered California general partnership (Form GP-1A).....	\$ 70.00
Non-registered California general partnership (Form CONV-1A) .....	\$ 30.00

## Filing Fees (continued)

### Registered General Partnerships:

Statement of Partnership Authority (Form GP-1) .....	\$ 70.00
Statement of Partnership Authority-Conversion (Form GP-1A) ...registered California general partnership converted from a:	
California stock corporation .....	\$150.00
California limited liability company, California limited partnership or a foreign entity .....	\$ 70.00
Statement of Denial (Form GP-2).....	\$ 30.00
Statement of Dissociation (Form GP-3) .....	\$ 30.00
Statement of Dissolution (Form GP-4) .....	NO FEE
Statement of Merger (Form GP-6) between partnerships or partnerships and foreign other business entities .....	\$ 30.00
Certificate of Merger (Form OBE MERGER-1) between partnerships and domestic other business entities .....	\$150.00
Statement of Amendment/Cancellation (Form GP-7).....	\$ 30.00
Converting to a:	
California stock corporation (Articles of Incorporation containing a statement of conversion) .....	\$150.00
California limited liability company (Form LLC-1A) or a California limited partnership (Form LP-1A).....	\$ 70.00
Foreign entity (Form CONV-1A).....	\$ 30.00

### Domestic and Foreign (out-of-state or out-of-country) Limited Liability Partnerships:

Registration of Limited Liability Partnership (Form LLP-1).....	\$ 70.00
Amendment to Registration (Form LLP-2) .....	\$ 30.00
Alternative Security Provision – Initial Filing (Form LLP-3) .....	NO FEE
Alternative Security Provision – Annual Confirmation (Form LLP-3).....	\$ 30.00
Notice of Change of Status (Form LLP-4) .....	\$ 30.00

### Unincorporated Associations:

Registration of Unincorporated Nonprofit Association.....	\$ 10.00
Statement By Unincorporated Association.....	\$ 25.00
Initial & Biennial Statement By Common Interest Development Association (Form SI-CID) .....	\$ 15.00

### Foreign (out-of-state or out-of-country) Associations:

Statement and Designation by Foreign Association.....	\$100.00
Amended Statement and Designation by Foreign Association .....	\$ 30.00
Certificate of Surrender of Right to Transact Intrastate Business .....	NO FEE

### Foreign (out-of-state or out-of-country) Lending Institutions:

Statement by Foreign Lending Institution.....	\$ 50.00
Supplement to Statement by Foreign Lending Institution.....	NO FEE

### Foreign (out-of-state or out-of-country) Partnerships *(Other than a foreign limited partnership subject to Chapter 5.5 (commencing with section 15900) of the California Corporations Code or a commercial or banking partnership established and transacting business in a place without the United States):*

Statement by Foreign Partnership.....	\$ 25.00
---------------------------------------	----------

**Reservation of Corporation, Limited Liability Company  
or Limited Partnership Name**

Issuing a Certificate of Reservation of a Corporate, Limited Liability Company, or Limited Partnership Name.....\$ 10.00  
Priority Telephone Service - Name Availability (each name searched – requires a prepaid account).....\$ 4.00

**Resignation of Agent**

Statement of Resignation of Agent Upon Whom Process May Be Served in California.....NO FEE

**Substituted Service of Process**

Delivery to the Secretary of State of copies of process against a corporation, limited liability company, limited partnership, general partnership, limited liability partnership, firm, association, business trust, or nonresident personal representative of an estate, for each corporation, limited liability company, etc., sought to be served by such delivery.....\$ 50.00

**Certificate Fees**

Issuing a Certificate of Filing of any document.....\$ 5.00  
Issuing a Certificate of Status (certifying to the current status of the entity) .....\$ 5.00  
Issuing a Certificate of Listing (for each document listed).....\$ 5.00  
Issuing a Certificate of No Record.....\$ 5.00  
Issuing a certificate prescribed by the Secretary of State for recording with the county recorder pursuant to California Corporations Code section 1109 (corporations only).....\$ 5.00

**Reproduction/Certification Fees**

Affixing certificate and Seal of State, unless otherwise provided for.....\$ 5.00  
Except as provided in California Government Code section 12185, the fee for comparing a copy of any law, resolution, record or other document or paper with the original, or the certified copy of the original on file.....\$ 3.00  
Making a copy of any record or document on file\* .....\$1.00 for the first page plus \$ .50 for each additional page, per copy

\*The last complete Statement of Information filed by a corporation or limited liability company is available for reproduction. The most current Statement of Information is also available whether a completed or "NO CHANGE" form is of record.

**Other Services**

Mail and over the counter requests for status information  
(for each name searched) - corporations, limited liability companies and limited partnerships only.....\$ 4.00  
Priority Telephone Service - status information (requires a prepaid account)  
(for each name searched) – corporations, limited liability companies and limited partnerships only .....\$ 4.00  
FAX return of status information or copies of documents (per entity, in addition to any other fees)  
FAX transmitted within the United States.....\$ 5.00  
FAX transmitted internationally.....\$ 10.00

**To Facilitate Requests:** Requests for certificates, status information, and/or copies of filed documents should be directed to the Business Programs Division, IRC Unit, P.O. Box 944260, Sacramento, CA 94244-2600. Sufficient fees must accompany all requests. If the number of pages is unknown when ordering copies, you may send either a check in the amount of \$20.00 per entity (refunds will be issued for amounts over \$5.00) or a blank check with a not to exceed amount written below the payment line (e.g., "NOT TO EXCEED \$40.00"). A self-addressed envelope will also help to facilitate the return of your request.



**Special Handling Fees**

Special handling fees are charged for filing, certificate, copy and name reservation requests that are hand-delivered to this office for over-the-counter (drop off) processing. Special handling fees are in addition to regular fees for such services and are applicable each time a filing, certificate, copy or name reservation request is presented. Special handling fees must be presented separate from other applicable fees. Documents or requests that are delivered with a special handling fee are processed in priority over documents or requests submitted by mail.

**Special handling is NOT applicable to documents or requests received through the mail.**

Special handling fee for filing a document.....	\$ 15.00
Special handling fee for certificates and for certified or uncertified copies of filed documents .....	\$ 10.00
Special handling fee for reserving a corporate, limited liability company or limited partnership name .....	\$ 10.00

**Preclearance and Expedited Filing Services**

The Secretary of State offers preclearance and expedited filing services (as described below) for documents filed with the Secretary of State pursuant to the California Corporations Code, the California Financial Code or the California Insurance Code.

**Preclearance and expedited filing services are NOT applicable to documents received through the mail.**

- **Preclearance service** provides a customer with the opportunity to submit a business entity document in person to the Secretary of State's Sacramento office prior to filing to determine if the document conforms to law and to receive a preclearance response within one of the following guaranteed time frames and for the specified preclearance fee:

Class I Service.....	24 hour response time .....	\$500.00
Class II Service.....	72 hour response time .....	\$400.00
Class III Service .....	5 business day response time.....	\$300.00
Class IV Service .....	10 business day response time.....	\$250.00

- **Expedited filing service** provides a customer with the opportunity to submit for filing a business entity document in person to the Secretary of State's Sacramento office and to receive a filing response within one of the following guaranteed time frames and for the specified expedite fee:

Class A Service (preclearance approval required).....	4 hour response time .....	\$500.00
Class B Service (must be received by the Secretary of State by 9:30 a.m.).....	Same day response time (by 4:00 p.m.).....	\$750.00
Class C Service.....	24 hour response time .....	\$350.00

Preclearance and expedited fees should be presented separate from other applicable fees. Please refer to the Secretary of State's website at [www.sos.ca.gov/business/be/preclearance-expedited-services.htm](http://www.sos.ca.gov/business/be/preclearance-expedited-services.htm) for detailed information regarding the preclearance and expedited filing services.

# 3

## Selecting a Business Name

Alan M. Insul

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### **§3.1 I. SCOPE OF CHAPTER**

This chapter discusses the selection of a business name by a California business entity. It covers the basic considerations applicable to name selection. See §§3.2-3.5. It also discusses California and federal laws, as well as the common law, relating to trade name availability and protection (see §§3.6-3.17) and fictitious business name requirements. See §§3.8-3.12. Further, the chapter covers the entity-specific name requirements (see §§3.18-3.29) and includes a checklist for conducting a name search. See §3.30. Forms include the Secretary of State's official forms for name availability and reservation, a fictitious business name statement, and a letter seeking consent to the use of a potentially confusingly similar name. See §§3.31-3.34.

The discussion in this chapter primarily concerns selection of the name of a business rather than selection of the name for a product. However, some principles apply to both, such as the need to avoid the likelihood of confusion with a prior user of the same or similar name or trademark. Trade name protection is touched on in §§3.7, 3.16-3.17, but for more detailed discussion of trade name and trademark protection, consult *Intellectual Property in Business Transactions* (Cal CEB 2008) and *Trade Secrets Practice in California* (2d ed Cal CEB 1996).

## II. OVERVIEW

### §3.2 A. Applicable Principles

The selection of a business name is one of the first decisions made by an entrepreneur. As a practical matter, name selection from the client's perspective is driven by the marketing and personal goals of the client for their particular business. See §3.3. From the practitioner's perspective, the likely business size, form of doing business, geographic location of the business or where its business may be conducted, and method of engaging in the business all have a direct impact on how he or she will advise the client with respect to the use of a proposed trade or commercial name. The goal of every legal review of a prospective business name is to either procure rights for the client's business or avoid infringing on some other person's name rights. The former may ultimately add value to the client's business while the latter may cost the client business value. If the client's business infringes on or constitutes an impermissible use of a pre-existing trade name, the client's nascent business may lose business opportunities associated with having to change the name, manner of conducting business (whether in terms of the geographic scope of the business operations or goods and services offered), or perhaps having to respond to litigation associated with claims of another to use of the trade name.

Another major consideration associated with the name selection is the form of doing business. At the simplest level, a sole proprietor engaging in a geographically localized business may only be concerned with obtaining fictitious name protection. At the other extreme, a start-up business may be planning on doing business worldwide and involving sophisticated forms of capitalization from venture capital to initial public offerings. In the latter situation, the decisions concerning name use may require exhaustive multi-jurisdictional analysis of applicable laws as well as databases and lists of pre-existing business names, symbols, and designations to obtain legal protection in a particular jurisdiction.

**NOTE:** Because several different bodies of law govern the choice of a business name, the attorney representing a person starting a business should be familiar with federal, state, and common law trade name and trademark laws (see §§3.6-3.17), as well as with name requirements and restrictions governing the particular form of entity and scope of business (see §§3.18-3.29). The proliferation of product promotion in the mass media has created a minefield of prior existing rights in various names and trademarks. Problems usually arise from actual or possible conflict with the names of other businesses or names used as trademarks to identify services or products already in use.

**PRACTICE TIP:** Name selection is the one aspect of representing a business client that is most often given short shrift. Although a client may tend to undervalue name search analysis, it is counsel's job to explain the critical import of this step and the need to establish the scope of the inquiry. The task of name selection can be made difficult by the maze of overlapping and multijurisdictional laws that potentially affect business name rights. Advocating that a client undertake such an analysis can challenge even the most patient of entrepreneurs anxiously waiting to launch his or her business. In addition, counsel is likely to face client protestations about costs associated with such analyses when, as is the case with most new business ventures, the entrepreneurs' limited capital generally is being hoarded for things other than legal fees.

Name-driven questions often lead to a useful and candid discussion between counsel and client about the nature and scope of the business. In turn, this exchange may help spot potential areas of concern not readily discernable otherwise. For example, a discussion about the use of the business name to conduct business over the Internet could lead to a discussion about whether the client intends to do business internationally. Or a discussion of the client's intent to sell manufactured cosmetic goods overseas might lead to a discussions about complying with a foreign country's laws on the importation and sale of cosmetic goods.

Under trade name and trademark law, a trade name is not the same as a trademark. A trade name, which pertains to both the business and its goodwill, is the name by which a business is known to the public (e.g., "3M" is the trade name for "Minnesota Mining and Manufacturing Co."). In contrast, a trademark is associated with a vendible good or

service as a guaranty of quality, *i.e.*, the brand name applied to a particular product or service (*e.g.*, "Tide" detergent). See *Balesteri v Holler* (1978) 87 CA3d 717, 721, 151 CR 229. A name or mark cannot be adopted or used if it is so similar to a prior name or mark that the public would be confused about the source, origin, sponsorship, or affiliation of the goods or services involved. See §§3.7, 3.16-3.17. Therefore, a new business should avoid any name that could give rise to the likelihood of confusion. It can be costly for a client to "undo" trade name use that is subsequently determined infringing. Changing a trade name or trademark after it has been adopted may involve a loss of business value, a waste of advertising effort, and incidental costs for changing signs, stationery, and directory listings. By comparison, dropping a name before it has been adopted is relatively cost free. Accordingly, the attorney should err on the side of caution in advising a client whether its intended use of a particular name is permissible.

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**Source:** Business Law/Selecting and Forming Business Entities/3 Selecting a Business Name/§3.3 B. Type of Business as Affecting Scope of Name Inquiry

### **§3.3 B. Type of Business as Affecting Scope of Name Inquiry**

Most often, a business client's primary goal in using a name is that it has some personal meaning or conveys something about the business. The practitioner's role is to help the client determine the proper level of name inquiry and research to ensure that the client is not inadvertently usurping a name protected under some statute, treaty, or principle of law. Clients sometimes have difficulty in understanding the need for this analysis.

**PRACTICE TIP:** Counsel should explain the need for name search analysis and the potential consequences to the fledgling business for improper use of a proposed trade name, including liability and injunctive prohibition against use of the name. These consequences can be disastrous, whether they occur early in the inception of a cash-strapped business, or later when the business is more established and has a substantial stake in the continued use of the contested name.

The type and scope of business typically define the issues pertinent to the selection of a business name. For example, a new business consisting of a corner coffee shop with the owner's name (*e.g.*, Jim's Coffee Shop), with no plans for expansion outside the immediate neighborhood, may justify a prior user inquiry that is limited to local usage. If a mail-order business is involved, however, even a cottage industry conducted out of a person's home may call for a full-scale search of federal usages.

The particular name chosen and the owner's motivation for making the choice can be important when a name is chosen based on similarity to a prior well-known mark or name. For example, a business name that parodies an established mark or name may elicit an angry cease-and-desist letter, or even a suit for injunctive relief, from the owner of the mark. Bus & P C §14402.

### **§3.4 C. Determining Rights in Name**

Once the new business entity has been advised of the laws that protect prior users of trademarks and trade names, the next step is to determine whether any prior users may be able to assert such rights. The simplest technique to ascertain prior users is a database search of existing federal and state trademark registrations. Such a search is available from a number of online computer services whose databases typically include pending trademark applications. However, a lag time exists between the filing of an application and a record of the application appearing on a commercial database. Federal trademark searches may be made directly at the website of the United States Patent and Trademark Office. For the website address, see the Directory.

**NOTE:** There is no unrestricted right to use even one's own name in a business, if use of that name could cause confusion. *MacSweeney Enters. v Tarantino* (1965) 235 CA2d 549, 558, 45 CR 546. In *MacSweeney*, the court held that the use of a family name could be enjoined even when the plaintiff was the senior user of the trade name, but the name had acquired secondary meaning, and actual consumer confusion was shown. This result was unaffected by the fact that the defendant's goods and services were superior to those of the plaintiff, or that monetary damages were not shown.

Although a client may personally conduct a trademark search, the interpretation of a search report is best made by a qualified trademark practitioner. Moreover, because a database search is considered to be only a primary level search, more comprehensive searches are often advisable. A typical second-tier search (a "common law" search) includes nonregistered trademark and trade name uses compiled from a large number of sources by a commercial reporting agency. The sources searched are based on the particular industry, goods, or services associated with the proposed name use.

If the trade name is intended to be used outside the United States, the scope of inquiry will necessarily be greater. It should at the very least cover the foreign jurisdictions in which the new business is likely to have its greatest presence. Although such an expanded inquiry can be expected to take significantly more time, it must necessarily be balanced against the client's legitimate concerns about preserving time and money.

**PRACTICE TIP:** When representing a business buyer acquiring a business, the attorney should be careful to establish whether the name of the business is also being acquired as opposed to the name being reserved on some basis. See *Balesteri v Holler* (1978) 87 CA3d 717, 721, 151 CR 229; see also Bus & P C §§14101, 14103, 14401.

**Source:** Business Law/Selecting and Forming Business Entities/3 Selecting a Business Name/§3.5 D. Secretary of State and County Clerk Lists of Business Names

### **§3.5 D. Secretary of State and County Clerk Lists of Business Names**

California, like most states, maintains a listing of certain business names. The Secretary of State's office maintains a list of names of all corporations, limited liability companies, limited partnerships, and limited liability partnerships that have filed their formation documents with the Secretary of State. The Secretary of State's office should be contacted to check the availability of the proposed business name, as measured against these lists. This step should be taken regardless of the form of business contemplated, because the existence of a business entity with the same or a similar name may make the choice problematic. For contact information, see the Directory.

**PRACTICE TIP:** The procedure for checking the availability of a corporate name and reserving it is so simple and inexpensive that it should be followed whenever circumstances permit to avoid the possibility that the corporate documents will have to resubmitted. See §§3.30-3.32. For attorneys and others who regularly form business entities, such as corporations and limited liability companies, the Secretary of State's office allows for establishment of a prepaid account that can be used to telephonically check name availability and reserve available names. However, the prepaid account is not available for proposed names of limited partnerships. See §3.27; see also the Directory.

**NOTE:** The Secretary of State's database is not integrated, and the Secretary of State does not prohibit, for example, the use of a corporate name in conflict with that of a limited liability company. Therefore, it is prudent to check all available name databases. Further, counsel may consider use of a name that is substantially the same as that of an existing entity if consent can be obtained, and the Secretary of State finds that the public is not likely to be misled. Corp C §§201(b), 17052(c); 2 Cal Code Regs §21003. See also 2 Cal Code Regs §21005, which describes names "likely to mislead the public"; for example, names that falsely imply a governmental affiliation by use of words like "Agency," "Commission," "Department," "Bureau," "Division," "Municipal" or "Board." 2 Cal Code Regs §21005(b)(1).

County clerks are required to maintain indexes of fictitious business names (see §§3.8-3.12). However, because no central registry of fictitious business names exists, inquiry may be necessary on a county-by-county basis. The California State Association of Counties maintains a list of California counties on its website. See the Directory.

### **III. GOVERNING LAWS**

#### **§3.6 A. California Statutes and Regulations**

California statutes that affect the choice of a business name include:

- Bus & P C §§14401-14405 (trade names);
- Bus & P C §§14411-14418 (trade name registration); and
- Bus & P C §§17900-17930 (fictitious business name).

California statutes that restrict the selection of a business by type of entity include:

- Corp C §§201, 202 (corporations and close corporations);
- Corp C §12302 (consumer cooperative corporations);
- Corp C §13409 (professional corporations);
- Corp C §15612 (limited partnerships);
- Corp C §16952 (limited liability partnership); and
- Corp C §17052 (limited liability companies).

In addition to the above, the Secretary of State has adopted detailed regulations governing approval of business entity names. See 2 Cal Code Regs §§21000-21009. The regulations provide guidelines for the Secretary of State to use to determine whether proposed business entity names are the same as, deceptively similar to, or substantially the same as an existing name. The regulations also provide guidance as to the manner and circumstances in which a proposed business entity name already in use still may be approved for use upon obtaining the required consent of the pre-existing user and a determination that the use is not likely to mislead the public.

Sections 21000(a)-(b) provide a detailed description of parameters to be applied by the Secretary of State in determining whether a name in articles of incorporation or organization will be found the same, deceptively similar to, substantially the same as, or distinguishable from an existing name. However, the regulation makes clear that the list is not exhaustive, and that the regulations do not limit the Secretary of State's discretion to determine whether the name will mislead the public. 2 Cal Code Regs §21000(c). See also §§21002, 21007, and 21008.

On consent to use a pre-existing business entity's "same" or "substantially similar" name, see 2 Cal Code Regs §§21003-21005.

### §3.7 1. Trade Name Protection

The trade name statutes are found in Bus & P C §§14400-14416 and the related goodwill provisions are found in Bus & P C §§14100-14103. However, the statutory definition of a trade name is not included in these statutes. Rather, "trade name" is defined in the Model State Trademark Law (Bus & PC 14200-14272) as "any name used by a person to identify a business or vocation of that person." Bus & P C §14202(d). To compare the federal Lanham Act's definition of a trade name, see §3.16.

The Business and Professions Code provisions that protect trade names do not provide for a system of registration of trade names. This parallels the federal system. See §3.16. Case law follows the common law rule that first use controls in California. See *Weatherford v Eytchison* (1949) 90 CA2d 379, 202 P2d 1040. Further, if an out-of-state party's use is already known in California, even though the party is not conducting business in California, a second user in California is subject to restraint. See *Stork Restaurant, Inc. v Sahati* (9th Cir 1948) 166 F2d 348 (mere geographical distance between two businesses was insufficient to preclude finding that general public would have been misled to believe two clubs were affiliated or that sources would have been confused). On the priority of use of conflicting trade names, see §3.12.

The Model State Trademark Law intends that California's antidilution law be substantially consistent with federal law on a prospective basis. Bus & P C §§14270, 14272. The Model State Trademark Law defines "dilution" as follows (Bus & P C §14202(k)-(m)):

(k) "Dilution" means dilution by blurring or dilution by tarnishment, regardless of the presence or absence of any of the following:

- (1) Competition between the owner of the famous mark and other parties.
- (2) Actual or likely confusion, mistake, or deception.
- (3) Actual economic injury.

(l) "Dilution by blurring" means association arising from the similarity between a mark or a trade name and a famous mark that impairs the distinctiveness of the famous mark.

(m) "Dilution by tarnishment" means association arising from the similarity between a mark or a trade name and a famous mark that harms the reputation of the famous mark.

**NOTE:** Courts have been concerned that antidilution laws can be used to stifle rather than promote competition. See *Toho Co., Ltd. v Sears, Roebuck & Co.* (9th Cir 1981) 645 F2d 788. Antidilution laws have been applied to protect marks that are distinctive and associated with a single user and to protect trade names when the newcomer's use would be likely to degrade the first user's name. See *Grupo Gamesa S.A. de C.V. v Dulceria El Molino* (CD Cal 1996) 39 USPQ2D 1531; see also *Steinway & Sons v Demars & Friends* (CD Cal 1981) 210 USPQ 954.

## 2. Fictitious Business Name

### §3.8 a. Definitions

A fictitious business name is defined for each type of entity as follows:

**NOTE:** The term "registrant" means the person that has filed the fictitious business name statement and who is the legal owner of the business. Bus & P C §17903. Registered LLPs are exempt from the fictitious business name requirements. See Corp C §§16953, 16959, 16961. See §3.28.

- For an individual, as a name that does not include the individual's surname or one that suggests the existence of additional owners. See Bus & P C §17900(b)(1).

**NOTE:** Terms such as "Company," "& Company," "& Son," "& Sons," "& Associates," and "Brothers" (but not words that merely describe the business being conducted) suggest the existence of additional owners. Bus & P C §17900(c).

- For corporations, as any name other than the name stated in the articles of incorporation (see §§3.20-3.26). Bus & P C §17900(b)(3).

**NOTE:** No person may adopt a fictitious business name that includes "Corporation," "Corp.," "Incorporated," or "Inc." unless that person is a corporation organized pursuant to the laws of California or some other jurisdiction. Bus & P C §17910.5(a). A fictitious business name statement that would violate these rules will not be accepted for filing. Bus & P C §17910.5(c). For an example of how this rule may lead to an inability to prosecute otherwise valid claims, see the discussion of *Opp v St. Paul Fire & Marine Ins. Co.* (2007) 154 CA4th 71, 64 CR3d 260, in §3.11.

- For general partnerships, as one that does not include the surname of each general partner or one that suggests the existence of additional owners (see §3.19). Bus & P C §17900(b)(2).

**NOTE:** Under the fictitious business name statutes, the term "general partner" has the specific meaning of a partner of a general partnership or, with respect to an unincorporated association other than a partnership, a person interested in the business whose potential liability with respect to the business is substantially the same as a general partner. Bus & P C §17901.

- For limited partnerships that have filed with the Secretary of State, as any name other than the name on the certificate of limited partnership on file with the California Secretary of State (see §3.27). Bus & P C §17900(b)(4).
- For LLCs, as any name other than the name stated in the articles of organization on file with the California Secretary of State (see §3.29). Bus & P C §17900(b)(5).

**NOTE:** No person may adopt a fictitious business name that includes "Limited Liability Company" or "LLC" or "LC" unless that person is a LLC organized pursuant to the laws of California or some other jurisdiction. However, a person is not prohibited from using the complete words "Limited" or "Company" or their abbreviations in the person's business name as long as the use does not imply that the person is a limited liability company. Bus & P C §17910.5(b). A county clerk is not permitted to accept a fictitious business name statement that would violate these rules. Bus & P C §17910.5(c).

### **§3.9 b. Filing Requirements**

Every person who regularly transacts business in California for profit under a fictitious business name (see §3.8) must file a fictitious business name statement. Bus & P C §17910. The fictitious business name statement must be filed, by mail or in person, with the county clerk (or county clerk-recorder) in the county where the entity has its principal place of business in California within 40 days of first conducting business under the fictitious name. If the entity has no place of business in California, the statement must be filed in Sacramento county. Bus & P C §§17910, 17915. The fee for filing a fictitious business name statement is \$10 for the first fictitious business name and owner, and \$2 for each additional fictitious business name or owner filed on the same statement and doing business at the same location. Bus & P C §17929(a).

**PRACTICE TIP:** The practitioner may also wish to consider filing fictitious business name statements in other counties where the entity will be transacting business subject to satisfaction of the other requirements for filing a fictitious business name statement. See Bus & P C §17915.

**NOTE:** Many small business owners are under the mistaken impression that filing a fictitious business name statement affords them protection against claims of others to the name. In fact, the mere filing of the fictitious business name does not protect the business owner. Bus & P C §14418.

Bus & P C §17913 specifies the information required to be set forth in a fictitious name statement and requires that the statement appear substantially in the form provided by statute. See §3.33. Once filed with the county clerk, the fictitious business name statement must be published in a newspaper of general circulation in that county within 30 days of filing the statement; if that county has no newspaper of general circulation, then the statement must be published in newspaper of general circulation in an adjoining county. If the entity has no place of business in California, the statement must be published in Sacramento county. Bus & P C §17917(a); Govt C §6064. The newspaper should be one that circulates in the area where business will be conducted. Bus & P C §17917(b). The advertisement must be published once a week for 4 consecutive weeks, with 5 days between each date of publication. Govt C §6064. An affidavit of publication must then be filed with the county clerk within 30 days after completion of publication. Bus & P C §17917(d).

**NOTE:** The entity's formation documents should provide that the principals are authorized to conduct business under any other or substitute name and file an appropriate fictitious business name statement in each county in which the entity conducts business under that name. As a practical matter, most financial institutions will require an entity to provide a filed copy of the fictitious business name statement if it plans to deposit checks made payable to the fictitious business name.

The business must also refile (but not necessarily republish) the statement before a currently filed statement expires. Bus & P C §17910; see Bus & P C §17917(c) (providing limited exception from publication requirement if filed within 40 days of expiration).

A fictitious name statement expires on the earlier of the following (Bus & P C §17920):

- 5 years from the date of filing in the county recorder's office;

**CAUTION:** Even though the filing fee includes the cost for the recorder to notify a registrant that the certificate is about to expire, it is up to the registrant to make the renewal. In fact, effective January 1, 2010, if the United States Postal Service returns a notice of expiration of a fictitious business name to the county clerk as undeliverable, the clerk is not required to retain the notice. Bus & P C §17929(e). Clients, therefore, should be advised to calendar the expiration of the certificate along with other significant deadlines for their business.

- 40 days after any change in the facts set forth in the filed statement other than a change in the residence address of an individual, partner, or trustee or the filing of a statement of withdrawal from a partnership (Bus & P C §17923); or

- The date a registrant files a statement of abandonment (see Bus & P C §17922).

The fee for filing a statement of abandonment of use of a fictitious business name is \$5. Bus & P C §17929(b). The fee for filing a statement of withdrawal from a partnership that operates under a fictitious business name is \$5. Bus & P C §17929(c).

**NOTE:** The Fictitious Business Name Act (Bus & P C §§17900-17930) interacts with the Business and Professions Code sections relating to trade names. In particular, Bus & P C §14411 provides that a fictitious business name registrant enjoys a rebuttable presumption of exclusive right to use its fictitious business name as a trade name in the county in which its registration statement was filed, provided that it was the first to file in that county and is actually engaged in a trade or business using the fictitious business name in the county.

Real estate investment trusts and nonprofit corporations need not file fictitious business name statements. Bus & P C §17911-17912. Further, LLPs are not required to do business under their official name, and registered LLPs are exempt from the fictitious business name requirements. Corp C §16961. However, law firm LLP applicants must agree to practice under the name filed with the State Bar. See State Bar LLP R 3.3, discussed in §3.14.

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**Source:** Business Law/Selecting and Forming Business Entities/3 Selecting a Business Name/§3.10 c. Effect of Filing Statement

**§3.10 c. Effect of Filing Statement**

A certified copy of a fictitious business name statement establishes a rebuttable presumption of all of the following (Bus & P C §17926(c); see Bus & P C §17926(b) (fee for certified copy)):

- The existence of the original statement;
- The execution of the statement by the person by whom it purports to have been executed; and
- The truth of the information required by Bus & P C §17913, §17922, or §17923 that is contained in the statement.

These rebuttable presumptions affect the burden of producing evidence. Bus & P C §17926(d).

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**Source:** Business Law/Selecting and Forming Business Entities/3 Selecting a Business Name/§3.11 d. Effect of Noncompliance

### **§3.11 d. Effect of Noncompliance**

A person who has not filed a fictitious business name statement may not sue on a contract made, or a transaction engaged in, under the fictitious business name. Bus & P C §17918. A party may cure this defect any time before trial. See *Tyrone v Kelley* (1973) 9 C3d 1, 14, 106 CR 761; *Kadota Fig Ass'n of Producers v Case-Swayne Co.* (1946) 73 CA2d 796, 167 P2d 518. But see *Opp v St. Paul Fire & Marine Ins. Co.* (2007) 154 CA4th 71, 64 CR3d 260 (defect was not curable as matter of law). Further, the failure to file the statement is not a defense; an entity may be sued under its fictitious name. See Bus & P C §17918. See also *Advising California Partnerships* §4.36 (3d ed Cal CEB 1999).

*Opp v St. Paul Fire & Marine Ins. Co.*, *supra*, provides an interesting interplay between the fictitious business name statutes and use of entity names by an individual. In that case, an unlicensed corporation subcontracted to perform work for which a contractor's license was required. The president held a license in his individual capacity. In an action to recover on the bankrupt prime contractor's payment bond, the fact that the corporation was unlicensed precluded recovery. When the president amended the complaint to assert that he, the licensed contractor, was merely engaging in business under the fictitious name that was the name of the corporation, the court found that he was not only precluded from recovery because he failed to register a fictitious name, but that the presence of the entity designation "Inc." was reserved exclusively for corporations and a county was therefore prohibited as a matter of law from recording the entity's fictitious name for an individual (see Bus & P C §17910.5). As a result, the individual plaintiff was unable to recover on the payment bond because as a matter of law, the contracting entity was the corporation, a separate entity and an unlicensed building contractor. 154 CA4th at 76.

Any person who executes, files, or publishes a fictitious business name statement, knowing that the statement is false, in whole or in part, is guilty of a misdemeanor and may be fined up to \$1000. Bus & P C §17930.

**Source:** Business Law/Selecting and Forming Business Entities/3 Selecting a Business Name/§3.12 e. Priorities and Conflicting Use of Names

### **§3.12 e. Priorities and Conflicting Use of Names**

The filing of a fictitious business name statement by a person required to file under Bus & P C §17910 establishes a rebuttable presumption that the registrant has the exclusive right to use the fictitious business name (or any confusingly similar trade name) as a trade name, in the county where the statement is filed, if the registrant is the first to file the statement containing the fictitious business name in that county, and is actually engaged in a trade or business using the fictitious business name or a confusingly similar name in that county. Bus & P C §14411.

Filing articles of incorporation for a domestic corporation (see Corp C §200), or obtaining a certificate of qualification for a foreign corporation (see Corp C §§2105-2106), establishes a rebuttable presumption that the corporation has the exclusive right to use the corporate name (and any confusingly similar trade name) as a trade name, in the state set forth in the articles or certificate, if the corporation is the first to have filed the articles or obtained the certificate containing the corporate name, and is actually engaged in a trade or business using that name or a confusingly similar name. Bus & P C §14415.

**NOTE:** Business & Professions Code §§14411 and 14415 do not create new substantive rights. Rather, the statutes merely determine the initial burden of producing evidence on the issue of likelihood of confusion, which is then determined under common law principles.

The priorities between corporations and fictitious business name registrants within a county are addressed by Bus & P C §14416. See *American Petrofina, Inc. v Petrofina of California, Inc.* (9th Cir 1979) 596 F2d 896, 898. Under that section, if a corporation is entitled to the rebuttable presumption regarding a trade name (see Bus & P C §14415), and a registrant is also entitled to the rebuttable presumption (see Bus & P C §14411), whichever one filed the fictitious business name statement or the articles of incorporation or obtained the certificate of qualification first, and is actually engaged in a trade or business using the name, is entitled to the presumption as against the other. The rebuttable presumption presumes that the corporation or registrant who filed first or obtained the certificate of qualification first has the exclusive right to use the fictitious business name, corporate name, or a confusingly similar name, as a trade name in the county where the registrant filed the fictitious business name statement. Bus & P C §14416.

Filing articles of incorporation does not in itself authorize the use in California of a corporate name in violation of the rights of another under the federal Lanham Act (15 USC §§1051-1141n), the California Model State Trademark Law (Bus & P C §§14200-14272), the Fictitious Business Name Act (Bus & P C §§17900-17930), or the common law, including rights in a trade name. Bus & P C §14417. This is also true with respect to filing a fictitious business name statement. Bus & P C §14418. On use of a name otherwise deemed by the Secretary of State to resemble another name so closely as to deceive the public, see §3.23.

**WARNING:** Absent an agreement to the contrary, there is no presumption that the acquisition of the *goodwill* of the business alone includes its trade name. Bus & P C §§14101, 14103. However, to the extent the trade name is to be transferred, it is transferred as part of the goodwill as personal property. Bus & P C §14401.

To the extent a secondary user is impermissibly infringing on the use of another person's trade name, the infringement use may be enjoined. Bus & P C §14402 ("Any court of competent jurisdiction may restrain, by injunction, any use of trade names in violation of the rights defined in this chapter").

**Source:** Business Law/Selecting and Forming Business Entities/3 Selecting a Business Name/§3.13 3. Trademark Protection

### **§3.13 3. Trademark Protection**

Because a new business name may conflict with a protected trademark, the new business owner should consider whether any trademarks are similar to the new venture's trade name. California law provides for registration of trademarks. See Bus & P C §§14205-14217. The Secretary of State maintains for public examination a record of all marks registered or renewed under the trademark registration law. See Bus & P C §14225.

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**Source:** Business Law/Selecting and Forming Business Entities/3 Selecting a Business Name/§3.14 4. State Bar Rules Concerning Law Firm Names

### **§3.14 4. State Bar Rules Concerning Law Firm Names**

An attorney may not use a firm trade name or other professional designation that suggests the firm is connected with a governmental agency or has a tendency to confuse or mislead the public into believing that it is. See Cal Rules of Prof Cond 1-400(D)(2)-(3). A trade name violates Rule 1-400 if any of these three tests are present (California State Bar Formal Opinion No. 2004-167(I)):

- (1) The name implies that the firm is publicly supported;
- (2) The name is deceptive with respect to the members of the firm who are performing legal services; or
- (3) The name is misleading as to the types of legal services offered.

Thus, for example, a private law firm name such as "Workers' Compensation Relief Center" violates Rule 1-400 because it could mislead clients into thinking the firm is a governmental office or because it could lead clients to believe that it can actually offer "relief." California State Bar Formal Opinion No. 2004-167(I).

By the same token, use of a governmental title on firm letterhead, such as "Jane Smith, Member of the City Council of the City of Jamestown," is not permitted under Rule 1-400(D)(2) because it is akin to a communication that may confuse or deceive the public. California State Bar Formal Opinion No. 2004-167(II).

In general, registered LLPs are not required to do business under their official name, and registered LLPs are exempt from the fictitious business name requirements. Corp C §16961. See §§3.9, 3.28. However, the State Bar rules require that LLP applicants must agree to practice under the name filed with the State Bar. State Bar LLP R 3.3.

### **§3.15 5. Checking Availability of and Reserving Business Name**

Corporations, limited partnerships, and limited liability companies may check the availability of and reserve a proposed business name. Corp C §§201(c), 15613, 17053. These procedures are so simple and inexpensive that they should be followed whenever circumstances permit, to avoid the possibility that business formation documents will need to be resubmitted. The procedures involve the following three steps:

- (1) The client selects several alternative names and ranks them in order of preference.
- (2) The attorney does an online search of the Secretary of State's business name database and/or sends a name availability inquiry letter to the California Secretary of State. (This step is optional.) See form in §3.31.
- (3) If the attorney does not have a prepaid account allowing checks of name availability and name reservations by telephone, the attorney sends a letter reserving one or more names, in order of preference, and the applicable fee, to the California Secretary of State. See form in §3.32. The Secretary issues a certificate of reservation.

The Secretary of State has an online searchable database accessible to the public. For the website, see the Directory. Anyone can perform an online search of this database. To determine whether a desired name is already in use, the attorney may make an initial, informal search on this database. A search performed on this database is not definitive, but it is fast and generally accurate. In addition to this informal search, or instead of it, the attorney may submit a written request to determine the availability of a name to the Secretary of State by mail only, not through online or e-mail requests.

Even if the Secretary of State determines that a name is available, the name may conflict with a registered trademark or service mark, a common law trade name or service name, or an existing fictitious business name. The only way to be certain that a name is not in use is to conduct a name search. See §3.30.

**PRACTICE TIP:** If it is anticipated that a business entity will register and do business in other states, it would be prudent to check the availability of a proposed name in those states.

**WARNING:** Checking the availability of a business name does not confer any rights to the name, including any reservation of that name or any binding effect on the Secretary of State.

If a name meets the statutory requirements, the business name may be reserved with the Secretary of State for a period of 60 days. Corp C §§201(c), 15901.09(c), 17053. See Govt C §§12186(a), 12188(a), 12190(a) (\$10 fee). A written request to reserve a name may be submitted to the Secretary of State by mail or in person for an additional fee, but online or e-mail requests are not available. See §3.32. The Secretary of State will not reserve the name for two or more consecutive periods for the same applicant, or for the use or benefit of the same person. Corp C §§201(c), 15901.09(c), 17053. Further, consecutive reservations may not be made by or for the use or benefit of the same person for names so similar that they are prohibited. Corp C §§201(c), 15613, 17053. See Corp C §§201(b), 15901.09(c), 17052(c). Corp C §17053. Thus, a name must be available for at least 1 business day before the same person may again reserve the name.

**PRACTICE TIP:** In addition to mailing or hand delivering the name reservation form (see §3.32), a name may also be reserved over the telephone using a prepaid account. For the telephone number to call to set up a prepaid account, see the Directory. With a prepaid account and a positive account balance, an attorney may inquire about the availability of a business name by phone for a small fee per search. It takes about 2 weeks to establish an account.

### **§3.16 B. Trade Name Protection Under Federal Law**

The Lanham Act (15 USC §§1051-1141n) is the primary federal statute relating to trademarks. Trademarks and trade names are technically distinct. However, one of the Lanham Act statutes (see 15 USC §1125(a)) has been construed to afford protection against infringement of a trade name used in interstate commerce. See *Accuride Int'l, Inc. v Accuride Corp.* (9th Cir 1989) 871 F2d 1531; *New W. Corp. v NYM Co.* (9th Cir 1979) 595 F2d 1194, 1198. The Lanham Act defines the terms "trade name" and "commercial name" to mean any name used by a person to identify his or her business or vocation. 15 USC §1127. To compare California's definition of "trade name" under the Model State Trademark Law (Bus & P C 14200-14272), see §3.7.

In general, trade names are symbols used to distinguish companies, partnerships, and businesses, and symbolize the reputation of a business as a whole. In contrast, trademarks and service marks are designed to identify and distinguish a company's goods and services.

The Lanham Act does not provide for federal registration of trade names, as distinguished from trademarks. However, this does not mean that an action will not lie for trade name infringement. In fact, the differences between a trade name and trade mark were described by the Ninth Circuit as follows (*Accuride Int'l, Inc.*, 871 F2d at 1534):

The major legal distinction between trademarks and trade names is that trade names cannot be registered and are therefore not protected under 15 U.S.C. §1114. [Citation omitted.] However, analogous actions for trade name infringement can be brought under section 43(a).

See also *American Steel Foundries v Robertson* (1926) 269 US 372, 380, 70 L Ed 317, 46 S Ct 160 (difficulty in making neat distinctions between trade names and trademarks).

Therefore, a prior user of a trade name used in interstate commerce may bring a cause of action in federal court under Section 43(a) of the Lanham Act (15 USC §1125(a)(1)(A)-(B)), which prohibits false designations of origin and false descriptions. The statute, which does not require a federal trademark registration, states:

Any person who, on or in connection with any goods or services, or any container for goods, uses in commerce any word, term, name, symbol, or device, or any combination thereof, or any false designation of origin, false or misleading description of fact, or false or misleading representation of fact, which —

(A) is likely to cause confusion, or to cause mistake, or to deceive as to the affiliation, connection, or association of such person with another person, or as to the origin, sponsorship, or approval of his or her goods, services, or commercial activities by another person, or

(B) in commercial advertising or promotion, misrepresents the nature, characteristics, qualities, or geographic origin of his or her or another person's goods, services, or commercial activities, shall be liable in a civil action by any person who believes that he or she is or is likely to be damaged by such act.

As in an action for trademark infringement under 15 USC §1114, the key question under Section 43(a) (15 USC §1125) is whether the public is likely to be deceived or confused by the similarity of the marks. *Accuride Int'l, Inc.*, 871 F2d at 1533.

### §3.17 C. Trade Name Protection Under Common Law

In addition to federal law, under the common law of most states a business may not use a name that would give rise to a likelihood of confusion on the part of the public with respect to the source, sponsorship, or affiliation of goods and services. An already established business is afforded protection under the common law for its name. Thus, under both California common law and statutes, whoever first adopts and uses a trade name, either within or without the state, is its original owner. *American Petrofina, Inc. v Petrofina of California, Inc.* (9th Cir 1979) 596 F2d 896, 897. Further, the extent of protection given to trade names is the same as that afforded trademarks. However, because goods sold under a trademark are usually sold throughout a larger territory and a trade name is generally used to designate some local business, the protection in the use of a trade name is limited to the territory in which the business is carried on. *Weatherford v Eytchison* (1949) 90 CA2d 379, 383, 202 P2d 1040.

Accordingly, a new business should investigate whether there have been any prior usages of names similar to the one it is considering in the area in which the new business intends to operate and in areas where it intends eventually to extend its business. This investigation will typically involve a name search. See §3.30.

When a potentially conflicting prior user is discovered, the new business will have to consider whether there is a likelihood of confusion that might make it advisable to adopt a different name. Without likelihood of confusion, there is no trade name infringement under California common law. Factors to consider include the geographic separation of the businesses, the degree of competition between the businesses, the similarity of the names, and the strength of the prior user's name. These factors are interrelated, and no single factor is determinative of the issue.

The Ninth Circuit in *AMF, Inc. v Sleekcraft Boats* (9th Cir 1979) 599 F2d 341, 348, articulated a list of eight factors that need to be analyzed for the likelihood of confusion in the context of trademark:

- (1) The strength of the plaintiff's mark;
- (2) The relatedness of the goods produced by each party using the trade name;
- (3) The similarity of the names;
- (4) Evidence of actual confusion;
- (5) The marketing channels used;
- (6) The likely degree of purchaser care;
- (7) The defendant's intent in selecting the name; and
- (8) The likelihood of expansion of the product lines.

These factors are not applied mechanically. Rather, courts may examine some or all of the factors, depending on their relevance and importance. *Au-Tomotive Gold, Inc. v Volkswagen of Am., Inc.* (9th Cir 2006) 457 F3d 1062, 1076, cert denied (2007) 549 US 1282.

**NOTE:** This test was explicitly extended to trade name conflicts in *Accuride Int'l, Inc., supra*.

**Source:** Business Law/Selecting and Forming Business Entities/3 Selecting a Business Name/§3.18 IV. SPECIFIC ENTITY NAME REQUIREMENTS

### **§3.18 IV. SPECIFIC ENTITY NAME REQUIREMENTS**

The selection of a business name is often subject to legal constraints arising from the type and scope of business. Similarly, the filing requirements for a business's name can vary depending on the type of entity and the particular business in which the entity is engaged.

Sections 3.19-3.29 discuss the numerous entity-specific name requirements. However, business entities are generally barred from holding themselves out to the public as a type of entity that they are not. For example, entities that are not corporations (see §§3.20-3.26) may not adopt a fictitious business name that includes "Corporation," "Corp.," "Incorporated," or "Inc." Bus & P C §17910.5(a); see Corp C §§15612(d), 17052(d). An entity that does not qualify as a cooperative corporation may not use the word "cooperative," any abbreviation of it, or any related word. Corp C §12311(b). Similarly, entities that are not LLCs may not adopt a fictitious business name that includes "limited liability company," "LLC" or "LC." The names and abbreviations "Company," "Limited," "Co.," and "Ltd." may be used in a name, if that use does not wrongfully imply that the business is a limited liability company. Bus & P C §17910.5(b).

The Secretary of State has promulgated regulations that provide guidance for determining whether a name is the same as, deceptively similar to, or substantially the same as an existing business entity name, as well as the manner and method by which consent may be obtained for filing a proposed name already in use by a pre-existing business entity. 2 Cal Code Regs §§21000-21009. See §§3.6, 3.20, 3.22, 3.27.

**Source:** Business Law/Selecting and Forming Business Entities/3 Selecting a Business Name/§3.19 A. General Partnerships

### **§3.19 A. General Partnerships**

California's general partnership law, the Uniform Partnership Act of 1994 (RUPA) (Corp C §§16100-16962), does not provide for filing a general partnership name. However, RUPA provides for filing a statement of authority with the Secretary of State, including the partnership name, and, if desirable, recording a certified copy in the appropriate county authority. Corp C §§16105, 16303. This is not name reservation, but it can provide clarification to those dealing with the partnership.

A general partnership name that does not include the surname of each general partner, or that suggests the existence of additional owners, is a "fictitious business name." Bus & P C §17900(b)(2). A name "suggests the existence of additional owners" if, in addition to the partners' surnames, it includes words such as "Company," "& Company," "& Son," "& Sons," "& Associates," or "Brothers." Bus & P C §17900(c).

A partnership using a fictitious business name must file a fictitious business statement with the clerk of the county in which the partnership has its principal place of business in California. If the registrant has no place of business in California, the registrant should file with the clerk of Sacramento County. Bus & P C §17915. See §3.9. See also form in §3.33.

**NOTE:** A general partnership may wish to file fictitious business name statements in other counties in which it conducts business to discourage use of its trade name by other parties.

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## **B. Corporations**

### **§3.20 1. Permissible Names**

California law allows broad flexibility in the selection of a corporate name. Typically, the abbreviations such as "Inc." or "Corp." will be used at the end of the name. In most situations, words such as "Incorporated" or "Corporation" (or their abbreviations) need not appear in the corporate name. There are, however, a few restrictive rules:

- If the entity is a statutory close corporation, its name must include the word "Corporation," "Incorporated," or "Limited," or an abbreviation of one of these words. Corp C §202(a).
- If an individual's name is used as the corporate name, some other word or words (*e.g.*, "Corporation," "Incorporated," "Limited," "Company") must be used to show that the name is not that of the individual alone.

Regulations provide guidance on the letters, symbols, and numbers allowed and how they will be interpreted in determining whether or not the proposed business entity name is the same as, deceptively similar to, or substantially the same as an existing name (2 Cal Code Regs §§21000(a)-(b)):

(a) Business entity names must use the English alphabet or Arabic numerals (0, 1, 2, 3, 4, 5, 6, 7, 8, 9) or symbols as listed in Section 21002(b)(6)(B) or a combination thereof. Except as provided in Section 21003(c), for the purposes of determining whether a proposed name is the same, deceptively similar to, substantially the same as, or distinguishable from an existing name, letters of the English alphabet shall not be interpreted as Roman numerals and will not be considered to have numeric value.

(b) For the purposes of determining whether a proposed name is the same, deceptively similar to, substantially the same as, or distinguishable from an existing name:

- (1) No distinction between uppercase and lowercase letters, typeface or font will be recognized.
- (2) Accent marks above letters and other English language diacritics will not be recognized.
- (3) Subscript or superscript characters will be treated as standard characters and will not appear above or below other characters in a business entity name.

For examples of unacceptable proposed names under 2 Cal Code Regs §21002, see also §3.22.

A further consideration in selecting a corporate name is whether the name is available for use in other states where the corporation will be conducting business. Most states have laws similar to that of California governing corporate names.

**WARNING:** Careful thought should be given to selecting the corporation's name. Approval of a name by the California Secretary of State does not grant the corporation immunity from future claims of trademark or trade name infringement. Nor does it afford any protection if the name is used in another jurisdiction or otherwise protected under applicable federal or state law trademark or unfair competition law. Counsel should encourage the principals to check telephone books, trade publications, and the Internet to ensure that the proposed name or one confusingly similar is not already in use. It can be expensive and frustrating for a new business to begin operation under a particular name only to discover that the name must be changed because it is confusingly similar or identical to a name being used by another party. When substantial amounts of money will be expended to develop goodwill in connection with the corporate name, it may be appropriate to conduct a search with the United States Patent and Trademark Office. See the Directory.

On the other hand, corporations and most other forms of doing business are not obliged to do business under the corporate or business name, provided that they comply with applicable requirements for filing and publishing notice of doing business under another name. See Bus & P C §§17900-17930.

**NOTE 1:** A suspended corporation loses its name while it is under suspension, and the name of a suspended corporation may be reserved and adopted by another corporation. *Boyer v Jones* (2001) 88 CA4th 220, 105 CR2d 824. However, care should be exercised when adopting a suspended corporation's name, because customers or creditors of the former entity may mistakenly confuse the new entity with the former one. Moreover, a suspended

corporation may amend its articles of incorporation in order to select a new name. Rev & T C §23301.

**NOTE 2:** A noncorporate person cannot attempt to give itself the appearance of being a corporation by filing a fictitious business name statement using a corporate designation such as "Inc.," "Incorporated," or "Corporation." Bus & P C §17910.5. County clerks are authorized to refuse to accept any filing that would violate this or any other provision in connection with names.

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### §3.21 2. Prohibited Names

A corporate name may *not* include the following:

- The words "bank," "trust," "trustee," or related words without the approval of the Commissioner of Financial Institutions (see Corp C §§201(a), 12302);
- The words "industrial loan company," "investment and loan company," "thrift company," or "thrift and loan company" unless actually engaged in the industrial loan business (Fin C §18104);

**NOTE:** Companies authorized to engage in the industrial loan business must include the words "industrial loan company," "investment and loan," "thrift company," "thrift and loan company," or "bank" as part of the company name included in the articles of incorporation. Fin C §18101.6.

- The words "savings association," "savings bank," "savings and loan association," "building and loan association," "building association," or any combination employing either or both of the words "building" or "loan," with one or more of the words "saving," "savings," or words of similar import (Fin C §5652(a));

**NOTE:** The name of savings and loan associations must contain the words "savings association," "savings and loan association," "savings bank," or other approved designation. Fin C §5650.

- The word "cooperative," any abbreviation of it, or any related word, unless the corporation qualifies as a cooperative (Corp C §12311(b); see Bus & P C §11003.2 (stock cooperative); Corp C §12200 (consumer cooperative corporation); CC §§817 and 817.1 (limited-equity housing cooperative or workforce housing cooperative, respectively); nor may a person, firm, corporation, or association use the word "cooperative" as part of its corporate name or other business name or title for producers' cooperative marketing activities, unless it has complied with the Food and Agriculture Code (Food & A C §54036);
- The words "Olympic," "Olympiad," "Citius Altius Fortius," "Paralympic," "Paralympiad," "Pan-American," "America Espirito Sport Fraternite," or any combination of those words (see 36 USC §220506);
- The words "national," "federal," "United States," "reserve," or "deposit insurance" (18 USC §709);
- "Federal Deposit," "Federal Deposit Insurance," "Federal Deposit Insurance Corporation," or any combination of these three words (18 USC §709);
- "National Credit Union," "National Credit Union Administration," "National Credit Union Board," "National Credit Union Share Insurance Fund," "Share Insurance," or "Central Liquidity Facility," or the letters "NCUA," "NCUSIF," or "CLF," or any other combination or variation of those words or letters (18 USC §709);
- "Federal Home Loan Bank," "Federal Intermediate Credit Bank," "Department of Housing and Urban Development," "Housing and Home Finance Agency," "Federal Housing Administration," "Government National Mortgage Association," "United States Housing Authority," or "Public Housing Administration," the letters "HUD," "FHA," "PHA," or "USHA," or any combination or variation of those words or letters alone or in combination with other words or letters (18 USC §709);
- "United States Mint," "U.S. Mint," or any colorable imitation of those words (18 USC §709);
- "Overseas Private Investment," "Overseas Private Investment Corporation," or "OPIC" (18 USC §709);
- Words or letters referring to law enforcement agencies, unless permitted by federal law (18 USC §709); or
- The words "Smokey Bear" or "Woodsy Owl" and associated slogans without authorization (16 USC §580p; 18 USC §§711-711a).

**Source:** Business Law/Selecting and Forming Business Entities/3 Selecting a Business Name/§3.22 3. Secretary of State's Discretion Concerning Filing of Name

### §3.22 3. Secretary of State's Discretion Concerning Filing of Name

The name of a corporation is filed with the Secretary of State as part of the articles of incorporation. However, the Secretary of State will not file articles of incorporation if the corporation's proposed name is likely to mislead the public, or if it is the same as, or "resembles so closely as to tend to deceive," the following (Corp C §201(b)):

- The name of a domestic corporation;
- The name of a foreign corporation that is authorized to transact intrastate business or has registered its name in California (see Corp C §2101);
- The name that a foreign corporation has assumed (see Corp C §2106(b));
- A name that will become the record name of a domestic or foreign corporation on the effective date of a filed corporate instrument when there is a delayed effective date (see Corp C §§110(c), 5008(c));
- A name that is under reservation for another corporation (see Corp C §201, 5122, 7122, 9122).

Use of a name that violates Corp C §201(b), even if filed by the Secretary of State, may be enjoined.

Further, regulations (see 2 Cal Code Regs §§21000-21009) provide guidance as to what names will be acceptable, the manner in which that may be determined, and the procedures by which even some conflicting proposed names for business entities may nonetheless be approved for filing. See §§3.6, 3.20. Proposed names may be deemed the same as or deceptively similar to existing business entity names when the difference between the proposed and existing name is (2 Cal Code Regs 21002(b)):

the use of upper case letters, lowercase letters, the use of superscript or subscript letters or numerals or the use of an ampersand in place of "and" or vice versa....the existence or absence of one or more business entity endings....the use of a possessive "s", or a plural.

If the conflicting business entity name is substantially similar but not identical to that of the applicant, the Secretary of State may permit the filing with the consent of the business entity with the conflicting name. See 2 Cal Code Regs §§21003-21004. Consent must be on the letterhead of the consenting business entity, signed by an authorized representative, be unequivocal and without conditions, and expressly identify the person or business entity being granted permission to use the name. 2 Cal Code Regs §21004(a). If multiple existing business entities are using the desired name, consent must be obtained from the first to acquire the name. 2 Cal Code Regs §21004(c). See form in §3.34.

**PRACTICE TIP:** The more generic-sounding the name, the more the practitioner should urge the client to permit the name to be reserved. The process of reserving the name is both quick and nominal in cost. See §§3.15, 3.30.

### **§3.23 4. Use of Consolidated List**

As discussed in §3.22, the Secretary of State will not accept articles of incorporation for filing if the proposed corporate name resembles closely or is the same as any name on the consolidated list of all corporate names that the Secretary's office maintains. See Corp C §201(b). The consolidated list includes:

- Names of all California corporations in good standing;
- Names of all foreign corporations qualified to transact intrastate business in California and in good standing;
- Corporate names reserved under Corp C §201(c);
- Names of nonqualified foreign corporations registered under Corp C §2101; and
- Names that will become record names of domestic or qualified foreign corporations at some delayed effective date of a filed corporate instrument, such as a merger agreement.

**NOTE:** Although the Secretary of State's acceptance of a corporation's articles for filing implies that the corporate name does not conflict with the names on the consolidated list, use of the name may nevertheless violate the rights of another person who had previously acquired rights to the use of the name by reason of some other law, such as the Lanham Act (15 USC §§1051-1127), California's Model State Trademark Law (Bus & P C §§14200-14272), the Fictitious Business Name Act (Bus & P C §§17900-17930), and common law rights, including rights in a trade name. See §§3.7-3.17. The Secretary of State provides a written notification of these facts with the receipt for the corporation's filing fee.

**PRACTICE TIP:** Counsel should include the Secretary of State's notification when transmitting copies of the articles of incorporation and the Secretary of State's receipt to clients, along with a cover letter explaining the issues in greater detail and suggesting the measures that a client may make to ensure its right to use the corporate name and to protect the name against use by others (*e.g.*, a federal and/or state trade name search, or a multi-jurisdictional name search if the corporation plans on doing business in other jurisdictions).

## **5. Specific Types of Corporations**

### **§3.24 a. Professional Corporations**

In general, a professional corporation (see chap 10) must bear the surname of one or more of the present, past, or prospective shareholders. The name must include the words "professional corporation," "law/medical/dental corporation" (as appropriate), "corporation," "incorporated," or an abbreviated form of one these terms. Corp C §13409. See, e.g., Bus & P C §§1804, 2415, 6171; Law Corp R IV(A)(5); 16 Cal Code Regs §1344.

Professional corporations are subject to specific additional requirements regarding names. For example, special rules apply to the following types of professional corporations:

- Dental corporations (the name of a dental corporation and any name or names under which it may be rendering professional services must contain and be restricted to the name or the last name of one or more of the present, prospective, or former shareholders and include the words "dental corporation" or wording or abbreviations denoting corporate existence, unless otherwise authorized by a valid permit (see Bus & P C §1804; see also Bus & P C §1701.5));
  - Medical and podiatric corporations (see Bus & P C §§2285, 2415 (fictitious name permit));
  - Architectural corporations (see Bus & P C §5536);
  - Engineering corporations (see Bus & P C §6738); and
  - Land surveying corporations. See Bus & P C §8729.
- Extensive limits also apply to law corporations. See Bus & P C §6171; Law Corp R IV(A)(5).

**NOTE:** A professional corporation may use a fictitious business name if the rules for the particular profession permit it and the name is available. See Bus & P C §1701.5 (dental), 2415 (medical or podiatric); Cal Rules of Prof Cond 1-400; Law Corp R IV(A)(5). Permission to use a fictitious business name must be obtained from the appropriate licensing board before incorporating.

A professional may always practice using his or her name followed by the professional designation and indication of incorporation. For example, Jane Q. Doctor may practice as "Jane Q. Doctor, M.D., Inc."

On forming professional corporations, see chap 10.

**Source:** Business Law/Selecting and Forming Business Entities/3 Selecting a Business Name/§3.25 b. Nonprofit Corporations

### **§3.25            b. Nonprofit Corporations**

In addition to the general rules applicable to corporate names (see §§3.20-3.23), the name of a nonprofit corporation may not contain the words "bank," "trust," "trustee," or related words without the approval of the Commissioner of Financial Institutions. Corp C §§5122(a), 7122(a), 9122(a).

The Secretary of State will not accept a name that "is likely to mislead the public or that is the same as, or resembles so closely as to tend to deceive" the following (Corp C §§5122(b), 7122(c), 9122(b)):

- A name that is already reserved; or
- The name of a domestic corporation or a foreign corporation qualified or registered in California, unless the corporation consents and the Secretary of State makes an affirmative finding that notwithstanding such consent, the name is not likely to deceive the public. 2 Cal Code Regs §21003(a).

The name of a nonprofit mutual benefit corporation may not create the impression that the corporation's purpose is public, charitable, or religious, or that it is a charitable foundation. Corp C §7122(b).

**NOTE:** Nonprofit corporations and associations, including organizations such as churches, labor unions, fraternal and charitable organizations, foundations, and similar organizations, are not required to file fictitious business name statements. Bus & P C §17911.

On the formation requirements for nonprofit corporations, see *Advising California Nonprofit Corporations*, chap 5 (3d ed Cal CEB 2009).

**Source:** Business Law/Selecting and Forming Business Entities/3 Selecting a Business Name/§3.26 c. Close Corporations

**§3.26 c. Close Corporations**

In addition to other restrictions applicable to corporations (see §§3.20-3.23), the name of a close corporation must include the word "corporation," "incorporated," or "limited," or an abbreviation of one of those words. Corp C §202(a).

On the formation requirements for close corporations, see chap 9.

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### **§3.27 C. Limited Partnerships**

The name of a limited partnership is set forth in its certificate of limited partnership, filed with the Secretary of State. Corp C §15902.01(a). Correspondingly, a foreign limited partnership's name is stated on its application for a certificate of registration. Corp C §15909.02. A limited partnership must include the words "limited partnership" or the abbreviations "L.P." or "LP" at the end of its name. Corp C §15901.08(b). The name may contain the name of any partner. Corp C §15901.08(a).

The proposed name of a limited partnership must be distinguishable in the records of the Secretary of State from the name of any limited partnership that has previously filed a certificate (see Corp C §15902.01) or of any registered foreign limited partnership (see Corp C §15909.01) and each reserved name (see Corp C §15901.09). Corp C §15901.08(d).

The regulations setting forth the manner by which proposed names are to be reviewed against existing business entity names (2 Cal Code Regs §§21000-21009) include a separate regulation to address the difference in language for review of limited partnership names as opposed to corporations or limited liability companies. See 2 Cal Code Regs §21009(a)-(b) (defining proposed name and restating the requirements of Corp C §15901.08(d)). A proposed name is considered "distinguishable on the record" from an existing name when the name "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." 2 Cal Code Regs §21009(c). A proposed name is not "distinguishable on the records" from an existing name if the only difference between the two is the existence or absence of any of the following entity endings: "Limited Partnership," "LP," "L.P.," "Limited Liability Limited Partnership," "LLLLP," or "L.L.L.P." 2 Cal Code Regs §21009(d)(1). Further, neither differing use of uppercase and lowercase letters, superscript or subscript letters and numbers, nor distinctive lettering or punctuation, are generally sufficient to distinguish proposed and existing names: For example, "Good Time Rest Home, LP" is not distinguishable from "Goodtime Rest Home LP." 2 Cal Code Regs §21009(d)(2)-(3). However, "the addition or omission of a space or spaces so that the proposed name creates a new word or words that have different meanings" may create an acceptable name. For example, "Got Ham LP" is acceptable against "Gotham, LP." 2 Cal Code Regs §21009(d)(4).

If the proposed name is not deemed distinguishable, then an applicant to use the name may nevertheless apply to the Secretary of State to use the name. The Secretary of State will authorize the use of the conflicting name if (Corp C §15901.08(e)):

- The present user, registrant, or owner of the conflicting name consents and such use is not likely to mislead the public. See also 2 Cal Code Regs §§21003, 21005;
- The applicant delivers to the Secretary of State a certified copy of the final judgment from a court of competent jurisdiction establishing the applicant's right to use the proposed name; or
- The applicant delivers proof to the satisfaction of the Secretary of State that the present user, registrant, or owner of the conflicting name has (a) merged into the applicant, (b) been converted into the applicant, or (c) transferred substantially all of its assets, including the conflicting name, to the applicant.

The name of a limited partnership may not use the words "bank," "insurance," "trust," "trustee," "incorporated," "inc.," "corporation," or "corp." Corp C §15901.08(g).

**PRACTICE TIP:** Any applicant may, on payment of the \$10 fee, obtain a certificate of reservation from the Secretary of State of any name not prohibited by Corp C §15901.09(b); Govt C §12188(a). The name may be reserved for two 60-day periods. The Secretary of State will not reserve the same name for more than two consecutive 60-day periods for the same applicant or for the use or benefit of the same person. Corp C §15901.09(c). A reserved name may be transferred to another person, effective on delivery to the Secretary of State of a notice of transfer stating the reserved name, the name and address of the person to whom the reserved name is to be transferred, and the basis on which the person seeks the use of the name pursuant to the categories listed in Corp C §15901.08(a). Corp C §15901.09(d).

**CAUTION:** The prepaid account available to check name availability and to reserve names cannot be used for proposed limited partnership names. The Secretary of State's website indicates that this is due to the requirements set forth in Corp C §15901.09.

**NOTE:** Subject to Corp C §15909.05, the name requirements of Corp C §15901.08 are applicable to all foreign limited partnerships with a certificate of registration to transact business in California. Corp C §15901.08(f). In turn, Corp C §15909.05 prohibits a foreign limited partnership from obtaining a certificate of registration until it adopts, for the purpose of transacting business in California, an alternate name that complies with Corp C §15901.08.

For limited partnerships, any name other than the name on the certificate of limited partnership on file with the California Secretary of State is a fictitious business name. Bus & P C §17900(b)(4). A partnership using a fictitious business name should file a fictitious business statement with the clerk of the county in which the partnership has its principal place of business in California. If the registrant has no place of business in California, the registrant should file with the clerk of Sacramento County. Bus & P C §17915. For filing requirements, see §3.9.

**NOTE:** A limited partnership may wish to file fictitious business name statements in other counties in which it conducts business to discourage use of its trade name by other parties.

### **§3.28 D. Limited Liability Partnerships**

The name of a registered limited liability partnership (LLP) must contain the words "Registered Limited Liability Partnership" or "Limited Liability Partnership" or the abbreviation "L.L.P.," "LLP," "R.L.L.P.," or "RLLP" as the last words or letters of its name. Corp C §16952.

**NOTE:** An LLP is not required to do business under its official name, and registered LLPs are exempt from the fictitious business name requirements. Corp C §16961; see Corp C §§16953, 16959. However, the State Bar rules require that applicants must agree to practice under the name filed with the State Bar. State Bar LLP R 3.3.

The name requirements for a foreign LLP are identical except that allowance is made for variations on these designations by another jurisdiction as long as the variations are similar. Corp C §16958(b).

Unlike for other entities such as corporations and limited liability companies, the Secretary of State arguably should not reject any name reservation application or registration application because of the similarity of the proposed LLP name to another name already in use. Compare Corp C §16953(c) (domestic LLPs) and §16959(c) (foreign LLPs) with Corp C §201(b) (corporations), §15901.08 (limited partnerships), and §§17052-17053 (limited liability companies).

**NOTE:** The legislature's different treatment of LLPs is based on its lack of concern that the public will be confused by similar law, accounting, or architectural firm names. For the same reason, although it is not explicitly spelled out in the statutes, a law, accounting, or architectural firm should not be required to change its name solely because it is converting to LLP status. However, the current regulations do not appear to provide for the differences for this species of general partnership from that of business entities such as corporations and limited liability companies or limited partnerships.

There is no procedure for reserving an LLP name.

### **§3.29 E. Limited Liability Companies**

The name of an LLC must contain the words "limited liability company" or the abbreviation "LLC" or "L.L.C." as the last words of the name. The words "Limited" and "Company" may be abbreviated as "Ltd." and "Co.," respectively. Corp C §17052(a).

**NOTE:** Entities that are not limited liability companies may not adopt a fictitious business name that includes "limited liability company," "LLC," or "LC." The names and abbreviations "Company," "Limited," "Co.," and "Ltd." may be used in a name, *if* that use does not wrongfully imply that the business is a limited liability company. Bus & P C §17910.5.

The LLC name may contain the name of one or more of the members. Corp C §17052(b).

**NOTE:** Filing the articles of organization does not protect against others' using the name, nor does it allow the use of the name in all circumstances. It merely means that no other LLC in California may use the name. Protection to prevent others from using the name may be obtained by registering the name as a trademark with the United States Patent and Trademark Office, or as a trademark or service mark with the California Secretary of State. See §§3.7, 3.16. For further discussion of trade name and trademark protection, see Trade Secrets Practice in California (2d ed Cal CEB 1996).

The LLC name may not contain the words "bank," "trust," "trustee," "incorporated," "inc.," "corporation," "corp.," "insurer," "insurance," or any other word that suggests that the LLC is in the business of issuing insurance policies or assuming insurance risks. Corp C §17052(d).

The LLC name may not be one that the Secretary of State determines is likely to mislead the public and may not be the same as, or resemble so closely as to tend to deceive, any of the following (Corp C §17052(c)):

- The name of any California LLC that has filed articles of organization;
- The name of any registered foreign LLC; or
- Any name that is under reservation by an LLC.

On regulations governing business entity names, see §§3.20 and 3.22-3.23.

**PRACTICE TIP:** An LLC may use a name that is substantially the same as that of an existing California or registered foreign LLC if the other LLC consents to the use of the name, and if the Secretary of State finds that the public is not likely to be misled. Corp C §17052(c); 2 Cal Code Regs §§21003(a)(2) and 21005. Further, the Secretary of State may approve the use of a name that is similar to the name used by an existing LLC if one or more descriptive words are added that will distinguish the goods or services of the proposed LLC from the existing LLC. For example, if there is an existing LLC with the name "Green Leaf Investors LLC," then the Secretary of State is likely to approve the names "Green Leaf Real Estate Partners LLC" or "Green Leaf Beauty Salon LLC." The Secretary of State would likely not approve the name "Green Leaf Company."

### §3.30 V. CHECKLIST: BUSINESS NAME SEARCH

▶ To download **Word** version,  
right click and choose  
*Save Target As*

▶ To download **WordPerfect** version,  
right click and choose  
*Save Target As*

- Evaluate business type and industry and particular name choice to determine scope of search. See §3.3.
- At a minimum, the search should include a search of each county in which the business plans to do business.
- At the other extreme, it may involve a complex multi-jurisdictional search of other similar business names as well as various jurisdictions' databases of trademarked or similarly protected intellectual property interests in the name in each foreign jurisdiction searched.
- For local businesses, check fictitious business name registry of county clerk for each county in which the business is likely to do business. See §3.5.
- Check with Secretary of State to determine whether an entity with same or similar name has already been established as a corporation, limited partnership, LLC, or LLP. See §§3.5, 3.18.
- If more than local transactions are involved, conduct search of federal and state registrations and applications to determine whether prior users have rights sufficient to create controversy. See §§3.5, 3.12, 3.18.
- Evaluate whether a more comprehensive common law search is required. If so, conduct and evaluate results of this search. See §3.3.
- Reserve business name if there will be any delay in filing business's formation documents. See §§3.15, 3.32.
- Make requisite filings of formation documents. See chaps 5-11.
- Determine whether fictitious business statement is required. If so, prepare and file form with appropriate county agency. See §§3.9, 3.33.

**Source:** Business Law/Selecting and Forming Business Entities/3 Selecting a Business Name/ VI. FORMS/§3.31 A.  
Form: Secretary of State's Name Availability Inquiry Letter

**VI. FORMS**

**§3.31 A. Form: Secretary of State's Name Availability Inquiry Letter**



# Name Availability Inquiry Letter

(Corporation, Limited Liability Company and Limited Partnership Names)

To inquire as to the availability of a corporation, limited liability company or limited partnership name, complete the order form below, listing up to three names to be checked. Submit your request by mail, along with a self-addressed envelope, to:

Secretary of State  
 Name Availability Unit  
 1500 11<sup>th</sup> Street, 3<sup>rd</sup> Floor  
 Sacramento, CA 95814

**Email and/or online inquiries regarding name availability cannot be accepted at this time.**

REQUESTOR'S INFORMATION	
YOUR NAME:	
FIRM NAME, IF ANY:	
ADDRESS:	
CITY/STATE/ZIP:	
TELEPHONE #:	FAX #:
SELECT ENTITY TYPE (choose only one)	
<input type="checkbox"/> Corporation	<input type="checkbox"/> Limited Liability Company
<input type="checkbox"/> Limited Partnership	
NAME(S) TO BE CHECKED	
1st Choice	
<b>FOR OFFICE USE ONLY</b>	( ) is available. ( ) is not available. We have:
2nd Choice	
<b>FOR OFFICE USE ONLY</b>	( ) is available. ( ) is not available. We have:
3rd Choice	
<b>FOR OFFICE USE ONLY</b>	( ) is available. ( ) is not available. We have:
<p><b>Note:</b> Checking the availability of a corporation, limited liability company or limited partnership name does not reserve the name and has no binding effect on the Secretary of State, nor does it confer any rights to a name. A name reservation request can be submitted by mail or in person (over-the-counter) to the Secretary of State's Sacramento office. Corporation names can also be reserved, in person, at either of the Secretary of State's regional offices located in Los Angeles and San Diego. Fees and instructions for reserving a name are included on the Name Reservation Request Form.</p>	
THE SPACE BELOW IS RESERVED FOR OFFICE USE ONLY	
Date:	I #
By:	

*Comment:* This form may be used by a corporation, limited partnership, or limited liability company to inquire about the availability of a business name. Up to three names may be checked on the same form. The request should be

mailed, along with a self-addressed envelope, to the address specified in the form.

This form is available at the Secretary of State's website at <http://www.sos.ca.gov/business/corp/pdf/naavinquiryform.pdf>. It may be completed online and printed, but it may not be submitted online.

Checking the availability of a corporation, limited partnership, or limited liability company does not reserve the name, confer any rights to the name, or have any binding effect on the Secretary of State.

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**Source:** Business Law/Selecting and Forming Business Entities/3 Selecting a Business Name/§3.32 B. Form: Secretary of State's Name Reservation Request

**§3.32 B. Form: Secretary of State's Name Reservation Request**





### Name Reservation Request Form (Corporation, Limited Liability Company, or Limited Partnership Names)

**The proposed name is being reserved for use by:**

Your Name: \_\_\_\_\_ Phone #: \_\_\_\_\_  
Firm Name (if any): \_\_\_\_\_ Fax #: \_\_\_\_\_  
Address: \_\_\_\_\_  
City/State/Zip: \_\_\_\_\_

**Type of Entity** (Select the applicable entity type. Only one type may be selected. **Note:** If the "Limited Partnership" type is selected, see page 2 of this Name Reservation Request Form for an additional requirement.)

Corporation                       Limited Liability Company                       Limited Partnership

**Name To Be Reserved** (Enter the name to be reserved. Only one reservation will be made per Name Reservation Request Form. You may list up to three names, in order of preference, and the first available name will be reserved for a period of 60 days. The remaining names will not be researched.)

**1st Choice:** \_\_\_\_\_  
\_\_\_\_\_ is available.                      \_\_\_\_\_ is available only with consent from:                      \_\_\_\_\_ is not available. We have:

**2nd Choice:** \_\_\_\_\_  
\_\_\_\_\_ is available.                      \_\_\_\_\_ is available only with consent from:                      \_\_\_\_\_ is not available. We have:

**3rd Choice:** \_\_\_\_\_  
\_\_\_\_\_ is available.                      \_\_\_\_\_ is available only with consent from:                      \_\_\_\_\_ is not available. We have:

**Suspended/Forfeited Entity**

If the proposed name is being reserved for the purpose of reviving a suspended or forfeited entity, check the box and include the entity number. \_\_\_\_\_  
Entity Number

**Mail Back Response**

If the Name Reservation Request Form is submitted in person **and** if you would like the reservation to be mailed back, check the box and include a self-addressed envelope.

**Fees** (Please make check(s) payable to the Secretary of State.)

**Reservation Fee:** The fee for reserving a corporation, limited liability company or limited partnership name is \$10.00 (per reserved name).

**Special Handling Fee:**

- In addition to the reservation fee, a \$10.00 special handling fee is applicable for processing each Name Reservation Request Form delivered in person (drop off) to the Secretary of State's office.
- The \$10.00 special handling fee must be remitted by separate check and will be retained whether the proposed name is accepted or denied for reservation.
- The special handling fee does not apply to name reservation requests submitted by mail.

**THE SPACE BELOW IS RESERVED FOR OFFICE USE ONLY**

Date:	Amt Rec'd:	R #:	By:
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## Name Reservation Request

(Corporation, Limited Liability Company, or Limited Partnership Names)

To request the reservation of a corporation, limited liability company or limited partnership name, complete the Name Reservation Request Form on the following page, attach a check in the amount of \$10.00 (made payable to the Secretary of State) and submit the request:

- **By mail**, along with a self-addressed envelope, to Secretary of State, Name Availability Unit, 1500 11th Street, 3rd Floor, Sacramento, CA 95814. Please refer to our Mail Processing Times webpage at [www.sos.ca.gov/business/be/mail-processing-times.htm](http://www.sos.ca.gov/business/be/mail-processing-times.htm) for current mail processing times.
- **In person (drop off)** at the Secretary of State's office in Sacramento. *Corporation* names also can be reserved, in person, at any of the Secretary of State's regional office locations. Please refer to our Regional Offices webpage at [www.sos.ca.gov/business/regional.htm](http://www.sos.ca.gov/business/regional.htm) for regional office locations and addresses. A special handling fee of \$10.00 is applicable for each name reserved in person. The special handling fee must be remitted separately and will be retained whether the proposed name is accepted or denied for reservation. The special handling fee is not applicable to requests submitted by mail.

Only one reservation will be made per request form. You may list up to three names, in order of preference, and the first available name will be reserved for a period of 60 days. The remaining names will not be researched.

A name reservation is made for a period of 60 days. The name reservation can be renewed to the same applicant or for the benefit of the same party, but not for consecutive periods.

E-mail and/or online requests for name reservations cannot be accepted at this time. Please complete the Name Reservation Request Form on the following page.

**Note:** The reservation of a proposed corporation, limited liability company or limited partnership name does not guarantee that the reserved name complies with all federal and state laws. At the time of filing the document containing the reserved name, it is your responsibility to ensure that you have complied with all federal and state laws, including specific name requirements. In some circumstances, the reserved name may require additional approval/consent pursuant to applicable law at the time of filing. Name styles for particular types of business entities and the need for consent/approval required by law are not considered at the time of the name reservation. Therefore, no financial commitment relating to the proposed name should be made based on the reservation, since the business entity record is not created/qualified/amended until the appropriate documents have been submitted to and filed by the Secretary of State.

**Corporation Names:**

A corporation name must not be a name that is "likely to mislead the public or the same as, or resembling so closely as to tend to deceive," the name of a California or foreign corporation that has registered with this office or a name that has been reserved by another party. Note: Names are considered deceptive if the only difference is a corporate ending. (California Corporations Code section 201(b) and 2106(b).) A Corporation name is reserved pursuant to California Corporations Code section 201(c).

**Limited Liability Company (LLC) Names:**

An LLC name: (1) must not be a name that is "likely to mislead the public or which is the same as, or resembles so closely as to tend to deceive," the name of a California or foreign LLC that has registered with this office or a name that has been reserved by another party. Note: Names are considered deceptive if the only difference is an LLC ending; (2) must end with the words "Limited Liability Company," or the abbreviations "LLC" or "L.L.C." The words "Limited" and "Company" may be abbreviated to "Ltd." and "Co.," respectively; (3) may not contain the words "bank," "trust," "trustee," "incorporated," "inc.," "corporation," or "corp.;" and (4) must not contain the words "insurer" or "insurance company" or any other words suggesting that it is in the business of issuing policies of insurance and assuming insurance risks. (California Corporations Code section 17052 and 17452.) An LLC name is reserved pursuant to California Corporations Code section 17053.

**Limited Partnership (LP) Names:**

An LP name: (1) must be distinguishable in the records of the Secretary of State from the name of an existing LP or an LP name that has been reserved by another party. Note: Names are not considered distinguishable if the only difference is a limited partnership ending; (2) must end with the phrase "Limited Partnership" or the abbreviation "LP" or "L.P.;" and (3) may not contain the words "bank," "insurance," "trust," "trustee," "incorporated," "inc.," "corporation," or "corp.;" Note: If entity is a foreign LP that is a foreign limited liability LP, the name must contain the phrase "limited liability limited partnership," or the abbreviation "LLLLP" or "L.L.L.P." and may not contain the abbreviation "LP" or "L.P." (California Corporations Code section 15901.08, 15909.05.) An LP name is reserved pursuant to California Corporations Code section 15901.09.

**Additional Requirement - Limited Partnership Names**

In addition to completing the information on page 1 of this Name Reservation Request Form, a request to reserve a limited partnership name also must state the eligibility for the reservation as required by California Corporations Code section 15901.09. **Please select the applicable statement below** and attach this page to page 1 of this request form. Note: Only one statement may be selected.

**The exclusive right to the use of the proposed limited partnership name is being reserved by:**

- a person intending to organize a limited partnership under Chapter 5.5 of the California Corporations Code and adopt the name.
- a domestic (California) limited partnership or a foreign (out-of-state or out-of-country) limited partnership authorized to transact business in California intending to adopt the name.
- a foreign limited partnership intending to obtain a certificate of registration to transact business in California and adopt the name.
- a person intending to organize a foreign limited partnership in the foreign jurisdiction and intending to have it obtain a certificate of registration to transact business in California and adopt the name.
- a foreign limited partnership formed in the foreign jurisdiction under the name.
- a foreign limited partnership formed in the foreign jurisdiction under a name that does not comply with the requirements of California Corporations Code section 15901.08(b) or 15901.08(c), but the name to be reserved may differ from the foreign limited partnership's actual name only to the extent necessary to comply with California Corporations Code section 15901.08(b) or 15901.08(c).

*Comment:* This form may be used to reserve the name of a corporation, limited partnership, or limited liability

company with the Secretary of State's office. Corp C §§201(c), 15901.09, 17053. The completed form, with an attached check for \$10 (see Govt C §§12182, 12186(a), 12188(a), 12190(a)), made payable to the Secretary of State, may be submitted by mail, along with a self-addressed envelope, to the address specified in the instructions.

This form is available at the Secretary of State's website, <http://www.sos.ca.gov/business/corp/pdf/naavreservform.pdf>. It may be completed online and printed, but it may not be submitted online. The Secretary of State does not accept e-mail requests for name reservations. For a discussion of telephone accounts, see §3.15.

The request may also be submitted in person at the Secretary of State's Sacramento office; corporate names may also be reserved, in person, at the Secretary of State's regional locations in Sacramento or Los Angeles. For the addresses of these offices, see the Directory. A special handling fee of \$15 per name must be remitted by separate check for each name reservation requested in person. Govt C §12182; 2 Cal Code Regs §21903(b)(3), (c).

Only one reservation may be made per request form. Up to three names may be listed, in order of preference, and the first available name will be reserved for a period of 60 days. Corp C §§201(c), 15613, 17053. The remaining names will not be researched.

A name reservation may be renewed after the 60-day period, but not for consecutive periods to the same applicant or for the benefit of the same party.

**Source:** Business Law/Selecting and Forming Business Entities/3 Selecting a Business Name/§3.33 C. Form: Fictitious Business Name Statement (Los Angeles County)

**§3.33 C. Form: Fictitious Business Name Statement (Los Angeles County)**



YOUR RETURN MAILING ADDRESS

LOS ANGELES  
REGISTRAR-RECORDER/ COUNTY CLERK

NAME:

ADDRESS:

CITY:

STATE:

ZIP CODE:

### FICTITIOUS BUSINESS NAME STATEMENT

TYPE OF FILING AND FILING FEE (Check one)

- Original- \$23.00 (FOR ORIGINAL FILING WITH ONE BUSINESS NAME ON STATEMENT);  New Filings- \$23.00 (CHANGES IN FACTS FROM ORIGINAL FILING- REQUIRES PUBLICATION)
- Refile- \$18.00 (NO CHANGES IN THE FACTS FROM ORIGINAL FILING)
- \$4.00-** FOR EACH ADDITIONAL BUSINESS NAME FILED ON SAME STATEMENT, DOING BUSINESS AT THE SAME LOCATION **\$4.00-** FOR EACH ADDITIONAL OWNER IN EXCESS OF TWO OWNERS

The following person(s) is (are) doing business as:

\*1. \_\_\_\_\_ 2. \_\_\_\_\_  
 \_\_\_\_\_  
 Print Fictitious Business Name(s)

\*\* \_\_\_\_\_  
 \_\_\_\_\_  
 Street address of principal place of business Mailing address if different

\_\_\_\_\_  
 City State Zip COUNTY City State Zip

Articles of Incorporation or Organization Number (if applicable): AI #ON \_\_\_\_\_

#### \*\*\* REGISTERED OWNER(S):

<p>1. _____        Full Name/Corp/LLC        _____        Residence Address        _____        City State Zip        _____        If Corporation or LLC - Print State of Incorporation/Organization</p>	<p>2. _____        Full Name/Corp/LLC        _____        Residence Address        _____        City State Zip        _____        If Corporation or LLC - Print State of Incorporation/Organization</p>
<p>3. _____        Full Name/Corp/LLC        _____        Residence Address        _____        City State Zip        _____        If Corporation or LLC - Print State of Incorporation/Organization</p>	<p>4. _____        Full Name/Corp/LLC        _____        Residence Address        _____        City State Zip        _____        If Corporation or LLC - Print State of Incorporation/Organization</p>

IF MORE THAN FOUR REGISTRANTS, ATTACH ADDITIONAL SHEET SHOWING OWNER INFORMATION

#### \*\*\*\* THIS BUSINESS IS CONDUCTED BY: (Check one)

- an Individual  a General Partnership  a Limited Partnership  a Limited Liability Company
- an Unincorporated Association other than a Partnership  a Corporation  a Trust  Copartners
- Husband and Wife  Joint Venture  State or Local Registered Domestic Partners  a Limited Liability Partnership

\*\*\*\*\* The registrant commenced to transact business under the fictitious business name or names listed above on \_\_\_\_\_  
 (Insert N/A above if you haven't started to transact business)

**I declare that all information in this statement is true and correct.**  
**(A registrant who declares as true information which he or she knows to be false is guilty of a crime.)**

REGISTRANTS /CORP/LLCNAME (PRINT) \_\_\_\_\_ TITLE \_\_\_\_\_

REGISTRANT SIGNATURE \_\_\_\_\_

If corporation, also print corporate title of officer. If LLC, also print title of officer or manager.

This statement was filed with the County Clerk of LOS ANGELES on the date indicated by the filed stamp in the upper right corner.

NOTICE - IN ACCORDANCE WITH SUBDIVISION (a) OF SECTION 17920, A FICTITIOUS NAME STATEMENT GENERALLY EXPIRES AT THE END OF FIVE YEARS FROM THE DATE ON WHICH IT WAS FILED IN THE OFFICE OF THE COUNTY CLERK, EXCEPT, AS PROVIDED IN SUBDIVISION (b) OF SECTION 17920, WHERE IT EXPIRES 40 DAYS AFTER ANY CHANGE IN THE FACTS SET FORTH IN THE STATEMENT PURSUANT TO SECTION 17913 OTHER THAN A CHANGE IN THE RESIDENCE ADDRESS OF A REGISTERED OWNER. A NEW FICTITIOUS BUSINESS NAME STATEMENT MUST BE FILED BEFORE THE EXPIRATION.

THE FILING OF THIS STATEMENT DOES NOT OF ITSELF AUTHORIZE THE USE IN THIS STATE OF A FICTITIOUS BUSINESS NAME IN VIOLATION OF THE RIGHTS OF ANOTHER UNDER FEDERAL, STATE, OR COMMON LAW (SEE SECTION 14411 ET SEQ., BUSINESS AND PROFESSIONS CODE).

I HEREBY CERTIFY THAT THIS COPY IS A CORRECT COPY OF THE ORIGINAL STATEMENT ON FILE IN MY OFFICE.

DEAN C. LOGAN, LOS ANGELES COUNTY CLERK

BY: \_\_\_\_\_, Deputy

YOUR RETURN MAILING ADDRESS

NAME:

ADDRESS:

CITY:

STATE:

ZIP CODE:

LOS ANGELES REGISTRAR-RECORDER/ COUNTY CLERK

COPY

FICTITIOUS BUSINESS NAME STATEMENT

TYPE OF FILING AND FILING FEE (Check one)

- Original- \$23.00 (FOR ORIGINAL FILING WITH ONE BUSINESS NAME ON STATEMENT)
Refile- \$18.00 (NO CHANGES IN THE FACTS FROM ORIGINAL FILING)
New Filings- \$23.00 (CHANGES IN FACTS FROM ORIGINAL FILING- REQUIRES PUBLICATION)
\$4.00- FOR EACH ADDITIONAL BUSINESS NAME FILED ON SAME STATEMENT, DOING BUSINESS AT THE SAME LOCATION \$4.00- FOR EACH ADDITIONAL OWNER IN EXCESS OF TWO OWNERS

The following person(s) is (are) doing business as:

\*1. \_\_\_\_\_ 2. \_\_\_\_\_
Print Fictitious Business Name(s)

\*\* \_\_\_\_\_
Street address of principal place of business Mailing address if different

City State Zip COUNTY City State Zip

Articles of Incorporation or Organization Number (if applicable): AI #/ON \_\_\_\_\_

\*\*\* REGISTERED OWNER(S):

1. \_\_\_\_\_
Full Name/Corp/LLC
Residence Address
City State Zip
If Corporation or LLC - Print State of Incorporation/Organization

2. \_\_\_\_\_
Full Name/Corp/LLC
Residence Address
City State Zip
If Corporation or LLC - Print State of Incorporation/Organization

3. \_\_\_\_\_
Full Name/Corp/LLC
Residence Address
City State Zip
If Corporation or LLC - Print State of Incorporation/Organization

4. \_\_\_\_\_
Full Name/Corp/LLC
Residence Address
City State Zip
If Corporation or LLC - Print State of Incorporation/Organization

IF MORE THAN FOUR REGISTRANTS, ATTACH ADDITIONAL SHEET SHOWING OWNER INFORMATION

\*\*\*\* THIS BUSINESS IS CONDUCTED BY: (Check one)

- an Individual a General Partnership a Limited Partnership a Limited Liability Company
an Unincorporated Association other than a Partnership a Corporation a Trust Copartners
Husband and Wife Joint Venture State or Local Registered Domestic Partners a Limited Liability Partnership

\*\*\*\*\* The registrant commenced to transact business under the fictitious business name or names listed above on \_\_\_\_\_
(insert N/A above if you haven't started to transact business)

I declare that all information in this statement is true and correct.
(A registrant who declares as true information which he or she knows to be false is guilty of a crime.)

REGISTRANTS /CORP/LLC NAME (PRINT) \_\_\_\_\_ TITLE \_\_\_\_\_

REGISTRANT SIGNATURE \_\_\_\_\_

If corporation, also print corporate title of officer. If LLC, also print title of officer or manager.

This statement was filed with the County Clerk of LOS ANGELES on the date indicated by the filed stamp in the upper right corner.

NOTICE - IN ACCORDANCE WITH SUBDIVISION (a) OF SECTION 17920, A FICTITIOUS NAME STATEMENT GENERALLY EXPIRES AT THE END OF FIVE YEARS FROM THE DATE ON WHICH IT WAS FILED IN THE OFFICE OF THE COUNTY CLERK, EXCEPT, AS PROVIDED IN SUBDIVISION (b) OF SECTION 17920, WHERE IT EXPIRES 40 DAYS AFTER ANY CHANGE IN THE FACTS SET FORTH IN THE STATEMENT PURSUANT TO SECTION 17913 OTHER THAN A CHANGE IN THE RESIDENCE ADDRESS OF A REGISTERED OWNER. A NEW FICTITIOUS BUSINESS NAME STATEMENT MUST BE FILED BEFORE THE EXPIRATION.

THE FILING OF THIS STATEMENT DOES NOT OF ITSELF AUTHORIZE THE USE IN THIS STATE OF A FICTITIOUS BUSINESS NAME IN VIOLATION OF THE RIGHTS OF ANOTHER UNDER FEDERAL, STATE, OR COMMON LAW (SEE SECTION 14411 ET SEQ., BUSINESS AND PROFESSIONS CODE).

I HEREBY CERTIFY THAT THIS COPY IS A CORRECT COPY OF THE ORIGINAL STATEMENT ON FILE IN MY OFFICE.

DEAN C. LOGAN, LOS ANGELES COUNTY CLERK

BY: \_\_\_\_\_, Deputy

**INSTRUCTIONS FOR COMPLETION OF STATEMENT****Business and Professions Code Section 17913:****\* Where one asterisk appears in the form:**

- (a) Insert the fictitious business name or names
- (b) Only those businesses operated at the same address and under the same ownership may be listed on one statement

**\*\* Where two asterisks appear in the form:**

- (a) If the registrant has a place of business in this state, insert the **street address and county** of his or her **principal place of business** in this state
- (b) If the registrant has no place of business in this state, insert the **street address and county** of his or her **principal place of business** outside this state and file with the Clerk of Sacramento County (B&P 17915)
- (c) Mail Box and Post Office Box Numbers are **not acceptable** as a business address when used alone without a street address

**\*\*\* Where three asterisks appear in the form:**

- (a) If the registrant is an **individual**, insert his or her full name and residence address
- (b) If the registrants are **husband and wife**, insert the full name and residence address of both the husband and the wife
- (c) If the registrant is a **general partnership, copartnership, joint venture, limited liability partnership, or unincorporated association other than a partnership**, insert the full name and residence address of each general partner
- (d) If the registrant is a **limited partnership**, insert the full name and residence address of each general partner
- (e) If the registrant is a **limited liability company**, insert the name and address of the limited liability company, as set out in its articles of organization on file with the CA Secretary of State, and the state of organization
- (f) If the registrant is a **trust**, insert the full name and residence address of each trustee
- (g) If the registrant is a **corporation**, insert the name and address of the corporation, as set out in its articles of incorporation on file with the CA Secretary of State, and the state of incorporation
- (h) If the registrants are **state or local registered domestic partners**, insert the full name and residence address of each domestic partner

**\*\*\*\* Where four asterisks appear in the form:**

- (a) Check whichever of the terms listed on the front of the form best describes the nature of the business

**\*\*\*\*\* Where five asterisks appear in the form:**

- (a) Insert the **date** on which the registrant first commenced to transact business under the fictitious business name or names listed, if already transacting business under that name or names
- (b) Insert N/A if you have not yet commenced to transact business under the fictitious business name or names listed

**Business and Professions Code Section 17914**

The statement shall be signed as follows:

- (a) If the registrant is an **individual**, by the individual
- (b) If the registrants are **husband and wife**, by the husband or wife
- (c) If the registrant is a **general partnership, limited partnership, limited liability partnership, copartnership, joint venture, or unincorporated association other than a partnership**, by a general partner
- (d) If the registrant is a **limited liability company**, by a manager or officer
- (e) If the registrant is a **trust**, by a trustee
- (f) If the registrant is a **corporation**, by an officer
- (g) If the registrant is a **state or local registered domestic partnership**, by one of the domestic partners

**Business and Professions Code Section 17915**

The fictitious business name statement **shall be filed** with the clerk of the county in which the registrant has his or her **principal place of business** in this state or, if the registrant has no place of business in this state, with the Clerk of Sacramento County. Nothing in this chapter shall preclude a person from filing a fictitious business name statement in a county other than that where the principal place of business is located, as long as the requirements of this subdivision are also met.

**Business and Professions Code Section 17917**

Publication for Original, New Filings (renewal with change in facts from previous filing), or Refile

- (a) Within 30 days after a fictitious business name statement has been filed, the registrant shall cause it to be published in a newspaper of general circulation in the county where the fictitious business name statement was filed or, if there is no such newspaper in that county, in a newspaper of general circulation in an adjoining county. If the registrant does not have a place of business in this state, the notice shall be published in a newspaper of general circulation in Sacramento County. The publication must be once a week for four successive weeks and an affidavit of publication must be filed with the county clerk where the fictitious business name statement was filed within 30 days after the completion of the publication.
- (b) If a refiling is required because the prior statement has expired, the refiling need **not** be published, unless there has been a change in the information required in the expired statement, provided the refiling is filed **within 40 days** of the date the statement expired.

**Business and Professions Code Section 17922**

Abandonment of Fictitious Business Name

- (a) Upon ceasing to transact business in this state under a fictitious business name that was filed in the previous five years, a person who has filed a fictitious business name statement **shall file** a statement of abandonment of use of fictitious business name. The statement shall be executed and published in the same manner as a fictitious business name statement and **shall be filed** with the county clerk of the county in which the person has filed his or her fictitious business name statement.

**Business and Professions Code Section 17930**

Any person who executes, files, or publishes any statement under this chapter, knowing that such statement is false, in whole or in part, shall be guilty of a misdemeanor and upon conviction thereof shall be punished by a fine not to exceed one thousand dollars (\$1,000).

*Comment:* This is an example of a form used to register a fictitious business name in Los Angeles County. See

[http://www.lavote.net/general/pdfs/fictitious\\_business\\_name.pdf](http://www.lavote.net/general/pdfs/fictitious_business_name.pdf). Before filing, it is recommended that counsel search the names listed in the fictitious business name database to verify that the desired name is not already in use. See Bus & P C §17925. See §3.5. Such a search may be conducted online, or in person at most county clerk's offices.

Fictitious business name statements (see Bus & P C §17913) are filed with, and are available from, each county clerk's office; forms are also available online. The statement must be filed by mail or in person with the county clerk (or county clerk-recorder) in the county where the entity has its principal place of business (or in Sacramento county if the entity has no place of business in California), no later than 40 days from the time business operations commence. Bus & P C §§17910, 17915. The statement may be filed in other counties as well. By statute, the fee for filing a fictitious business name statement is \$10 for the first fictitious business name and owner, and \$2 for each additional name or owner filed on the same statement and doing business at the same location. See Bus & P C §17929(a). However, the applicable filing fee is determined by the individual counties, and generally ranges from \$20 to \$29 for one business name and one business owner.

The individual registering the fictitious business name statement must publish the statement in a newspaper of general circulation in the county in which the statement is filed within 30 days of filing the statement. The advertisement must be published once a week for 4 successive weeks, with at least 5 days between each date of publication. See Bus & P C §17917(a). The newspaper should be one that circulates in the area where the business is conducted. See Bus & P C §§17917(b), 17924(a); Govt C §6064. An affidavit of publication must be filed with the county clerk within 30 days of the last publication date. See Bus & P C §§17917(d), 17924(a)(1), 17929(a).

A fictitious business name statement ordinarily expires 5 years from the date of filing and must be renewed before the expiration date. Bus & P C §17920(a). However, a statement also expires 40 days after any change in the facts set forth in the statement except that (1) a change in the residence address of an individual, general partner, or trustee or (2) the filing of a statement of withdrawal from partnership by a withdrawing partner does not cause the earlier expiration of the statement. Bus & P C §17920(b). Further, the statement expires when the registrant files a statement of abandonment of the fictitious business name statement. See Bus & P C §17920(c).

**Source:** Business Law/Selecting and Forming Business Entities/3 Selecting a Business Name/§3.34 D. Form: Letter Requesting Consent to Use Name Deemed Confusingly Similar

### §3.34 D. Form: Letter Requesting Consent to Use Name Deemed Confusingly Similar

► To download **Word** version,  
right click and choose  
**Save Target As**

► To download **WordPerfect** version,  
right click and choose  
**Save Target As**

\_\_ [Law firm letterhead] \_\_

\_\_ [Date] \_\_

**Re: Request of** \_\_ [name of client] \_\_ **to Use Name**

**Dear** \_\_ [name of corporation granting permission to use similar corporate name] \_\_:

We want to thank you for your prompt attention in regards to the above-captioned matter. Enclosed please find the contents of the letter that must, according to the Secretary of State, be on your company letterhead and directed to the Secretary of State's attention, to establish your consent to \_\_ [name of client] \_\_'s use of the name \_\_ [name rejected by Secretary of State] \_\_. If you would be so kind as to put this letter on your letterhead and forward it to our offices, we will then forward the letter to the Secretary of State to allow our client to incorporate under this name.

Once again, thank you for all your cooperation and prompt attention to this matter.

Sincerely yours,

\_\_ [Signature] \_\_

\_\_ [Typed name] \_\_

Attorney for \_\_ [name] \_\_

cc: \_\_ [name of client] \_\_

[LETTERHEAD OF \_\_ [NAME OF CORPORATION GRANTING PERMISSION TO USE SIMILAR CORPORATE NAME] \_\_]

\_\_ [Date] \_\_

Secretary of State  
Attn: Name Availability  
1500 11th Street  
Sacramento, CA 95814

**Re: Consent to Waiver of Objection to Incorporation of** \_\_ [name of client] \_\_.

**To Whom It May Concern:**

The undersigned is the Chief Executive Officer and authorized representative on behalf of \_\_ [full name of corporation/limited liability company/limited partnership granting request to use similar corporate name] \_\_. I hereby consent to the \_\_ [incorporation/organization/formation] \_\_ of an entity under the following name: \_\_ [exact full name of corporation/limited liability company/limited partnership requesting permission to use similar corporate name] \_\_.

**Date:** \_ \_ \_ \_ \_

\_\_ [NAME OF ENTITY] \_\_,

a \_\_ [specify entity, e.g., California corporation] \_\_

**By:** \_\_ [Signature] \_\_

**Name:** \_\_ [Typed name] \_\_

**Its:** \_\_ [Title] \_\_

*Comment:* This form is used to secure the consent of a corporation to use a corporate name that the Secretary of State has determined to be so closely resembling a prior trade name as to tend to deceive. It may be used when a client is insistent on use of a name that the Secretary of State has rejected. The form can be adapted for other types of business entities, such as limited partnerships and limited liability companies.

If possible, it is prudent to first contact the authorized representatives to gain a preliminary sense of their willingness to consent to the use of the name. Surprisingly, businesses often consent, so long as the proposed business does not conflict with that of the consenting business. Obviously, the larger the consenting business the more likely it is that approval may be withheld or unacceptably time-consuming. Thus, before this process is undertaken, counsel should carefully explain to the client the potential for delay and the lack of assurance of success.

The Secretary of State requires all consents to the use of a similar name be on the letterhead of the consenting business.

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## 4

# Choosing the State of Organization

David M. Serepca

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  - 1. Foreign Corporations §4.2
  - 2. "Quasi-California" Corporations
    - a. Test to Determine "Quasi-California" Corporation §4.3
    - b. Compliance Requirements for "Quasi-California" Corporations §4.4
- B. Considerations for Foreign Corporations Doing Business in California
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    - a. Obtaining Certificate of Qualification §4.6
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**§4.1 I. SCOPE OF CHAPTER**

Clients invariably ask about the advantages of organizing a new entity under the laws of another jurisdiction. For example, many clients believe that organizing in Nevada saves taxes, principally because Nevada imposes no corporate income tax, no franchise tax, and no personal income tax. Other clients believe that organizing in Delaware will facilitate financings, principally because Delaware is the jurisdiction of choice for many publicly traded corporations. Only in a few situations, however, is it advisable to organize a privately held entity under the laws of a state other than California if most of the operations, employees, and owners of the business will be located in California.

The choice of state of organization should be made after careful analysis of the advantages and disadvantages of the entity's obligations to pay California income tax, to qualify to do business in California, and to be governed by California law, even if it is organized under the laws of another jurisdiction. This chapter discusses some of these issues as they are generally applicable to corporations (see §§4.2-4.20), limited partnerships (see §§4.21-4.26), and limited liability companies (see §§4.27-4.34).

## **II. CORPORATIONS**

### **A. Application of California Law to Foreign Corporations**

#### **§4.2 1. Foreign Corporations**

The laws of the state of incorporation generally govern the internal affairs of a foreign corporation transacting business in California. 9 Witkin, *Summary of California Law, Corporations* §239 (10th ed 2005). Under California law, a foreign corporation is any corporation other than one formed under the laws of the State of California (see Corp C §167). Corp C §171. A foreign corporation transacting business in California is subject to the California General Corporation Law, Chapter 21 (Corp C §§2100-2117.1); that chapter generally requires that a foreign corporation qualify with the California Secretary of State and comply with various California corporate laws. See §4.5.

A foreign corporation with a principal executive office in California, or which customarily holds meetings of its board in California, whether or not the corporation is a "quasi-California corporation" (see §4.3), must also comply with the following provisions of the California General Corporation Law (Corp C §§1501(g), 1600(d), and 1602):

- Provisions requiring annual reports and other reports to shareholders (Corp C §1501);
- Provisions permitting inspection of the shareholders' lists (Corp C §1600);
- Provisions concerning the director's right to inspect corporate books and records (Corp C §1602).

In addition, a foreign corporation that keeps accounting books and records and its corporate minutes in California, or which has its principal executive office in California, must permit inspection and copying of those books, records, and minutes by a shareholder or holder of a voting trust certificate, or the holder's agent or attorney, at any reasonable time during normal business hours for a purpose reasonably related to the holder's interest. Corp C §1601.

## 2. "Quasi-California" Corporations

### §4.3 a. Test to Determine "Quasi-California" Corporation

As mentioned in §4.2, the internal affairs of a foreign corporation are generally governed by the laws of its state of incorporation. However, under California law, a foreign corporation may be what is referred to as a "quasi-California" corporation, which means it will be subject to certain enumerated provisions of the California Corporations Code concerning its internal affairs, notwithstanding that it is a foreign corporation. Whether a foreign corporation will be a quasi-California corporation and the consequences of the application of California law to the corporation, therefore, should be considered when choosing whether to incorporate in a foreign jurisdiction a particular entity that will have significant contacts with California.

A foreign corporation will be considered a quasi-California corporation if two tests are satisfied (see Corp C §2115(a)):

(1) The average of the corporation's business factors (*i.e.*, the average of its property factor, payroll factor, and sales factor, as defined under the California Revenue and Taxation Code; see Rev & T C §§25129, 25132, 25134) is more than 50 percent during its latest full income year; *and*

(2) More than half of its outstanding voting securities are held of record by persons having California addresses, as appears on the books of the corporation on the record date for the latest meeting of shareholders held during its latest full income year or, if no meeting was held during that year, on the last day of the latest full income year.

The quasi-California corporation law does not apply to corporations or their wholly owned subsidiaries that have outstanding securities that are listed on the New York Stock Exchange, the NYSE Amex, the NASDAQ Global Market, or the NASDAQ Capital Market. Corp C §2115(c).

The quasi-California corporation law also does not apply to a corporation if all of the corporation's voting shares (other than directors' qualifying shares) are owned directly or indirectly by a corporation or corporations not subject to Corp C §2115(a)-(b). Corp C §2115(c).

**EXAMPLE:** Demical Corporation, a privately held company, has operations in California and Nevada. The average value of all of the corporation's real and tangible personal property owned or rented and used during the last full income year was \$5 million, of which property with an average value of \$3 million was used in California. The total amount of compensation paid by the corporation everywhere during the last full income year was \$700,000, of which \$300,000 was paid in California. The total sales of the corporation everywhere during the last full income year was \$3 million, of which \$2 million was in California. More than 50 percent of its outstanding voting securities are held of record by persons who have California addresses. The tests are applied as follows:

- Property factor: The value of the company's California property is 60 percent of the \$5 million value of the company's total property.
- Payroll factor: The company's payroll in California is 43 percent of the company's \$700,000 total payroll.
- Sales factor: The company's sales in California are 67 percent of the company's \$3 million total sales.
- *Result:* The average of Demical's business factors (*i.e.*, 60 + 43 + 67, divided by three) is 56.67. Because the average of the business factors exceeds 50 percent and more than 50 percent of its outstanding voting securities are held of record by persons who have California addresses, Demical will be considered a quasi-California corporation.

**Source:** Business Law/Selecting and Forming Business Entities/4 Choosing the State of Organization/§4.4 b. Compliance Requirements for 'Quasi-California' Corporations

#### **§4.4 b. Compliance Requirements for "Quasi-California" Corporations**

A foreign corporation that is a quasi-California corporation must comply with certain provisions of the California General Corporation Law. Generally, it must start complying with these provisions on the first day of its first income year that begins on or after the 135th day of the income year immediately following the last income year for which the quasi-California corporation tests were met (*i.e.*, generally the second income year after the year in which the applicable tests were met). Corp C §2115(d). This is true regardless of any conflicts with the general corporation law of the state of its incorporation.

**PRACTICE TIP:** Since most new entities remain privately held for more than 2 income years, when organizing a new entity under the laws of a foreign jurisdiction, counsel should analyze whether the quasi-California corporation tests of Corp C §2115(a)(1)-(2) are likely to be met at the time of incorporation or in the foreseeable future and, if so, counsel should expect and prepare to meet the substantive requirements of California law that will be applicable under Corp C §2115(b).

The provisions of the California General Corporation Law with which a quasi-California corporation must comply, and which may be applicable its shareholders, are as follows (Corp C §2115(b)):

- General provisions and definitions to the extent applicable (Corp C §§100-195);
- Annual election of directors (Corp C §301);
- Removal of directors and filling of director vacancies (Corp C §§303-304, 305(c));
- Directors' standard of care (Corp C §309);
- Liability of directors for unlawful distributions, with limited exceptions (Corp C §316);
- Indemnification of directors, officers, and others (Corp C §317);
- Limitations on corporate distributions in cash or property (Corp C §§500-505);
- Liability of shareholders for unlawful distributions (Corp C §506);
- Annual shareholders' meeting (Corp C §600(b)-(c));
- Shareholders' right to cumulate votes at any election of directors (Corp C §708(a)-(c));
- Supermajority vote requirement (Corp C §710);
- Limitations on sales of assets, mergers, conversions, and reorganizations (Corp C §§1001(d), 1101(e), 1151-1152, 1200-1203);
- Dissenters' rights (Corp C §§1300-1313);
- Records and reports (Corp C §§1500-1501);
- Action by the Attorney General (Corp C §1508); and
- Rights of inspection (Corp C §§1600-1605).

For a discussion of the application of some of these provisions, see §4.15.

Counsel should be aware that a foreign corporation must advise any shareholder, officer, director, employee, other agent, or creditor of the corporation in writing that the corporation is subject to Corp C §2115(b) within 30 days of receipt of written request for that information. Corp C §2115(f).

Counsel should further be aware that, although it is not binding on California courts, the Delaware Supreme Court has held that the quasi-California corporation statute is not consistent with the internal affairs doctrine and the commerce clause of the United States Constitution. See *VantagePoint Venture Partners 1996 v Examen, Inc.* (Del 2005) 871 A2d 1108; but see *Wilson v Louisiana-Pacific Resources, Inc.* (1982) 138 CA3d 216, 187 CR 852.

## **B. Considerations for Foreign Corporations Doing Business in California**

### **§4.5 1. Qualification Requirement**

A corporation that has not been incorporated in California and that intends to transact business in California must first qualify to do business in California as a foreign corporation by obtaining a certificate of qualification. See §4.6.

"Transacting business" is defined as "entering into repeated and successive transactions of its business in this state, other than interstate or foreign commerce." Corp C §191(a). "Safe harbor" activities that a foreign corporation may conduct without being considered to be transacting business include the following (Corp C §191(c)(1)-(8)):

- Maintaining or defending any action or suit or administrative or arbitration proceeding, or settling such an action or proceeding, or settling claims or disputes generally;
- Holding board of directors' and shareholders' meetings;
- Maintaining bank accounts;
- Maintaining offices or agencies to transfer, exchange, or register securities or depositaries relating to its securities;
- Effecting sales through independent contractors;
- Soliciting or procuring orders when the orders require acceptance outside the state before becoming binding contracts;
- Creating evidences of debt or encumbrances on real or personal property; and
- Engaging in an isolated transaction completed within a period of 180 days.

In addition, a foreign corporation is not considered to be transacting business in California merely because of its status as one of the following (Corp C §191(b)):

- A shareholder of a domestic corporation or a foreign corporation transacting intrastate business;
- A limited partner of a domestic limited partnership or a foreign limited partnership transacting intrastate business; or
- A member or manager of a domestic limited liability company or a foreign limited liability company transacting intrastate business.

**NOTE:** Similar exceptions apply to foreign limited partnerships and limited liability companies. See §§4.22, 4.29.

Finally, a foreign corporation is not considered to be transacting business in California merely because its subsidiary is doing so. Corp C §191(b).

**Source:** Business Law/Selecting and Forming Business Entities/4 Choosing the State of Organization/§4.6 a. Obtaining Certificate of Qualification

#### **§4.6 a. Obtaining Certificate of Qualification**

Before transacting business, a foreign corporation must first obtain a Certificate of Qualification from the California Secretary of State. To obtain a certificate, the foreign corporation must file the Secretary of State form, Statement and Designation by Foreign Corporation. See form for a foreign stock corporation in §4.35. The form must be signed by a corporate officer, and must include the following (Corp C §2105(a)(1)-(5)):

- The name and state of incorporation or organization;
- The address of the corporation's principal executive office;
- The address of its principal California office, if any;
- A designated agent for service of process, either a natural person who has a business address or residence street address in California (see Corp C §1502(b)), or a corporate agent; and
- The corporation's irrevocable consent to service of process on the Secretary of State under certain circumstances.

The form must be submitted along with a certificate from the corporation's state of organization indicating that the corporation exists and is in good standing (Corp C §2105(b)), and a filing fee of \$100 (Govt C §12186(f)). A special handling fee of \$15 is charged for a statement filed over the counter rather than by mail (2 Cal Code Regs §21903(b)).

For more detailed discussion of the qualification requirements, see Organizing Corporations in California, chap 5 (3d ed Cal CEB 2001).

**Source:** Business Law/Selecting and Forming Business Entities/4 Choosing the State of Organization/ b. Foreign Corporations That Fail to Qualify/§4.7 (1) Voidability of Contracts

**b. Foreign Corporations That Fail to Qualify**

**§4.7 (1) Voidability of Contracts**

A party to a contract with a foreign corporation that fails to qualify to do business or to file a tax return may bring a lawsuit to declare the contract void. Rev & T C §§23304.1(b), 23304.5. As a result, the foreign corporation may be precluded from enforcing its contracts. See *White Dragon Prods. v Performance Guar.* (1987) 196 CA3d 163, 241 CR 745. The foreign corporation must, however, be given an opportunity to cure the voidability of its contracts (*i.e.*, file tax returns and pay all taxes). Rev & T C §23305.

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**Source:** Business Law/Selecting and Forming Business Entities/4 Choosing the State of Organization/§4.8 (2) Loss of Right to Sue

#### **§4.8 (2) Loss of Right to Sue**

A foreign corporation that fails to qualify may not maintain an action or proceeding in a California state court on any business transacted in California. Such a corporation may maintain an action only when it has paid a penalty of \$250, in addition to the fees due for filing the statement and designation required by Corp C §2105 and all past-due franchise and other taxes. Corp C §2203(c). Even though it may be unable to defend itself, the corporation is considered to consent to the jurisdiction of California courts in any civil action in which it is named as a party defendant. Corp C §2203(a).

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**Source:** Business Law/Selecting and Forming Business Entities/4 Choosing the State of Organization/§4.9 (3) Monetary Penalties

#### **§4.9 (3) Monetary Penalties**

A foreign corporation that fails to qualify may be subject to a number of fines, including

- \$20 for each day unauthorized intrastate business is transacted (Corp C §2203(a)); and
- A misdemeanor punishable by a fine of \$500 to \$1000 (Corp C §2258).

Agents of an unqualified foreign corporation may be subject to a misdemeanor charge punishable by a fine of \$50 to \$600. Corp C §2259.

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**Source:** Business Law/Selecting and Forming Business Entities/4 Choosing the State of Organization/§4.10 c. Annual Statement by Foreign Corporation

#### **§4.10 c. Annual Statement by Foreign Corporation**

Once qualified, the foreign corporation must annually file a Statement of Information (Foreign Corporation) (see §4.36) containing the following (Corp C §2117(a)-(b)):

- The names and addresses of its chief executive officer, secretary, and chief financial officer;
- The street address of its principal executive office;
- The mailing address of the corporation, if different from the street address of its principal executive office;
- The street address of its principal business office in California, if any;
- A statement of the general type of business that constitutes the principal business activity of the corporation; and
- A designated agent for service of process, either a natural person (with a California business or residence street address) or a corporate agent.

For more detailed discussion of the qualification requirements, see Organizing Corporations in California, chap 5 (3d ed Cal CEB 2001).

**Source:** Business Law/Selecting and Forming Business Entities/4 Choosing the State of Organization/§4.11 2. Obligation to Pay California Tax

## **§4.11 2. Obligation to Pay California Tax**

California generally applies its franchise tax to all nonfinancial corporations "doing business" within the state, regardless of whether the corporation is a California or foreign corporation. See Rev & T C §23151(a). Accordingly, incorporating in Nevada may not permit avoidance of California franchise tax. Under the unitary method of taxation, if a corporation doing business in California is a part of a single, unitary business among affiliated entities, including corporations operating wholly outside California or the United States, a portion of the total unitary business income of the corporation and affiliates (its worldwide income) is apportioned to California and becomes subject to the franchise tax. See Rev & T C §§25101-25141.

The United States Constitution requires a relationship (*i.e.*, a "nexus") between the taxing state and the business. *Wisconsin Dep't of Revenue v Wrigley Co.* (1992) 505 US 214, 120 L Ed 2d 174, 112 S Ct 2447. The nexus in California is broadly defined to exist when a company is "actively engaging in any transaction for the purpose of financial or pecuniary gain or profit." Rev & T C §23101(a).

In addition, for taxable years beginning on or after January 1, 2011, a foreign corporation taxpayer is "doing business" in California for a taxable year if any of four specific conditions has been satisfied (Rev & T C §23101(b)):

- (1) The taxpayer is commercially domiciled in California. See Rev & T C §25120(b).
- (2) Sales in California exceed the lesser of \$500,000 or 25 percent of total sales. See also Rev & T C §§25135-25137 and related regulations.
- (3) Real property and tangible personal property in California exceed the lesser of \$50,000 or 25 percent of total real property and tangible personal property. See also Rev & T C §§25129-25131 and 25137, and related regulations.
- (4) The amount paid in California for compensation exceeds the lesser of \$50,000 or 25 percent of the total compensation paid by the taxpayer. See also Rev & T C §§25120(c), 25133, and 25137, and related regulations.

The California Franchise Tax Board is required to revise the amounts specified in Rev & T C §23101(b)(2)-(4) annually. Rev & T C §23101(c)(1).

**NOTE:** A corporation is still subject to the California corporation income tax if it generates "net income derived from sources within this state" (Rev & T C §23501(a)), but is otherwise not sufficiently doing business in California to subject it to the franchise tax.

**Source:** Business Law/Selecting and Forming Business Entities/4 Choosing the State of Organization/§4.12 a. Apportionment by Three-Factor Formula

#### §4.12 a. Apportionment by Three-Factor Formula

The business income of an interstate unitary business is apportioned by California using a three-factor formula based on property, payroll, and sales. Rev & T C §25128. The purpose of the apportionment formula is to arrive at an average percentage that is applied to the total unitary business income to determine the portion of worldwide income taxable in California.

The first step is to determine each of the factors for the year as follows:

- The property factor is determined on the basis of all real and tangible personal property owned or rented by the taxpayer and used during the income year in the regular course of the taxpayer's trade or business. Rev & T C §25129. Property owned by the taxpayer is valued at original cost. Rev & T C §25130. Property rented is valued at eight times the net annual rent. Rev & T C §25130.
- The payroll factor is determined on the basis of all compensation paid to employees for services. Rev & T C §25132.
- The sales factor consists of all sales of tangible personal property. See Rev & T C §25134.

For each factor, the amount within California is divided by the total within and outside California to determine the factor's California fraction (the sales factor generally having twice the weight of the property and payroll factors). Rev & T C §25128(a). The formula is then expressed as follows:

$$\frac{[A + B + (2 \times C)]}{4} = \text{Fraction apportioned to California}$$

When:

A = Value of California property divided by value of total property

B = Payroll in California divided by total payroll

C = Sales in California divided by total sales

**EXAMPLE:** Under the same facts as those in the example in §4.3, if Demical Corporation has worldwide income of \$3 million, the three-factor method of allocation would be applied as follows:

$$[60 + 43 + (2 \times 67)] / 4 = 59.25$$

As a result, 59.25 percent of Demical's taxable income (*i.e.*, \$1,777,500) would be apportioned to California.

**NOTE:** An apportioning trade or business (other than one that derives more than 50 percent of its gross business receipts from conducting one or more specific "qualified" business activities) may now make an irrevocable annual election to apportion income with a single sales factor formula. For taxable years beginning on or after January 1, 2011, a qualifying and properly electing taxpayer may multiply business income only by the sales factor. Rev & T C §25128.5.

**Source:** Business Law/Selecting and Forming Business Entities/4 Choosing the State of Organization/§4.13 b. Relief From Tax Liability

#### **§4.13            b. Relief From Tax Liability**

Public Law 86-272, 73 Stat 555 (15 USC §§381-384) provides relief to businesses whose activities are limited to soliciting orders in another jurisdiction. Public Law 86-272 applies if (15 USC §381):

- The only business activity in California is "solicitation of orders... for sales of tangible personal property";
- The orders are approved outside California;
- The orders are filled by shipment from a point outside California; and
- The foreign corporation maintains no physical place of business in California.

Few California cases have analyzed Pub L 86-272. But see *Consolidated Accessories Corp. v Franchise Tax Bd.* (1984) 161 CA3d 1036, 208 CR 74 (Pub L 86-272 not applicable to goods sold on consignment).

**PRACTICE TIP:** Counsel should be mindful that Pub L 86-272, by virtue of the fact that it only applies to income from sales of tangible personal property, does not protect California source income derived from leasing, renting, licensing, or disposition of real property, or transactions involving intangibles, such as franchises, patents, copyrights, trademarks, service marks, and other intellectual property.

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**Source:** Business Law/Selecting and Forming Business Entities/4 Choosing the State of Organization/§4.14 c. Tax Liability in Foreign State of Organization

#### **§4.14 c. Tax Liability in Foreign State of Organization**

In addition to the obligation to pay a franchise or corporate tax to the State of California, a foreign corporation doing business in or deriving net income from California may also have to pay a franchise tax to the other state in which it is organized, even if it is not doing business there. Some states encourage the organization of corporations that will do business elsewhere by reducing or eliminating the franchise tax liability for corporations engaged in minimal activity in the state of incorporation.

Corporations that incorporate in California are not subject to the \$800 minimum franchise tax for the corporation's first taxable year. Rev & T C §23153(f)(1). As a result, California is probably one of the less expensive states in which to incorporate a small business.

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**Source:** Business Law/Selecting and Forming Business Entities/4 Choosing the State of Organization/§4.15 3. Laws Applicable to Internal Affairs

### **§4.15 3. Laws Applicable to Internal Affairs**

The choice of where to incorporate often has far-reaching implications with respect to the rights and responsibilities of corporate officers, directors, shareholders, and creditors because of the variation in laws from state to state. Organizing a corporation that has significant contacts with California in another jurisdiction to empower and protect management and directors and limit shareholder rights may not be advisable if these objectives are outweighed by the additional franchise tax imposed, the additional corporate compliance burden, and the continuing application of certain California laws providing for information and inspection rights (see §4.2) and those governing internal affairs (see §4.4).

Many practitioners and businesses favor incorporation in Delaware because of its liberal, pro-management and pro-director corporation statutes and its extensive body of case law on corporate issues. If California's quasi-California corporation rules apply, however (see §4.3), the additional limitations and burdens imposed on corporate governance by Corp C §2115 may offset many of the objectives of incorporating in Delaware. Sections 4.16-4.19 discuss some of the provisions of California law that apply to the internal affairs of a quasi-California corporation, which may not be modified by the corporation's charter.

**NOTE:** If a California-based business intends to go public at some point, it may be fine initially to incorporate in California, because underwriters often insist that California corporations reincorporate in Delaware in connection with an initial public offering. See Bonenfant, *The Initial Public Offering Process, Part I: Considerations for Your Client*, 9 CEB Cal Bus L Prac 162 (Fall 1995).

**Source:** Business Law/Selecting and Forming Business Entities/4 Choosing the State of Organization/§4.16 a. Restrictions on Limitation of Directors' Personal Liability for Breach of Fiduciary Duty and Indemnification

#### **§4.16 a. Restrictions on Limitation of Directors' Personal Liability for Breach of Fiduciary Duty and Indemnification**

Directors must perform their duties with the care that an ordinarily prudent person in a like position would exercise. Corp C §309(a). Failure to do so exposes directors to claims of negligent mismanagement. Under California law, however, the personal liability of directors may be limited or eliminated in a corporation's articles of incorporation (Corp C §309(c)), subject to the specific exceptions set forth in Corp C §204(a)(10), which prohibits the articles from limiting or eliminating personal liability of directors for the following generally described acts:

- Intentional misconduct;
- Bad faith or breach of the duty of loyalty;
- Any transaction in which the director derived improper personal benefit;
- Reckless disregard of duty;
- Abdication of duty;
- Liability associated with transactions involving interested directors under Corp C §310; or
- Unlawful distributions under Corp C §316.

Under California law, directors may not be indemnified for these liabilities. See Corp C §317. However, a corporation may indemnify an agent (defined to include directors) in a civil action that is not by or in the right of the corporation if the agent acted in good faith and in a manner that the agent reasonably believed to be in the best interests of the corporation. Corp C §317(b). California corporations may also indemnify an agent for expenses incurred in a derivative action if the agent acted in good faith (in a manner that the agent believed to be in the best interests of the corporation and its shareholders). Corp C §317(c). For further discussion of indemnification, consult Counseling California Corporations, chap 2 (3d ed Cal CEB 2008).

Other states may provide lower standards of care and more narrow exceptions to limitation of personal liability for corporate directors. Examples under Delaware law include the following:

- Breach of the duty of care is the performance of duties with gross negligence (rather than negligent mismanagement, as under California law) and due care in the decision-making context is "process due care" only (rather than substantive due care) (*Brehm v Eisner* (Del 2000) 746 A2d 244, 259, 264);
- A Delaware corporation may insulate directors for anything less than intentional misconduct or bad faith; and
- Under 8 Del Code Ann §102(b)(7) (which is similar but not as broad as Corp C §204(a)(10)), a Delaware corporation may include in its charter a waiver of liability, which provides that the corporation's directors are not personally liable to the corporation or its stockholders for monetary damages except for breach of loyalty, for acts that are not in good faith or involve intentional misconduct, for unlawful dividends or stock repurchases, and for transactions from which the director derived an improper personal benefit.

Under Delaware law, a corporation may indemnify an agent if the agent's actions were reasonably believed to be in *or not opposed to* the best interests of the corporation. 8 Del Code Ann §145(a), (b). However, in a derivative action, no indemnification may be made in respect to any claim, issue, or matter to which the agent is adjudged liable to the corporation unless and only to the extent that the Court of Chancery (or the court in which the action or suit was brought) determines on application that, despite the adjudication of liability but in view of all the circumstances of the case, the agent is fairly and reasonably entitled to indemnity for expenses that the court deems proper. 8 Del Code Ann §145(b).

For a privately held foreign corporation that is considered a quasi-California corporation (see §4.3), however, (1) the higher California standard of care and broader exceptions to limitations of directors' personal liability apply, and (2) the California limitations on indemnification of directors for breach of fiduciary duty apply. Corp C §2115(b). Accordingly, a private company that will be deemed a quasi-California corporation should not incorporate in another jurisdiction in an attempt to obtain the standard of care or scope of indemnification applicable to directors by the other jurisdiction or to obtain limitations permitted by that other jurisdiction on directors' personal liability, because California standards will

apply to a claim of breach of fiduciary duty and/or for indemnity brought in California.

**NOTE:** In a case with important ramifications for choosing the state of organization of a start-up company, the California Court of Appeal has held (1) there is no fiduciary duty under California law owed to creditors by directors of a corporation solely by virtue of its operating in the "zone" or "vicinity" of insolvency; (2) there is no broad, paramount fiduciary duty of care or loyalty that the directors of an insolvent corporation owe to creditors solely because of a state of insolvency; (3) the scope of any extra-contractual duty owed by corporate directors to the insolvent corporation's creditors is limited in California, consistent with the trust fund doctrine, to the avoidance of actions that "divert, dissipate, or unduly risk corporate assets that might otherwise be used to pay creditors' claims," such as where there is self-dealing or the preferential treatment of creditors; and (4) even if a claim for breach of such fiduciary duty to creditors can be pleaded, directors are presumed to be immune from liability under the business judgment rule. *Berg & Berg Enters. v Boyle* (2009) 178 CA4th 1020, 100 CR3d 875. See also *Credit Lyonnais Bank Nederland, N.V. v Pathe Communications Corp.* (Del Ch, Dec. 30, 1991, No. 12150) 1991 Del Ch Lexis 215, \*108 n5, and its progeny, pursuant to which Delaware law may provide a higher standard of care to creditors when a Delaware corporation is in the "zone of insolvency."

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**Source:** Business Law/Selecting and Forming Business Entities/4 Choosing the State of Organization/§4.17 b. Shareholder Protections Concerning Removal of Directors

#### **§4.17            b. Shareholder Protections Concerning Removal of Directors**

Under California corporate law, any director may be removed with or without cause (see Corp C §§302-303) before expiration of the director's term in office. A director may be removed without cause if approved by the shareholders holding outstanding shares (see Corp C §152), subject to the following generally described limitations:

- Effect of hypothetical cumulative voting (Corp C §303(a)(1));
- Application of class or series voting requirements (Corp C §303(a)(2)); and
- Classified board restrictions (Corp C §303(a)(3)).

Further, holders of at least 10 percent of the number of outstanding shares of any class may bring suit to remove a director for fraudulent or dishonest acts or gross abuse of authority or discretion. Corp C §304.

In other states the rights of shareholders to remove directors is or may be more limited. For example, while Delaware allows any director or the entire board of a Delaware corporation to be removed with or without cause generally by holders of a majority of shares, the exceptions are more limited:

- For cumulative voting restrictions to apply, a Delaware corporation must have elected cumulative voting in its certificate of incorporation (see 8 Del Code Ann §214).
- A Delaware corporation with a classified board may generally effect removal only for cause (see 8 Del Code Ann §141(k)(1)).

For similar limitations on Nevada corporations, see Nev Rev Stat §78.335.

For a privately held foreign corporation that is considered a quasi-California corporation (see §4.3), the California shareholder protections concerning removal of directors without cause and removal by court proceedings will apply. Corp C §2115(b). Accordingly, a private company that will be deemed a quasi-California corporation should not incorporate in another jurisdiction in an attempt to limit shareholder protections concerning the removal of directors without cause and by court proceedings, because California standards will apply in an action to contest removal brought in California.

**Source:** Business Law/Selecting and Forming Business Entities/4 Choosing the State of Organization/§4.18 c. Prohibition Against Privately Held Corporations Having Classified Boards

**§4.18 c. Prohibition Against Privately Held Corporations Having Classified Boards**

In California, the directors of a privately held corporation must be elected at each annual meeting to hold office until the next annual meeting; a classified board of directors is not permitted. Corp C §301(a); see Corp C §301.5. Other states, such as Delaware, allow for a classified board election by any corporation. See 8 Del Code Ann §141(d).

However, for a privately held foreign corporation considered a quasi-California corporation (see §4.3), the California prohibition against classified boards applies. Corp C §2115(b). Accordingly, a private company that will be deemed a quasi-California corporation should not incorporate in another jurisdiction in order to attempt to authorize a classified board, because California law will apply and prohibit the use of a classified board.

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**Source:** Business Law/Selecting and Forming Business Entities/4 Choosing the State of Organization/§4.19 d. Cumulative Voting

**§4.19 d. Cumulative Voting**

California grants shareholders the right to cumulate votes at any election of directors. Corp C §708(a). While this right may be eliminated by a publicly traded corporation (see Corp C §301.5(a)), it may not be eliminated by a privately held corporation. Other states, e.g., Delaware, require cumulative voting to be elected in the charter. See 8 Del Code Ann §214.

However, for a privately held foreign corporation that is deemed a quasi-California corporation (see §4.3), the California protection for shareholders to elect directors using cumulative voting applies to the exclusion of the law of the jurisdiction in which the foreign corporation incorporated. Corp C §2115(b); see *Wilson v Louisiana-Pacific Resources, Inc.* (1982) 138 CA3d 216, 187 CR 852. Thus, a private company that will be deemed a quasi-California corporation should not incorporate in another jurisdiction merely to attempt to avoid cumulative voting rights of shareholders, because California law will apply.

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**Source:** Business Law/Selecting and Forming Business Entities/4 Choosing the State of Organization/§4.19A e. Voting in Mergers and Sales

#### **§4.19A e. Voting in Mergers and Sales**

California law generally requires separate class voting in acquisitions structured as mergers and asset sales that constitute reorganizations (in general, transactions in which stock of the acquiring party or acquiring parent party is used as consideration). Corp C §§181, 1201(a). Similarly, California law generally affords dissenters' rights to target corporation shareholders in reorganization transactions that are not unanimously approved, including reorganizations structured as asset sales in exchange in whole or in part for stock. Corp C §181(c), 1201(a), 1301(a). Other states do not necessarily provide for these rights. However, for a privately held foreign corporation that is deemed a quasi-California corporation (see §4.3), the California voting and dissenters' rights requirements will apply. Corp C §2115(b); see *Wilson v Louisiana-Pacific Resources, Inc.* (1982) 138 CA3d 216, 187 CR 852.

**NOTE:** A private company that will be deemed a quasi-California corporation should not incorporate in another jurisdiction in order to attempt to avoid class voting in a sale of the company or to avoid dissenters' rights in asset-for-stock sales, because California law will apply.

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#### **§4.20 4. Other Considerations**

Despite the discussion in §§4.15-4.19 concerning California law that may be applicable to foreign corporations deemed to be quasi-California corporations, some provisions of law governing the internal affairs of a foreign corporation will not be contradicted by California law governing quasi-California corporations. Among them are the following two.

**Changing number of directors.** After the issuance of shares, only the approval of the outstanding shares will permit adoption of a bylaw specifying or changing a fixed number of directors of a California corporation, or changing the maximum or minimum number of directors of a variable board (although the exact number of directors of a variable board may be fixed by the board in the manner provided in the bylaws), or changing from a fixed to a variable board or vice versa. Corp C §212(a). Further, a bylaw reducing the number of directors of a California corporation to less than five cannot be adopted if votes cast against adoption are more than or equal to 16  $\frac{2}{3}$  percent of the outstanding shares entitled to vote. Corp C §212(a).

In other states, such as Delaware, directors may generally pass a resolution to change the number of directors without shareholder approval if authorized in the corporation's charter. See 8 Del Code Ann §§109, 141(b).

For a privately held foreign corporation that is deemed a quasi-California corporation (see §4.3), the California protection for shareholders for adoption of certain bylaws concerning the size of the board does *not* apply. See Corp C §2115(b).

**Special shareholder meetings.** Holders of shares of a California corporation entitled to cast at least 10 percent of the votes at a shareholders' meeting have the right to call special shareholder meetings. Corp C §600(d). Other states (e.g., Delaware, Nevada) allow the organization's bylaws to limit the right to call special meetings. For a privately held foreign corporation that is deemed a quasi-California corporation (see §4.3), the California protection for 10-percent shareholders to call special meetings does *not* apply. See Corp C §2115(b).

**Source:** Business Law/Selecting and Forming Business Entities/4 Choosing the State of Organization/ III. LIMITED PARTNERSHIPS/§4.21 A. Application of California Law to Foreign Limited Partnerships

### **III. LIMITED PARTNERSHIPS**

#### **§4.21 A. Application of California Law to Foreign Limited Partnerships**

A foreign limited partnership transacting intrastate business in California is regulated by Corp C §§15909.01-15909.08.

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## **B. Considerations for Foreign Limited Partnerships Doing Business in California**

### **§4.22 1. Registration Requirement**

A foreign limited partnership that is transacting intrastate business in California must register to do business as a foreign limited partnership by obtaining a Certificate of Registration from the Secretary of State. Corp C §15909.02. See §4.23.

To "transact intrastate business" means to enter into repeated and successive transactions of business in California other than interstate or foreign commerce. Corp C §15901.02(ai)(1). A foreign limited partnership is *not* considered to be transacting intrastate business merely because of its status as one of the following (Corp C §15901.02(ai)(2)):

- A shareholder of a domestic corporation or a foreign corporation transacting intrastate business;
- A limited partner of a domestic limited partnership or a foreign limited partnership transacting intrastate business; or
- A member or manager of a domestic limited liability company or a foreign limited liability company transacting intrastate business.

Corporations Code §15901.02(ai)(3) lists activities that a foreign limited partnership may conduct without being considered to be transacting business. These "safe-harbor" activities include:

- Maintaining or defending any action or suit or administrative or arbitration proceeding, or settling such an action or proceeding, or settling claims or disputes generally;
- Holding meetings of partners or carrying on other activities concerning the partnership's internal affairs;
- Maintaining bank accounts;
- Maintaining offices or agencies to transfer, exchange, or register securities or depositaries relating to its securities;
- Effecting sales through independent contractors;
- Soliciting or procuring orders, by mail or through employees or agents or otherwise, when the orders require acceptance outside the state before becoming binding contracts;
- Creating or acquiring evidences of debt or encumbrances on real or personal property;
- Securing or collecting debts or enforcing mortgages and security interests in property securing the debts;
- Engaging in an isolated transaction completed within a period of 180 days; and
- Transacting business in interstate commerce.

**Source:** Business Law/Selecting and Forming Business Entities/4 Choosing the State of Organization/§4.23 a. Obtaining Certificate of Registration

#### **§4.23 a. Obtaining Certificate of Registration**

Before transacting business in California, a foreign limited partnership must first obtain a Certificate of Registration from the Secretary of State. To obtain a certificate, the foreign limited partnership must file an Application for Registration (Secretary of State Form LP-5). See form in §6.40. The form must be signed by a general partner and include the following information (Corp C §15909.02):

- The name, and state and date of formation;
- A designated agent for service of process, either a natural person (with a California business or residence street address) or a corporate agent;
- The address of the principal executive office and the address of its principal office in this state, if any;
- The names and business or residence addresses of the general partners; and
- Whether the foreign limited partnership is a foreign limited liability limited partnership.

The application must be submitted with a \$70 registration fee. Govt C §12188(c).

**Source:** Business Law/Selecting and Forming Business Entities/4 Choosing the State of Organization/§4.24 b. Foreign Limited Partnerships That Fail to Register

**§4.24            b. Foreign Limited Partnerships That Fail to Register**

A foreign limited partnership that transacts intrastate business in California without a Certificate of Registration is subject to a penalty of \$20 for each day unauthorized business is transacted, up to a maximum of \$10,000. Corp C §15909.07(c). Failure to register does not, however, impair the validity of any contract or act of the foreign limited partnership, nor does it prevent the partnership from defending any action in California. Corp C §15909.07(d).

**NOTE:** A limited partner of a foreign limited partnership does not become liable as a general partner solely because the partnership has transacted intrastate business in California without registering. Corp C §15909.07(e).

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**Source:** Business Law/Selecting and Forming Business Entities/4 Choosing the State of Organization/§4.25 2. Obligation to Pay California Tax

## **§4.25            2. Obligation to Pay California Tax**

Partnerships are "pass-through" entities. Each partner's distributive share of profits and losses is reported on his or her individual tax return. See §6.5.

California subjects limited partnerships (including foreign limited partnerships) to an annual tax of \$800 for the privilege of doing business in California. Rev & T C §§17935, 23153(d)(1). Thus, the organization of a limited partnership in another jurisdiction may create tax obligations to both California and the state of organization.

Further, California's unitary tax method of apportioning a corporation's worldwide income is also applied to income from partnerships. If the activities of a corporation and a partnership constitute a unitary business, the apportionment factors of the corporate partner include its pro rata share of the partnership's property, payroll, and sales.

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**Source:** Business Law/Selecting and Forming Business Entities/4 Choosing the State of Organization/§4.26 3. Laws Applicable to Internal Affairs

### **§4.26 3. Laws Applicable to Internal Affairs**

The laws of the state or country under which a foreign limited partnership is organized govern its organization, internal affairs, and the liability of its limited partners. Corp C §15909.01. Generally, the difference in state law turns on whether the state adopted the Revised Uniform Limited Partnership Act promulgated by the National Conference of Commissioners on Uniform State Laws (NCCUSL). California has adopted a revised version of the Act. See Uniform Limited Partnership Act of 2008 (Re-RULPA) (Corp C §§15900-15912.07).

Under California law, limited partners are afforded many of the same rights available to corporate shareholders. Factors that may vary from state to state include:

- The breadth of activities that a limited partner may undertake without incurring liabilities as general partner.
- The ability of the general partners to continue partnership operations on events of termination.
- Limitations on the return of capital contributions.

Counsel organizing in another jurisdiction a limited partnership that has a significant percentage of California limited partners and is transacting intrastate business in California, or plans to do so, should weigh the value of the anticipated benefits of the applicable laws of the foreign jurisdiction that will govern internal affairs against the burdens of the applicable California laws that will provide information and inspection rights and require regulatory compliance.

**Source:** Business Law/Selecting and Forming Business Entities/4 Choosing the State of Organization/§4.27 IV.  
LIMITED LIABILITY COMPANIES

#### **§4.27 IV. LIMITED LIABILITY COMPANIES**

A foreign limited liability company (LLC) is defined as either (Corp Code §17001(q)):

- An entity formed under the limited liability company laws of any state other than California; or
- An entity organized under the laws of any foreign country that is:
  - An unincorporated association;
  - Organized under a statute pursuant to which an association may be formed that affords each of its members limited liability with respect to the liabilities of the entity; and
  - Not a corporation, partnership, or business trust.

For information on operating a foreign LLC in California, see *Forming and Operating California Limited Liability Companies*, chap 14 (2d ed Cal CEB 2007).

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**Source:** Business Law/Selecting and Forming Business Entities/4 Choosing the State of Organization/§4.28 A. Application of California Law

#### **§4.28 A. Application of California Law**

A foreign LLC transacting intrastate business in California is regulated by Corp C §§17450-17457. None of those provisions may be varied in the LLC's articles of organization or operating agreement, except to the extent expressly provided in the Beverly-Killea Limited Liability Company Act (Corp C §§17000-17656). Corp C §17005(c).

The laws of the state or foreign country of organization generally govern the internal affairs of a foreign LLC transacting business in California. Corp C §17450(a). One exception, however, is that California residents who are members of a foreign LLC are entitled to the same information and inspection rights that inure to members of a California LLC under Corp C §17106, if at least 25 percent of the voting interests of the foreign LLC are held by California residents. Corp C §17453.

Because the rights given to California shareholders are more extensive than those given to California members of foreign LLCs, it may occasionally be worthwhile to use a foreign LLC rather than a corporation for the sole purpose of limiting the rights of the equity owners, *e.g.*, rights accruing under the quasi-California corporation statute (see §4.3). However, if the company can qualify for an IRC subchapter S election, and the benefits of minimizing taxation outweigh the potential burdens of shareholders' rights, then it may be more worthwhile to use a foreign corporation, because such corporations are not subject to the additional California revenue tax imposed on LLCs (see §4.33). Furthermore, use of a close corporation election (see §8.4) and shareholders' agreement (see §§9.36-9.51) can obviate the need for many of the corporate formalities that are traditionally cited as reasons to choose a limited liability company. See Corp C §§158, 186, 300(b).

## **B. Considerations for Foreign LLCs Doing Business in California**

### **§4.29 1. Registration Requirement**

An LLC that has not been formed in California and that intends to transact intrastate business in California must first register to do business in California as a foreign LLC. Corp C §17451(a). See §4.30. The phrase "transact intrastate business" is defined to mean "to enter into repeated and successive transactions of business in [California], other than in interstate or foreign commerce." Corp C §17001(ap).

A foreign LLC is *not* considered to be transacting intrastate business merely because of its status as (Corp C §17001(ap)(1)):

- A shareholder of a domestic corporation or of a foreign corporation transacting intrastate business;
- A limited partner of a domestic limited partnership or of a foreign limited partnership transacting intrastate business; or
- A member or manager of a domestic limited liability company or of a foreign limited liability company transacting intrastate business.

Corporations Code §17001(ap)(2) lists activities that a foreign LLC may conduct without being considered to be transacting business. These "safe-harbor" activities include, but are not limited to, the following:

- Holding meetings of managers or members;
- Maintaining bank accounts;
- Selling through independent contractors;
- Borrowing money;
- Engaging in isolated transactions; and
- Maintaining or defending legal actions.

**Source:** Business Law/Selecting and Forming Business Entities/4 Choosing the State of Organization/§4.30 a. Obtaining Certificate of Registration

#### **§4.30 a. Obtaining Certificate of Registration**

Before transacting business in California, a foreign LLC must first obtain a Certificate of Registration from the Secretary of State. To obtain a certificate, the foreign LLC must file an Application for Registration as Foreign Limited Liability Company (Secretary of State Form LLC-5) (see form in §11.41) signed by an authorized person, which includes the following (Corp C §17451(a)):

- The name, and state and date of organization;
- A statement that the foreign limited liability company is authorized to exercise its powers and privileges in its state of organization;
- A designated agent for service of process, either a natural person (with a California business or residence street address) or a corporate agent;
- A statement that the Secretary of State is appointed the agent of the foreign limited liability company for service of process if the agent has resigned and has not been replaced or if the agent cannot be found or served with the exercise of reasonable diligence;
- The address of its principal executive office; and
- The address of its principal California office, if any.

The Application must be submitted along with a Certificate of Good Standing from the LLC's state of organization and a filing fee of \$70. Govt C §12190(c). For further information, see §11.27. See also Forming and Operating California Limited Liability Companies, chap 14 (2d ed Cal CEB 2007).

**Source:** Business Law/Selecting and Forming Business Entities/4 Choosing the State of Organization/§4.31 b. Foreign LLCs That Fail to Register

**§4.31            b. Foreign LLCs That Fail to Register**

The penalties for failure to register are similar to the provisions that apply to foreign corporations that fail to qualify. Foreign LLCs that fail to register may not maintain any action, suit, or proceeding in any California court. Corp C §17456(a). An LLC that transacts intrastate business in California without registration is subject to a penalty of \$20 per day for each day that the unauthorized business is transacted, up to a maximum of \$10,000. Corp C §17456(b). Members of a foreign LLC do not become liable for its debts and obligations merely because it transacted intrastate business in California without being registered. Corp C §17456(c).

Thus, a foreign LLC's failure to register will not result in the loss of limited liability for members. This result ensures that if registration becomes required because the intrastate activities of an unregistered foreign LLC change or increase, the company's failure to register in a timely fashion will not have any unanticipated catastrophic consequences.

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**Source:** Business Law/Selecting and Forming Business Entities/4 Choosing the State of Organization/§4.32 c. Biennial Statement of Information

**§4.32 c. Biennial Statement of Information**

A foreign LLC qualified in California must file the same biennial Statement of Information that a domestic LLC is required to file. Corp C §17060(a). See §11.33.

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**Source:** Business Law/Selecting and Forming Business Entities/4 Choosing the State of Organization/§4.33 2. Obligation to Pay California Tax

#### **§4.33 2. Obligation to Pay California Tax**

Foreign LLCs are required to pay the same annual \$800 franchise tax and the same annual fees based on total income that are payable by domestic LLCs. Rev & T C §17941. See §11.7. Moreover, the unitary tax method of apportioning a foreign corporation's worldwide income is also applied to foreign LLCs and their affiliated groups. See §4.12.

Further, an LLC is subject to an additional California "fee" on its "total income" (not merely "net income") from all sources "derived from or attributable to this state" under Rev & T C §17942(a).

**NOTE:** Before January 1, 2007, "total income" included income earned in all states and was not apportioned based on the level of the LLC's activity in each state. The lack of apportionment was challenged, and the California Court of Appeal held that the California annual fee paid by LLCs (based on worldwide gross receipts) is unconstitutional under the commerce clause of the United States Constitution when paid by a foreign (non-California) LLC that did not conduct any business in California. *Northwest Energetic Servs., LLC v California Franchise Tax Bd.* (2008) 159 CA4th 841, 71 CR3d 642. In *Northwest*, the court ruled that the annual fee is actually a tax, and all taxes must be apportioned among the various states on a reasonable basis. Because the annual fee is not fairly apportioned to recognize the level of activity within California versus outside of California, the fee/tax is unconstitutional. In a second case, the Court of Appeal held that when a foreign (non-California) LLC conducts business both within and outside of California, the LLC is entitled to a refund not of the entire fee, but an amount apportioned based on the extent of out-of-state business conducted by the LLC. *Ventas Fin. I, LLC v California Franchise Tax Bd.* (2008) 165 CA4th 1207, 81 CR3d 823, cert denied (2009) \_\_\_ US \_\_\_, 173 L Ed 2d 1076, 129 S Ct 1917. On FTB procedures for submitting claims for refunds of previously paid fees, see §11.7.

### **§4.34 3. Laws Applicable to Internal Affairs**

The laws of the state or foreign country under which the foreign LLC is organized govern its organization and internal affairs as well as the liability and authority of its managers and members. Corp C §17450(a). Although the major characteristics of LLCs formed under the laws of other states are similar to LLCs formed under California law, the differences may warrant forming an LLC under the laws of another state, even if it is intended to transact most or all of its business in California, provided that the benefits outweigh the additional franchise tax imposed and the additional compliance burden. Some examples include the following:

**EXAMPLE 1:** Delaware expressly permits members to waive the fiduciary duties that in California are owed by a member-manager to the other members. That waiver option could be preferable for tax-exempt entities for which the assumption of fiduciary duties may jeopardize their tax-exempt status. See 6 Del Code Ann §18-1101(c).

**EXAMPLE 2:** Delaware law allows a single LLC to hold separate assets in separate "series." See 6 Del Code Ann §18-215(a). The principal benefit of the "Delaware Series LLC" is that it insulates the liabilities associated with the assets of any one particular series from the assets held in the other series. See 6 Del Code Ann §18-215(b). This ability to place multiple assets in a single LLC, yet insulate the liabilities associated with each of those assets, eliminates the administrative burden and expense of forming multiple LLCs. California will likely respect a validly formed Delaware Series LLC that qualifies to do business in California. Corporations Code §17450(b) provides that a foreign LLC "may not be denied registration by reason of any difference between those laws and the laws of this state." Series LLCs may not be *formed* in California at this time. However, Delaware series LLCs may be recognized as separate LLCs for California franchise tax purposes. See Rev & T C §17942(b). See also *Forming and Operating California Limited Liability Companies*, chap 15 (2d ed Cal CEB 2007).

Other factors that may vary from state to state include the following:

- Purposes for which an LLC can be lawfully organized;
- The need for a written operating agreement and whether members are required to enter into it;
- Remedies for a member's failure to make required contributions;
- Rights of creditors to require contributions;
- Restrictions on distributions to members;
- Agency powers of members and managers;
- Standards of conduct for members and managers and limitations on liability and rights of indemnification;
- Transfer of membership interests and admission of new members;
- Voting rights of members;
- Rights of withdrawal or resignation; and
- Dissolution and windup procedures.

**Source:** Business Law/Selecting and Forming Business Entities/4 Choosing the State of Organization/ V. FORMS/§4.35  
A. Form: Statement and Designation by Foreign Corporation (Secretary of State Form S&DC-STOCK/NONPROFIT)

**V. FORMS**

**§4.35**      **A. Form: Statement and Designation by Foreign Corporation (Secretary of State Form S&DC-STOCK/NONPROFIT)**



**STATEMENT AND DESIGNATION  
BY FOREIGN CORPORATION**

\_\_\_\_\_  
(Name of Corporation)

\_\_\_\_\_, a corporation organized and existing under the laws of \_\_\_\_\_, makes the following statements and designation:  
(State or Place of Incorporation)

1. The address of its principal executive office is \_\_\_\_\_  
\_\_\_\_\_.
2. The address of its principal office in the State of California is \_\_\_\_\_  
(If none, leave Item 2 blank.)

**DESIGNATION OF AGENT FOR SERVICE OF PROCESS IN THE STATE OF CALIFORNIA**  
(Complete either Item 3 or Item 4.)

3. (Use this paragraph if the process agent is a natural person.)  
\_\_\_\_\_, a natural person residing in the State of California, whose complete street address is \_\_\_\_\_  
\_\_\_\_\_, is designated as agent upon whom process directed to this corporation may be served within the State of California, in the manner provided by law.
4. (Use this paragraph if the process agent is another corporation.)  
\_\_\_\_\_  
\_\_\_\_\_  
a corporation organized and existing under the laws of \_\_\_\_\_, is designated as agent upon whom process directed to this corporation may be served within the State of California, in the manner provided by law.
5. It irrevocably consents to service of process directed to it upon the agent designated above, and to service of process on the Secretary of State of the State of California if the agent so designated or the agent's successor is no longer authorized to act or cannot be found at the address given.

\_\_\_\_\_  
(Signature of Corporate Officer)

\_\_\_\_\_  
(Typed Name and Title of Officer Signing)

*If an individual is designated as the agent for service of process, include the agent's business or residential street address in California (a P.O. Box address is not acceptable). If another corporation is designated as the agent for service of process, do not include the address of the designated corporation. Note: Corporate agents must have complied with California Corporations Code section 1505 prior to designation, and a corporation cannot act as its own agent.*



## Requirements for Qualification of Foreign Nonprofit Corporations

To qualify a foreign (out-of-state or out-of-country) nonprofit corporation to transact intrastate business<sup>1</sup> in the State of California, the foreign corporation must file the enclosed Statement and Designation by Foreign Corporation form with the California Secretary of State. (California Corporations Code section 2105.)

Upon the filing of the Statement and Designation by Foreign Corporation form, a Certificate of Qualification will be issued to the corporation by the California Secretary of State.<sup>2</sup> Note: The Certificate of Qualification is issued only at the time of qualification and will not be reissued if lost or misplaced.

### Additional Requirement

A certificate by an authorized public official of the state or place of incorporation, to the effect that the corporation is an existing corporation in good standing status in that state or place, **must be attached** to the Statement and Designation by Foreign Corporation form at the time of filing. The certificate must also indicate the corporation is a nonstock, nonprofit corporation. Note: A certified copy of the Articles of Incorporation does not meet statutory requirements and cannot be accepted in lieu of the required certificate.

### Where to File

Documents can be delivered in person (drop off) to any office location between the hours of 8:00 a.m. and 4:30 p.m., Monday through Friday (excluding holidays) or mailed to the Sacramento office. The mailing address and office locations are as follows:

Sacramento Office  
Business Entities Section  
1500 11th Street, 3rd Floor  
Sacramento, CA 95814  
(916) 657-5448

Mailing Address  
Document Filing Support Unit  
P.O. Box 944260  
Sacramento, CA 94244-2600

Los Angeles Regional Office  
300 South Spring Street, Room 12513  
Los Angeles, CA 90013  
(213) 897-3062

San Diego Regional Office  
1350 Front Street, Suite 2060  
San Diego, CA 92101  
(619) 525-4113

To facilitate the processing of documents mailed to our Sacramento office, a self-addressed envelope and a letter referencing the corporate name as well as your own name, return address and telephone number should also be submitted. Please refer to our Mail Processing Times webpage at [www.sos.ca.gov/business/be/mail-processing-times.htm](http://www.sos.ca.gov/business/be/mail-processing-times.htm) for current mail processing times.

**Note:** The regional offices are only able to process qualification documents delivered in person (drop off). Please refer to our Regional Offices webpage at [www.sos.ca.gov/business/regional.htm](http://www.sos.ca.gov/business/regional.htm) for detailed information regarding the submission of documents to the regional offices.

<sup>1</sup> California Corporations Code section 191 defines "transacting intrastate business" as "entering into repeated and successive transactions of its business in this state, other than interstate or foreign commerce."

<sup>2</sup> After the foreign corporation has qualified, an Amended Statement by Foreign Corporation form must be filed with the California Secretary of State whenever the name of the corporation is changed in the foreign jurisdiction and whenever the corporation makes a change affecting an assumed name under California Corporations Code section 2106(b). (California Corporations Code section 2107(a).) The Amended Statement by Foreign Corporation form is available on the Secretary of State's website at [www.sos.ca.gov/business/be/forms.htm](http://www.sos.ca.gov/business/be/forms.htm).

## Fees

The fee for filing the Statement and Designation by Foreign Corporation is \$30.00. A \$15.00 special handling fee is applicable for processing documents delivered in person (drop off) to the Sacramento office or to any of the regional offices. The special handling fee is in addition to the filing fee, should be included in a separate check, and will be retained whether the document is filed or rejected. The preclearance and/or expedited filing of a document *within a guaranteed time frame* can be requested in the Sacramento office for an additional fee in lieu of the special handling fee. Please refer to the Secretary of State's website at [www.sos.ca.gov/business/be/preclearance-expedited-services.htm](http://www.sos.ca.gov/business/be/preclearance-expedited-services.htm) for detailed information regarding preclearance and expedited filing services. The special handling fee or preclearance and expedited filings services are not applicable to documents submitted by mail.

Payments for documents submitted:

- by mail to Sacramento can be made by check or money order.
- in person (drop off) at the Sacramento office can be made by check, money order, cash, or credit card (Visa or MasterCard).
- in person (drop off) at a regional office can be made by check, money order, or credit card (Visa or MasterCard). Regional offices are not able to accept cash.

Checks or money orders should be made payable to the Secretary of State.

## Copies

The Secretary of State will certify up to two copies of the filed document without charge, **provided that the copies are submitted to the Secretary of State with the document to be filed.** Any additional copies submitted will be certified with payment of \$8.00 per copy.

## Franchise Tax Requirements

A qualified foreign nonprofit corporation is a taxable entity and subject each year to an **\$800** minimum California franchise tax **unless** the corporation has applied for tax-exempt status and the Franchise Tax Board determines the corporation qualifies for tax-exempt status. Therefore, until such a determination is made, the corporation must file a return and pay the associated tax every year until the corporation formally surrenders its right to transact intrastate business.

**After** filing its Statement and Designation By Foreign Corporation with the Secretary of State, the qualified foreign nonprofit corporation may apply for tax-exempt status in California by mailing an Exemption Application (FTB Form 3500), along with an endorsed copy of the Statement and Designation By Foreign Corporation and all other required supporting documentation, to the Franchise Tax Board, P.O. Box 942857, Sacramento, California 94257-4041. Form 3500 can be accessed from the Franchise Tax Board's website at [www.ftb.ca.gov](http://www.ftb.ca.gov) or can be requested by calling the Franchise Tax Board at (800) 338-0505. For further information regarding franchise tax exemption, refer to the Franchise Tax Board's website or call the Franchise Tax Board at (916) 845-4171. Questions regarding franchise tax requirements must be directed to the Franchise Tax Board.

## Additional Resources

All corporations are subject to state and federal tax laws and may be subject to additional requirements depending on the type of corporation and/or the type of business conducted. Please refer to our Business Resources webpage at [www.sos.ca.gov/business/be/resources.htm](http://www.sos.ca.gov/business/be/resources.htm) for a list of other agencies you may need to contact to ensure proper compliance. **Note: The Secretary of State does not license corporations.** For licensing requirements, please contact the city and/or county where the principal place of business is located and/or the state agency with jurisdiction over the activities of the corporation.

## Requirements for Qualification of Foreign Nonprofit Corporations

### INSTRUCTIONS:

To qualify to transact intrastate business in the State of California the foreign (out-of-state or out-of-country) corporation must file the enclosed Statement and Designation by Foreign Corporation form with the California Secretary of State. The document should be typed with letters in dark contrast to the paper. Documents not suitable for reproduction will be returned unfiled. Note: The file date of the Statement and Designation by Foreign Corporation form is generally the date the document complying with applicable law is received in the Secretary of State's office.

**Additional Requirement:** A certificate by an authorized public official of the state or place of incorporation, to the effect that the corporation is an existing corporation in good standing status in that state or place, **must be attached** to the Statement and Designation by Foreign Corporation form at the time of filing. The certificate must also indicate the corporation is a nonstock, nonprofit corporation. Note: A certified copy of the Articles of Incorporation does not meet statutory requirements and cannot be accepted in lieu of the required certificate.

### Complete the Statement and Designation by Foreign Corporation form as follows:

**Entity Name:** Enter the name of the foreign corporation exactly as it appears on the certificate of good standing.

Note: If the name of the foreign corporation is not available for use in the State of California, the corporation must qualify under an assumed name (i.e., a name other than the true corporate name) as required by California Corporations Code section 2106(b). If an assumed name is required, complete the first line of the form with true corporate name, followed by the words "which will do business in California as (state the assumed name)".

**Jurisdiction:** Enter the jurisdiction (state or place of incorporation) of formation of the foreign corporation.

**Item 1:** Enter the complete address, including the zip code, of the principal executive office of the foreign corporation. Please do not abbreviate the name of the city.

**Item 2:** Enter the complete address, including the zip code, of the principal office in California, if any. Please do not abbreviate the name of the city.

**Item 3:** If an individual is designated as the agent for service of process,<sup>1</sup> complete Item 3 with the name of the agent and the agent's business or residential **street** address in California (a P.O. Box address is not acceptable). Please do not enter "in care of" (c/o) or abbreviate the name of the city. Do not complete Item 4 when the agent is an individual.

**Item 4:** If another corporation is designated as the agent for service of process, complete Item 4 with the name of the corporate agent exactly as it appears on the records of the California Secretary of State.

Note: Before another corporation may be designated as agent, that corporation must have previously filed with the Secretary of State a certificate pursuant to California Corporations Code section 1505. **A corporation cannot act as its own agent** and no domestic or foreign corporation may file pursuant to Section 1505 unless the corporation is currently authorized to engage in business in California and is in good standing on the records of the California Secretary of State. Do not complete Item 3 when the agent is another corporation.

**Item 5:** This exact statement is required by the California Corporations Code and should not be altered.

**Execution:** The Statement and Designation by Foreign Corporation form must be signed by an officer of the foreign corporation.

<sup>1</sup> An "agent for service of process" is an individual (director, officer or any other person, whether or not affiliated with the corporation) who resides in California or another corporation designated to accept service of process if the corporation is sued. Note: The agent must agree to accept service of process on behalf of the corporation prior to designation.

State's website, <http://www.sos.ca.gov/business/corp/pdf/foreign/corp-s&dcgen.pdf>. It may then be printed and mailed or hand-delivered to the Secretary of State's office at any of the addresses indicated in the form instructions.

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**Source:** Business Law/Selecting and Forming Business Entities/4 Choosing the State of Organization/§4.36 B. Form: Statement of Information (Foreign Corporation) (Secretary of State Form SI-350)

**§4.36 B. Form: Statement of Information (Foreign Corporation) (Secretary of State Form SI-350)**





State of California Secretary of State



STATEMENT OF INFORMATION (Foreign Corporation)

FEES (Filing and Disclosure): \$25.00. If amendment, see instructions.

IMPORTANT — READ INSTRUCTIONS BEFORE COMPLETING THIS FORM

This Space For Filing Use Only

1. CORPORATE NAME (Please do not alter if name is preprinted.)

F

DUE DATE:

NO CHANGE STATEMENT (Not applicable if agent address of record is a P.O. Box address. See instructions.)

2. [ ] If there has been no change in any of the information contained in the last Statement of Information filed with the California Secretary of State, check the box and proceed to Item 12. If there have been any changes to the information contained in the last Statement of Information filed with the California Secretary of State, or no statement has been previously filed, this form must be completed in its entirety.

COMPLETE ADDRESSES FOR THE FOLLOWING (Do not abbreviate the name of the city. Items 3 and 4 cannot be P.O. Boxes.)

3. STREET ADDRESS OF PRINCIPAL EXECUTIVE OFFICE CITY STATE ZIP CODE
4. STREET ADDRESS OF PRINCIPAL BUSINESS OFFICE IN CALIFORNIA, IF ANY CITY STATE ZIP CODE CA
5. MAILING ADDRESS OF THE CORPORATION, IF DIFFERENT THAN ITEM 3 CITY STATE ZIP CODE

NAMES AND COMPLETE ADDRESSES OF THE FOLLOWING OFFICERS (The corporation must have these three officers. A comparable title for the specific officer may be added; however, the preprinted titles on this form must not be altered.)

6. CHIEF EXECUTIVE OFFICER/ ADDRESS CITY STATE ZIP CODE
7. SECRETARY/ ADDRESS CITY STATE ZIP CODE
8. CHIEF FINANCIAL OFFICER/ ADDRESS CITY STATE ZIP CODE

AGENT FOR SERVICE OF PROCESS (If the agent is an individual, the agent must reside in California and Item 10 must be completed with a California street address (a P.O. Box address is not acceptable). If the agent is another corporation, the agent must have on file with the California Secretary of State a certificate pursuant to Corporations Code section 1505 and Item 10 must be left blank.)

9. NAME OF AGENT FOR SERVICE OF PROCESS
10. STREET ADDRESS OF AGENT FOR SERVICE OF PROCESS IN CALIFORNIA, IF AN INDIVIDUAL CITY STATE ZIP CODE CA

TYPE OF BUSINESS

11. DESCRIBE THE TYPE OF BUSINESS OF THE CORPORATION

12. THE INFORMATION CONTAINED HEREIN IS TRUE AND CORRECT.

DATE TYPE/PRINT NAME OF PERSON COMPLETING FORM TITLE SIGNATURE

**INSTRUCTIONS FOR COMPLETING FORM SI-350**

For faster processing, the required statement for most corporations can be filed online at <https://businessfilings.sos.ca.gov/>. Alternatively, statement forms are available on the Secretary of State's website at <http://www.sos.ca.gov/business/> and can be viewed, filled in and printed from your computer. Completed forms along with the applicable fees can be mailed to Secretary of State, Statement of Information Unit, P.O. Box 944230, Sacramento, CA 94244-2300 or delivered in person to the Sacramento office, 1500 11<sup>th</sup> Street, 3<sup>rd</sup> Floor, Sacramento, CA 95814. If you are not completing this form online, please type or legibly print in black or blue ink. This form is filed only in the Sacramento office.

Every foreign corporation shall file a Statement of Information with the California Secretary of State annually during the applicable filing period. The applicable filing period for a foreign corporation is the calendar month during which its original Statement and Designation by Foreign Corporation was filed and the immediately preceding five calendar months. A corporation is required to file this statement even though it may not be actively engaged in business at the time this statement is due. Changes to information contained in a previously filed statement can be made by filing a new form, completed in its entirety.

**LEGAL AUTHORITY:** Statutory filing provisions are found in California Corporations Code section 2117, unless otherwise indicated. Failure to file this Statement of Information by the due date will result in the assessment of a \$250.00 penalty. (Corporations Code section 2206; Revenue and Taxation Code section 19141.)

**FEES:** The Statement of Information must be accompanied by a \$20.00 filing fee and \$5.00 disclosure fee. The filing fee and the disclosure fee may be included in a single check made payable to the Secretary of State. **All foreign corporations must pay a total of \$25.00 at the time of filing the statement.** If this statement is being filed to amend any information on a previously filed statement and is being filed outside the applicable filing period, as defined above, no fee is required.

**COPIES:** The Secretary of State will endorse file one copy of the statement if an exact copy is submitted along with the statement to be filed. Copies submitted with the statement to be filed can be certified upon request and payment of the \$8.00 per copy certification fee.

**PUBLICLY TRADED FOREIGN CORPORATIONS:** Every publicly traded foreign corporation must also file a Corporate Disclosure Statement (Form SI-PT) annually, within 150 days after the end of its fiscal year. A "publicly traded foreign corporation" is a foreign corporation, as defined in Corporations Code section 171, that is an issuer as defined in Section 3 of the Securities Exchange Act of 1934, as amended (15 U.S.C. Sec. 78c), and has at least one class of securities listed or admitted for trading on a national securities exchange, on the National or Small-Cap Markets of the NASDAQ Stock Market, on the OTC-Bulletin Board, or on the electronic service operated by Pink Sheets, LLC. Form SI-PT may be obtained from the Secretary of State's website at <http://www.sos.ca.gov/business/> or by calling the Statement of Information Unit at (916) 657-5448.

**Complete the Statement of Information (Form SI-350) as follows:**

- Item 1.** Please do not alter the preprinted name. If the corporate name is not correct, please attach a statement indicating the correct name and the date the Amended Statement by Foreign Corporation (Corporations Code section 2107) was filed with the California Secretary of State. If blank, enter the name of the corporation **exactly** as it is of record with the California Secretary of State.
- Item 2.** If there has been no change to the information contained in the last Statement of Information filed with the California Secretary of State, check the box and proceed to Item 12. Note: Effective January 1, 2008, a P.O. Box address is no longer an acceptable address for the agent for service of process. Therefore, if the last address for the agent for service of process is a P.O. Box address, the statement must be completed in its entirety.  
If there has been any change to the last Statement of Information filed with the California Secretary of State, including a change to any address, or no statement has ever been filed, complete this form in its entirety.
- Item 3.** Enter the complete street address, city, state and zip code of the principal executive office. Please do not enter a P.O. Box or abbreviate the name of the city.
- Item 4.** Enter the complete street address, city and zip code of the corporation's principal office in California, if any. Please do not enter a P.O. Box or abbreviate the name of the city. Complete this item only if the address in Item 3 is outside of California.
- Item 5.** Enter the mailing address of the corporation, if different from the street address of the principal executive office.
- Items 6-8.** Enter the name and complete business or residential address of the corporation's chief executive officer (i.e., president), secretary and chief financial officer (i.e., treasurer). Please do not abbreviate the name of the city. The corporation must have these three officers. An officer may hold more than one office. A comparable title for the specific officer may be added; however, the preprinted titles on this form must not be altered.
- Item 9.** Enter the name of the agent for service of process in California. An agent is an individual (director, officer or any other person, whether or not affiliated with the corporation) who resides in California or another corporation designated to accept service of process if the corporation is sued. The agent **must** agree to accept service of process on behalf of the corporation prior to designation.  
If an individual is designated as agent, complete Items 9 and 10. If another corporation is designated as agent, complete Item 9 and proceed to Item 11 (do not complete Item 10).  
Note: Before another corporation may be designated as agent, that corporation must have previously filed with the California Secretary of State, a certificate pursuant to Corporations Code section 1505. **A corporation cannot act as its own agent** and no domestic or foreign corporation may file pursuant to section 1505 unless the corporation is currently authorized to engage in business in California and is in good standing on the records of the California Secretary of State.
- Item 10.** If an individual is designated as agent for service of process, enter a business or residential **street** address in California (a P.O. Box address is not acceptable). Please do not enter "in care of" (c/o) or abbreviate the name of the city. If another corporation is designated as agent, leave Item 10 blank and proceed to Item 11.
- Item 11.** Briefly describe the general type of business that constitutes the principal business activity of the corporation.
- Item 12.** Type or print the name and title of the person completing this form and enter the date this form was completed.

*Comment:* On the use of this form, see §4.10. The form may be viewed and completed online at the Secretary of

State's website, [http://www.sos.ca.gov/business/corp/pdf/so/corp\\_so350.pdf](http://www.sos.ca.gov/business/corp/pdf/so/corp_so350.pdf). It may then be mailed or hand-delivered to the Secretary of State's office. The mailing address where the form should be submitted is indicated in the instructions to the form. Most corporations are also permitted to *file* this form online with the Secretary of State's office.

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## 5

# General Partnerships

Charles E. Toombs

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**§5.1 I. SCOPE OF CHAPTER**

This chapter provides an overview of issues that the practitioner must consider in forming a general partnership. It focuses on the nature of the partnership; factors that distinguish the partnership from a joint venture, agency, or other form of property co-ownership; the fiduciary responsibility of the partners; factors to consider in structuring the partnership; and formation documents.

## **II. CHARACTER OF GENERAL PARTNERSHIP**

### **§5.2 A. Uniform Partnership Act of 1994 (RUPA)**

The Uniform Partnership Act of 1994 (Corp C §§16100-16962), generally known by the acronym RUPA (Revised Uniform Partnership Act), applies to all general partnerships (including limited liability partnerships; see chap 7).

RUPA provides a statutory basis that enables attorneys to craft effective general partnership agreements. Many of RUPA's provisions may be amended by mutual agreement of the parties, reflecting the freedom of the parties to contract for specific provisions. The default provisions of RUPA fill in many of the gaps that may arise from the parties' oral agreements or from agreements that are otherwise silent on material terms. Corp C §16103.

Other forms of business entities, such as the limited liability company (see chap 11) or the subchapter S corporation (see §8.5), may be more advantageous than a general partnership. Such entities offer the legal protection afforded shareholders in a corporation and generally subject the bulk of business income to taxation at the individual owner level only (although certain fees and minimum franchise taxes still apply). However, the general partnership may still prove appropriate for businesses that are prevented from operating in these alternative forms but still require the flexibility provided by the general partnership form. For a comparison of the advantages and disadvantages of various business entities, see chap 2.

### **§5.3 B. Consensual Agreement**

A general partnership is statutorily defined as an association of two or more persons, formed under Corp C §16202, a predecessor law, or comparable law of another jurisdiction, to carry on as co-owners a business for profit. Corp C §16101(9). This definition includes a registered limited liability partnership. See chap 7. Such an association comprises a partnership regardless of whether the persons actually intend to form one. Corp C §16202(a). The association is formed by consensual agreement. There is no required form of agreement; it may be express, implied, oral, or written. An association formed under a statute other than RUPA, a predecessor statute, or a comparable statute of another jurisdiction is not a partnership. Corp C §16202(b). Profit sharing is evidence of a partnership but not a required element of the definition of a partnership. Corp C §16202(c); *Holmes v Lerner* (1999) 74 CA4th 442, 88 CR2d 130. Further, profit sharing is not presumed to create a partnership when the profits are received in payment for services as an independent contractor. Corp C §16202(c)(3)(B); *The Fifth Day, LLC v Bolotin* (2009) 172 CA4th 939, 963, 91 CR3d 633 (dissenting opinion of Mosk, J).

**NOTE:** The parties must actually express their mutual intent to form a partnership. The undisclosed or subjective intent of one person is legally insufficient, in and of itself, to create a legally recognizable partnership. *In re Marriage of Geraci* (2006) 144 CA4th 1278, 1292, 51 CR3d 234.

**PRACTICE TIP:** Partners should always enter into a written partnership agreement, rather than relying on an oral agreement, to remove any uncertainty regarding their legal relationships, to avoid the default provisions of RUPA, and to furnish the partners with a convenient guide to their relationship, its consequences, and their agreed variations from RUPA.

## **§5.4 C. Ostensible Partnership**

Parties who act as partners in conducting their business will likely be treated as partners for legal purposes. Individuals may be subject to partnership liability and treated as ostensible partners as a result of misrepresentations to third parties that suggest that they are partners in a partnership. Partners who consent to such nonpartner misrepresentations may also be bound by them. See Corp C §16308 (purported partnerships).

In determining whether a partnership is formed, the following rules apply (Corp C §16202(c)):

- Joint tenancy, tenancy in common, tenancy by the entireties, joint property, common property, or part ownership, even if the co-owners share profits made by use of the property, does not by itself establish a partnership.
- Sharing gross returns, even if the persons sharing them have a joint or common right or interest in property from which the returns are derived, does not by itself establish a partnership.
- A person who received a share of the profits of a business is presumed to be a partner in the business, unless the payments were for the following:
  - A debt by installment or otherwise;
  - Services as an independent contractor, or wages or other compensation to an employee;
  - Rent;
  - An annuity or other retirement benefit to a beneficiary, representative, or designee of a deceased or retired partner;
  - Interest or other charge on a loan, even if the payment amount varies with the profits of the business, including a direct or indirect present or future ownership of collateral, or rights to income, proceeds, or increase in value derived from the collateral; or
  - The sale of the goodwill of a business or other property by installment or otherwise.

**Source:** Business Law/Selecting and Forming Business Entities/5 General Partnerships/§5.5 1. Joint Venture Distinguished From Partnership

## **§5.5 1. Joint Venture Distinguished From Partnership**

A joint venture is formed for the purpose of engaging in a particular business transaction or conducting business for a set period of time. A joint venture results when two or more persons undertake to carry out a single business enterprise for profit. *Pellegrini v Weiss* (2008) 165 CA4th 515, 525, 81 CR3d 387. A joint venture, like a partnership, may be formed by written or oral agreement. See §5.3. A joint venture may also be assumed from the acts and declarations of the parties, because the existence of a joint venture depends on the intention of the parties. See *Pellegrini*, 165 CA4th at 525 (joint venture existed when evidence showed parties came together for common purpose of developing real estate for profit and parties executed memorandum of understanding stating their common goal; hence parties owed fiduciary duties to each other).

An association is not classified as a partnership simply because it is called a joint venture, but a joint venture will be treated as a partnership if it otherwise satisfies RUPA requirements. Comment to Corp C §16202.

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**Source:** Business Law/Selecting and Forming Business Entities/5 General Partnerships/§5.6 2. Agency Distinguished From Partnership

## **§5.6 2. Agency Distinguished From Partnership**

An agent represents a principal in dealings with third parties. CC §2295. An agent is authorized by the principal to act on behalf of the principal. See *Woolley v Embassy Suites, Inc.* (1991) 227 CA3d 1520, 278 CR 719; *Born v Koop* (1962) 200 CA2d 519, 19 CR 379; *Schroeder v Mauzy* (1911) 16 CA 443, 118 P 459.

A partnership, on the other hand, requires the association of two or more persons to carry on as co-owners a business for profit. Corp C §16202(a). See §5.3. Ownership involves the power of ultimate control. Partners, as co-owners of a business, each have the power of ultimate control. Although agents may share in the profits as means of compensation, they typically do not share in control and therefore are not co-owners of the business.

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**Source:** Business Law/Selecting and Forming Business Entities/5 General Partnerships/§5.7 D. Partnership as Distinct Entity

#### **§5.7 D. Partnership as Distinct Entity**

A partnership is an entity separate and distinct from its partners and not merely an aggregate of individual partners. Corp C §16201. Therefore, membership changes do not by themselves create a new partnership.

A partner has only its rights to a separate partnership interest (Corp C §16101(12)), and may transfer only its share of profits and losses and its right to receive distributions from the partnership, all of which constitute personal property (Corp C §16502). On ownership of partnership property, see §5.20.

**NOTE:** A business entity that comes into existence after the establishment of a contract made on its behalf may enforce that preorganization contract if it adopted or ratified the agreement. *02 Dev., LLC v 607 S. Park, LLC* (2008) 159 CA4th 609, 71 CR3d 608.

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**Source:** Business Law/Selecting and Forming Business Entities/5 General Partnerships/ E. Authority to Bind Partnership/§5.8 1. Mutual Agency

## **E. Authority to Bind Partnership**

### **§5.8 1. Mutual Agency**

One of the most important legal characteristics of a general partnership is the mutual agency relationship of partners. Each partner is an agent of the partnership for the purpose of its business. Corp C §16301. The acts of a partner apparently carrying on the ordinary course of the partnership business bind the partnership, unless the partner had no authority to act in a particular matter, and the person with whom the partner was dealing knew or received notification (see Corp C §16102) that the partner lacked authority for the act. Corp C §16301(1); *Blackmon v Hale* (1970) 1 C3d 548, 557, 83 CR 194. A partner's act that is apparently for carrying on the partnership business (or business of the kind carried on by the partnership) binds the partnership if the act was authorized by the other partners. Corp C §16301(2). A statement of partnership authority may vary these rules. See §5.44.

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## **§5.9 2. Transfers of Partnership Property**

Special rules govern the authority to transfer partnership property (Corp C §16302(a)):

- Partnership property held in the name of the partnership may be transferred by an instrument executed by a partner in the partnership name, subject to the terms of a statement of partnership authority (see §5.44).
- Partnership property held in the name of one or more partners may be transferred by an instrument executed by the persons in whose name the property is held if the instrument transferring the property to them indicates their capacity as partners or the existence of a partnership, but does not indicate the name of the partnership.
- Partnership property held in the name of one or more persons other than the partnership may be transferred by an instrument executed by the persons in whose name the property is held if the instrument transferring the property to them does not indicate their capacity as partners or the existence of a partnership.

A partnership may limit a partner's ability to bind the partnership by filing a statement of partnership authority. Corp C §16303. On ownership of partnership property, see §5.20.

**§5.10 F. Partners' Liability**

One of the chief concerns facing general partners is their virtually unlimited joint and several liability for debts of the partnership and acts of their fellow partners, unless otherwise agreed by the claimant or provided by law. Corp C §16306(a). But see *Great W. Bank v Kong* (2001) 90 CA4th 28, 108 CR2d 266 (co-obligor partner who settled debt with partnership creditor by becoming assignee of deficiency judgment against partnership could not enforce judgment against nonsettling partner).

Anyone who purports to be a partner or consents to being represented by another as a partner in a partnership is liable to anyone who enters into a transaction with the partnership or purported partnership based on that representation. See Corp C §16308. See also §§5.22-5.28.

### III. PARTNERS' OBLIGATIONS

#### §5.11 A. Fiduciary Duties

The Uniform Partnership Act of 1994 (RUPA) (Corp C §§16100-16962) addresses fiduciary duties of partners in a specific and expansive manner, resulting in a fair amount of certainty for partners. See Comment to Corp C §16404. See also *Pellegrini v Weiss* (2008) 165 CA4th 515, 525, 81 CR3d 387 (partners have fiduciary duty to act with highest degree of good faith towards each other regarding affairs of partnership). It is unclear whether the courts will expand the duties beyond those set forth in the law.

**NOTE:** In *Enea v Superior Court* (2005) 132 CA4th 1559, 34 CR3d 513, the court of appeal held that the defendant partners' lease of partnership property to themselves at below market rents breached their fiduciary duty to the partnership. In dicta, the *Enea* court stated that the legislature did not intend the enumerated fiduciary duties set forth in RUPA to be exclusive. The court quoted the legislative history of Corp C §16404, which states that §16404 "establishes a comprehensive, but not exhaustive definition of partnership fiduciary duties." 132 CA4th at 1565. Notwithstanding its discussion of the scope of the enumerated duties, however, the court found for the plaintiff, based on Corp C §16404(b)(1), which sets forth a partner's duty of loyalty to "account to the partnerships and hold as trustee for it any property, profit or benefit derived by the partner." 132 CA4th at 1565. See §5.12.

It is also unclear whether fiduciary duties applicable to general partnerships apply to limited partnerships (see chap 6) and limited liability companies (see chap 11), although some decisions indicate a willingness to bind limited partnerships to these standards. See Corp C §§15643, 15722, 17150, 17153. See also *Bardis v Oates* (2004) 119 CA4th 1, 14 CR3d 89 (discussing managing partners' fiduciary duties to limited partnership); *Everest Investors 8 v McNeil Partners* (2003) 114 CA4th 411, 8 CR3d 31 (limited partnership general partner has same liabilities to partnership and other partners as in general partnership); *BT-I v Equitable Life Assur. Soc'y* (1999) 75 CA4th 1406, 89 CR2d 811 (partner that forces out limited partner by acquiring partnership debt breaches fiduciary duty).

**§5.12 1. Duty of Loyalty**

A partner's duty of loyalty to the partnership and to the other partners includes the following obligations (Corp C §16404(b)):

- To account to the partnership and hold as trustee for it any property, profit, or benefit derived in the conduct and winding up of the partnership business or derived from a partner's use of partnership property or information, including the appropriation of a partnership opportunity.
- To refrain from dealing with the partnership as a party having an interest adverse to the partnership or on behalf of a party having an adverse interest.
- To refrain from competing with the partnership in the conduct of the partnership business before the dissolution of the partnership.

A partner's obligation to the partnership includes fiduciary duties not expressly stated in the Corporations Code or in a partnership agreement, such as the duty to pay market rate rent for offices the partners leased in a building owned by the partnership. *Enea v Superior Court* (2005) 132 CA4th 1559, 34 CR3d 513. See §5.11.

The partnership agreement may identify specific kinds of activities that do not violate the duty of loyalty. Corp C §16103(b)(3)(A). The agreement may also be tailored to allow, following full disclosure of all material facts, a specified number or percentage of partners to ratify an action that might otherwise violate the duty of loyalty. Corp C §16103(b)(3)(B).

**§5.13            2. Duty of Care**

A partner's duty of care to the partnership and the other partners is limited to refraining from engaging in "grossly negligent or reckless conduct, intentional misconduct, or a knowing violation of law." Corp C §16404(c); see *In re Textainer Partnership Secs. Litig.* (ND Cal, Dec. 12, 2005, No. C-05-0969 MMC) 2005 US Dist Lexis 40974 (self-dealing to the detriment of limited partners prohibited by §16404(c)). A partnership agreement may not unreasonably reduce the duty of care. Corp C §16103(b)(4).

**Source:** Business Law/Selecting and Forming Business Entities/5 General Partnerships/§5.14 3. Obligation of Good Faith and Fair Dealing

### **§5.14 3. Obligation of Good Faith and Fair Dealing**

A partner must act consistently with the obligation of good faith and fair dealing in carrying out duties to the partnership and the other partners. Corp C §16404(d). A partnership agreement may not eliminate this obligation, but it may prescribe reasonable standards for measuring the performance of this obligation. Corp C §16103(b)(5).

The obligation of good faith and fair dealing also applies to a person winding up the partnership business as the personal or legal representative of the last surviving partner. Corp C §16404(g). Partners also owe an obligation of good faith to dissociated partners.

**NOTE:** The term "good faith and fair dealing" is not defined under RUPA, allowing the courts to develop its meaning based on the facts of individual cases.

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**§5.15 B. Permissible Exceptions to Partner's Duties and Obligations**

The partners' duties and obligations are somewhat flexible, as demonstrated by the following points:

- A partner does not violate a duty or obligation under RUPA or the partnership agreement merely by furthering the partner's own interest. Corp C §16404(e). See *Jones v Wagner* (2001) 90 CA4th 466, 108 CR2d 669 (court found no breach of fiduciary duty when partner that made down payment bought property at foreclosure sale following another partner's default on mortgage payments, and refused to create obligation among partners to make capital contributions beyond 50/50 formula to which they had agreed).
- A partner may lend money to and transact other business with the partnership; for each loan or transaction, the partner's rights and obligations regarding performance or enforcement are generally the same as those of a person who is not a partner. Corp C §16404(f).

In interpreting these duties and obligations, one court has held that co-obligor partners who settled a debt with a partnership creditor by becoming assignees of a deficiency judgment against the partnership could not enforce that judgment against the nonsettling partner because "assignment of a joint and several debt to one of the co-obligors extinguishes that debt." *Great W. Bank v Kong* (2001) 90 CA4th 28, 32, 108 CR2d 266.

**Source:** Business Law/Selecting and Forming Business Entities/5 General Partnerships/§5.16 C. Enforcement of Partners' Obligations

### **§5.16 C. Enforcement of Partners' Obligations**

The partnership may maintain an action against a partner for breaching the partnership agreement or violating a duty to the partnership. Corp C §16405(a). A partner may maintain an action against the partnership or another partner for legal or equitable relief, with or without an accounting as to partnership business, to enforce the partner's rights under RUPA or the partnership agreement. Corp C §16405(b). See *Advising California Partnerships*, chap 15 (3d ed Cal CEB 1999).

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#### **IV. APPLICATION OF CALIFORNIA LAW**

##### **§5.17 A. Taxation of California Partnerships**

California's tax treatment of general partnerships generally corresponds to the federal model of partnership taxation. Rev & T C §17851. California does not tax general partnership income at the entity level. The partnership's income and losses flow through to, and are taxed to or deducted by, the partners, normally retaining the character they had at the partnership level. Income and activities are apportioned to the partners on the basis of their interest in the partnership. See Rev & T C §§17851-17865.

California imposes a minimum annual franchise tax of \$800 on limited partnerships and limited liability companies for the privilege of conducting business in California. Rev & T C §§17935(a), 17941(a), 23153(d)(1). Limited liability companies are further subject to an annual fee based on the LLC's total income from all sources derived from or attributable to California for the taxable year. Rev & T C §§17942-17943, 19394. See §11.7. General partnerships are not subject to franchise taxes or fees.

**Source:** Business Law/Selecting and Forming Business Entities/5 General Partnerships/§5.18 B. Similarity to California Corporations

## **§5.18 B. Similarity to California Corporations**

The relationship between a partner and the partnership resembles the relationship between a shareholder and a corporation in the following ways:

- A partnership is an entity separate and distinct from its partners, not merely an aggregate of all its partners (Corp C §16201);
- A partner has rights to a separate partnership interest rather than direct ownership of any underlying asset (see Corp C §16101(12));
- A partner may transfer only its share of profit and loss and its right to receive a distribution from the partnership as personal property (Corp C §16502);
- A change in membership results in a buy-out of the dissociated partner rather than a dissolution. (Corp C §16701; see §5.35); and
- A creditor's ability to seize a partner's personal assets in satisfaction of partnership debts is restricted. See §5.24.

## **V. FACTORS TO CONSIDER IN STRUCTURING PARTNERSHIP AND DRAFTING PARTNERSHIP AGREEMENT**

### **§5.19 A. Partners' Rights and Obligations**

Relations among the partners and between the partners and the partnership are in general governed by the partnership agreement. See Corp C §16103; §5.42. The Uniform Partnership Act of 1994 (RUPA) (Corp C §§16100-16114), as a default statute, controls the legal relationship between the parties when a partnership agreement does not exist or the existing agreement is otherwise silent. Corp C §16103(a).

Partners have the following statutory rights and obligations (Corp C §16401(a)-(i)):

- The right to a properly maintained capital account;
- The right to equal sharing of partnership profits, with a partner's share of losses generally chargeable in proportion to the partner's share of the profits;
- The right to be reimbursed for payments made and the right to be indemnified for liabilities incurred in the ordinary course of business of the partnership or for preservation of partnership property;
- The right to reimbursement for advances to the partnership beyond required capital contributions;
- The right to have payments and advances treated as loans to the partnership that accrue interest from the date of payment or advance;
- Equal rights in the management and conduct of the partnership business;
- The obligation to use or possess partnership property only on behalf of the partnership;
- The inability to be paid for services performed for the partnership, other than reasonable compensation for services in winding up the partnership business; and
- The right to become a partner only with the consent of all of the existing partners.

A majority of the partners may resolve disputes that arise in the ordinary course of the partnership's business; unanimous consent is required for acts outside the ordinary scope of business and for amendments to the partnership agreement. Corp C 16401(j).

## **B. Ownership of Property**

### **§5.20 1. Partnership Property**

Property acquired by the partnership is property of the partnership and not of the partners individually. Corp C §16203. A partner is not a co-owner of partnership property and has no interest in the property of the partnership that can be transferred, voluntarily or involuntarily. Corp C §16501. If a person holds all of the partners' interests in the partnership, however, all of the partnership property vests in that person. That person may execute and file or record a document in the name of the partnership to evidence such vesting of the property. Corp C §16302(d).

Property is partnership property if acquired (Corp C §16204(a)):

- In the name of the partnership, or
- In the name of one or more partners if the instrument transferring title indicates either the person's capacity as a partner or the existence of a partnership (without indicating the name of the partnership).

Property is acquired in the name of the partnership if it is transferred (Corp C §16204(b)):

- To the partnership, in its name, or
- To one or more partners in their capacity as partners in the partnership, if the instrument transferring title indicates the name of the partnership.

Property purchased with partnership assets is partnership property whether or not the transferring instrument acknowledges the existence of the partnership or the capacity of the purchasers as partners. Corp C §16204(c).

Ultimately, among the partners the partners' intention controls whether property belongs to the partnership or to one or more of the partners in their individual capacities.

**Source:** Business Law/Selecting and Forming Business Entities/5 General Partnerships/§5.21 2. Nonpartnership Property

## **§5.21 2. Nonpartnership Property**

Partnership property may be transferred free of any claims of the partnership if the property is held in the name of individual partners, with no indication of their capacity as partners or of the existence of a partnership. Also, the property must be transferred by the partners in whose names it is held to a purchaser without knowledge that it is partnership property. Corp C §16302(a)(3).

Partnership agreements should accurately reflect the true nature of ownership of the partnership property to avoid application of the rules and presumptions under Corp C §16204, possible unwanted conveyances to good faith purchasers without knowledge of the partnership's claim to the property, and other misunderstandings or confusion. Further, because a partner may use or possess partnership property on behalf of the partnership (Corp C §16401(g)), the agreement should clearly establish any limitations on the rights of a partner in use of partnership assets.

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### **C. Liability for Partnership Obligations**

#### **§5.22 1. Partnership Liability to Third Parties**

A partnership may be sued in its own name. Corp C §16307(a). A partnership is liable for loss or injury caused by the wrongful conduct of a partner acting in the ordinary course of the partnership's business or with the partnership's authority. Corp C §16305(a). See *Advising California Partnerships* §3.64 (3d ed Cal CEB 1999).

If a partner misapplies money or property received on behalf of the partnership from a nonpartner, the partnership is liable for the loss. Corp C §16305(b). This provision imposes strict liability. Comment to Corp C §16305(b). A partner is not liable for a judgment against the partnership unless there is also a judgment against the partner. Corp C §16307(c).

A partner's act in the course of winding up the partnership is binding on the partnership if it would have bound the partnership before dissolution and if the other party to the transaction was unaware of the dissolution. Corp C §16804.

A partnership may limit the partners' authority with regard to certain transactions by filing a statement with the California Secretary of State. See §5.44.

## **§5.23 2. Partnership Liability to Partners**

A partner may bring suit against the partnership or another partner for almost any cause of action arising out of the conduct of the partnership business, including an action for an accounting and a final action for an accounting on dissolution and winding up. Corp C §16405(b). A partner may sue for legal or equitable relief to achieve the following (Corp C §16405(a)-(b)):

- Enforce the partner's rights under the partnership agreement;
- Enforce the partner's rights under RUPA (see Corp C §§16401, 16403-16404, 16701-16701.5);
- Compel a dissolution and winding up of the partnership (see Corp C §§16801-16807); or
- Enforce rights arising independently of the partnership, *e.g.*, personal injury or damage to property.

An accounting is not a prerequisite to the availability of remedies a partner may have against a partnership or other partners. See Corp C §16405(b). Thus, partners have access to the courts during the partnership term to resolve claims against the partnership, and courts have flexibility in crafting an appropriate remedy. These remedies may be limited or contracted away by the partners, subject to the requirements of Corp C §16103(b). See Comment to Corp C §16405.

Causes of action by a partner against the partnership are still subject to other applicable periods of limitation. As a result, a right to an accounting on dissolution and winding up does not revive a claim barred by law. Corp C §16405(c). Therefore, a partner must litigate its claims during the life of the partnership or risk losing them. Because an accounting is an equitable proceeding, it may be barred by laches if there is undue delay in bringing the action. The statute of limitations may be tolled by a partner's fraud. Comment to Corp C §16405.

A partnership is liable for loss or injury caused by the wrongful act or other actionable conduct of a partner acting within the scope of the partnership's business or with the authority of the partnership. Corp C §16305(a). A partner may sue the partnership on a tort theory (including "no-fault torts") or other theory during the term of the partnership, rather than being limited to the remedies of dissolution and accounting. Comment to Corp C §16305(a).

A partnership must reimburse a partner for payments made and indemnify a partner for liabilities incurred by the partner in the ordinary course of the business of the partnership or for the preservation of its business or property. Corp C §16401(c). A partnership must also reimburse a partner for any advances to the partnership beyond the amount of capital the partner agreed to contribute. Corp C §16401(d).

### **§5.24 3. Partner's Liability for Partnership Obligations**

Each partner is jointly and severally liable for all partnership obligations unless the claimant agrees otherwise or the law provides otherwise. Corp C §16306(a). See *United States v Galletti* (2004) 541 US 114, 158 L Ed 2d 279, 124 S Ct 1548 (general partners of California partnership individually liable for federal employment taxes assessed against partnership; IRS not required to assess individual partners). But see *Great W. Bank v Kong* (2001) 90 CA4th 28, 108 CR2d 266 (as co-obligors, partners assigned deficiency judgment could not enforce judgment against partner who failed to pay proportionate share; assignee partners could bring action for equitable contribution, however; see §5.15). This liability is subject to certain exceptions. Generally, a judgment creditor must first exhaust its claim against partnership assets before it may levy against the assets of an individual partner. See Corp C §16307(d). A judgment against a partnership may not be satisfied from a partner's assets unless there is also a judgment against the partner. Corp C §16307(c).

A partner's liability to third parties for partnership obligations cannot be altered by agreement among the partners. However, the partners may allocate responsibility for such third party obligations among themselves. See Corp C §§16103(b), 16401.

A partnership may maintain an action against a partner for breach of the partnership agreement or for breach of fiduciary duty to the partnership. Corp C §16405(a). See §§5.11-5.14 on fiduciary duties.

A new partner of an existing partnership is not liable for partnership obligations incurred before the partner was admitted. Corp C §16306(b).

**§5.25 a. After Dissociation**

A partner's dissociation does not discharge the partner's liability for partnership obligations incurred before dissociation, and the dissociating partner may in certain instances face liability under Corp C §16703(a)-(b). With certain exceptions, a partner who dissociates is liable as a partner to the other party in a transaction entered into by the partnership within 2 years after the partner's dissociation if at the time of entering into the transaction all of the following apply (Corp C §16703(b)):

- The other party reasonably believed that the dissociated partner was then a partner.
- The other party did not have notice (see Corp C §16102) of the partner's dissociation.
- The other party is not considered to have knowledge under Corp C §16303(e) (knowledge given in a statement of partnership authority regarding real property transfers) or notice under Corp C §16704(c) (partner's filing of a statement of dissociation).

The partnership creditor and the partners continuing the business may agree to release the dissociated partner from liability for a partnership obligation. Corp C §16703(c). A dissociated partner is also released from liability for a partnership obligation if the partnership creditor, with notice of the partner's dissociation but without a partner's consent, materially alters the nature or time of payment of a partnership obligation. Corp C §16703(d).

For special rules affecting limited liability partnerships, see Corp C §16306(c)-(h). For further discussion of a partner's liability after dissociation, see *Advising California Partnerships*, chap 16 (3d ed Cal CEB 1999).

**Source:** Business Law/Selecting and Forming Business Entities/5 General Partnerships/§5.26 b. After Dissolution

**§5.26            b. After Dissolution**

A partner of a general partnership typically is liable to the other partners after dissolution for its share of any partnership liability incurred under Corp C §16804. However, a partner who, with knowledge of the dissolution, incurs partnership liability by an act that is not appropriate for winding up the partnership business is liable to the partnership for damage arising from the liability. Corp C §16806(b). For further discussion of a partner's liability after dissolution, see *Advising California Partnerships*, chap 17 (3d ed Cal CEB 1999).

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**§5.27 4. Partnership Indemnification**

A partnership must reimburse a partner for payments made and must indemnify a partner for liabilities incurred in the ordinary course of partnership business or for preservation of the partnership's business. Corp C §16401(c). Indemnification may create a loss toward which the partners must contribute. Although the right to indemnification is usually enforced in the settlement of accounts among partners on dissolution and winding up, the right accrues when the liability is incurred and may be enforced during the term of the partnership. Comment to Corp C §16401. See *Kazanjian v Rancho Estates, Ltd.* (1991) 235 CA3d 1621, 1 CR2d 534 (under preexisting law, if partnership is unable to meet indemnification obligations, partners must contribute sums necessary to satisfy such liabilities).

**NOTE:** A partner's fiduciary duties of care to the partnership and the other partners may not be eliminated entirely, but may be reasonably reduced or increased, by the partnership agreement. See §§5.11-5.14. Thus, the practitioner must craft the appropriate standard of care and ensure that the agreement's indemnification provisions fit that standard.

**§5.28            5. Insurance**

The partnership should obtain a comprehensive liability insurance policy that, subject to policy limitations, may serve as a funding source to provide coverage to a partner for claims arising out of the wrongful acts of another partner, subject to the partner's own liability for such actions. For discussion of limitations on insurance as they may apply to limited liability partnerships, see §7.26.

## **D. Capital Contributions and Capital Structure**

### **§5.29 1. Default Provisions**

The default provisions of RUPA govern contributions to the partnership in the absence of any agreement to the contrary. These provisions are as follows:

- Each partner has an account credited with the value of money and other property, net of the amount of any liabilities, the partner contributes to the partnership and the partner's share of partnership profits. Corp C §16401(a)(1).
- Each partner is entitled to be reimbursed for payments made and indemnified for liabilities incurred in the ordinary course of business or for the preservation of the partnership business or property. Corp C §16401(c).
- A partnership must reimburse a partner for any advance beyond the amount of capital the partner agreed to contribute to the partnership. Corp C §16401(d).
- A payment or advance by the partner under Corp C §16401(c) or (d) constitutes a loan to the partnership that accrues interest from the date of payment or advance. Corp C §16401(e). If the interest rate for such a loan is not specified in the agreement, the rate is governed by CC §3289. Corp C §16104(b).

The practitioner, in consultation with the client, must carefully consider whether the partnership agreement should override these default provisions.

**§5.30            2. Additional Financing**

The partnership agreement should include provisions that govern when and how additional contributions of capital and property may be required based on the operational needs of the business. The parties may provide for additional contributions from part or all of operating profits. Alternatively, the parties may provide for additional optional or mandatory capital calls from the partners if the partnership needs additional funds to operate. The partners may also ask for additional loans to fund short-term or long-term financial partnership needs.

**§5.31 3. Failure to Make Contributions**

The partners must consider the impact of a partner's failure to make an initial contribution or a continuing contribution to the partnership. There are many possible results. For example:

- The parties may provide for immediate dissolution of the partnership, subject to any creditors' claims.
- The remaining partners may continue the partnership without the defaulting partner's participation.
- The nondefaulting partners may elect to make the required contribution themselves in proportion to their required contributions or make loans of the additional sums that the defaulting partner failed to contribute.
- The nondefaulting partners may purchase the shares of the defaulting partner, forcing that partner out of the partnership.
- The nondefaulting partners may maintain a cause of action for equitable contribution under CC §1432. *Great W. Bank v Kong* (2001) 90 CA4th 28, 108 CR2d 266.

#### **§5.32 4. Profit and Loss Sharing**

Under the default rules of RUPA, each partner in a general partnership is entitled to an equal share of the partnership profits and is liable for losses in proportion to the partner's share of profits. Corp C §16401(b). On the winding up of a partnership's business, each partner is entitled to the excess of credits in the partner's capital account. Corp C §16807(b).

Partnership losses are charged to a partner's account. Corp C §16401(a)(2). As a result, a partner is not obligated to contribute to partnership losses before his or her withdrawal or liquidation of the partnership unless the partners agree otherwise. The partner's negative capital account represents a debt to the partnership, absent agreement to the contrary. Each partner's capital account is also credited with that partner's share of profits. Corp C §16401(a)(1).

Under IRC §704(b), all items of partnership income and loss must be allocated to a partner in the same ratio as the partner's overall interest in the partnership unless the partnership agreement contains a contrary provision that has "substantial economic effect." The criteria for determining whether special allocations have substantial economic effect are set forth in Treas Reg §1.704-1(b)(2). An allocation of income, gain, loss, deduction, or credit to a partner will be respected if the allocation:

- Has substantial economic effect (Treas Reg §1.704-1(b)(2)); or
- Is in accordance with the partner's interest in the partnership (Treas Reg §1.704-1(b)(3)).

Allocations with "substantial economic effect" are decreed to be in accordance with a partner's interest in the partnership.

**PRACTICE TIP:** A general practitioner should consult a tax attorney to ensure that disproportionate allocations have the requisite substantial economic effect. For further discussion of allocations of income and loss, see *Advising California Partnerships*, chap 13 (3d ed Cal CEB 1999).

The default rules further provide that partners share profits *per capita* rather than *in proportion to capital contributions*, as do corporate shareholders or partners in a limited partnership. Corp C §16401(b). The partnership agreement must contain appropriate alternative language if the partners wish to avoid this rule.

**NOTE:** These default rules apply even if one or more of the partners contribute no capital. Although it may seem unfair that the contributor of services who contributes little or no capital should be obligated to contribute toward the capital loss of the large contributor who contributed no services, partners are free to take advantage of their respective bargaining positions to vary such allocations and avoid application of these default rules. See Comment to Corp C §16401. See also §5.5.

**§5.33            5. Distributions**

The partners may determine how distributions are to be made. Distributions in excess of the money necessary to operate the partnership may be made in proportion to the initial capital contributions, in proportion to a partner's share of profits, or in proportion to the cash flow of the partnership (*i.e.*, the amount of profits increased by the amount of such items as depreciation or amortization expenses, which do not affect cash flow available for distribution). The partnership may also make distributions based on proceeds from the sale or refinancing of capital assets.

Distributions disproportionate to the sharing of profits and losses can be made provided they have "substantial economic effect." See IRC §704(b); see §5.32. There may also be distribution preferences so that partners who provide capital obtain a preferred return, such as a form of annual return on investment. The practitioner preparing the partnership agreement should review the tax impact of distributions, discussed in *Advising California Partnerships*, chap 13 (3d ed Cal CEB 1999).

## **§5.34 6. Transfer or Assignment of Partnership Interests**

Absent a provision to the contrary in the partnership agreement, a partner may transfer its share of partnership profits and losses and its right to receive distributions. Corp C §§16502-16503(a). These interests constitute personal property. Corp C §16502. Transfers do not cause the partner's dissociation or a dissolution and winding up of the partnership business. Corp C §16503(a)(1). The partnership does not have to give effect to a transferee's rights until the partnership has notice of the transfer. Corp C §16503(e). A transfer in violation of a restriction contained in the partnership agreement is ineffective for a transferee who has notice of the restriction at the time of transfer. Corp C §16503(f).

The mere transfer of a right to profits or a right to distributions does not give the transferee the right to participate in management of the partnership business, to have access to partnership information, or to inspect partnership books; the transferor partner retains all the rights and duties of a partner other than the interest in distributions transferred. Corp C §16503(a)(2), (d).

The transferee has the following rights (Corp C §16503(b)):

- To receive, in accordance with the transfer, distributions to which the transferor would otherwise have been entitled.
- To receive, in accordance with the transfer, the net amount otherwise distributable to the transferor partner on the dissolution and winding up of the partnership business.
- To seek a judicial determination that it is equitable to wind up the partnership business (see Corp C §16801(6)).

In a dissolution and winding up, the transferee is entitled to an account of the partnership transactions from the date of the latest account agreed to by all partners. Corp C §16503(c).

## **§5.35 E. Dissociation of Partner**

A partner will be dissociated from the partnership on the occurrence of any of the following (Corp C §16601):

- The partnership receives notice of a partner's withdrawal;
- An event agreed to in the partnership agreement that causes dissociation;
- The partner's expulsion under the terms of the partnership agreement;
- The partner's expulsion by unanimous vote of the partners under the express circumstances set forth in Corp C §16601(4);
- A judicial determination on the request of the partnership or any partner under the circumstances set forth in Corp C §16601(5);
- The partner's bankruptcy, assignment for the benefit of creditors, or appointment of a trustee or receiver;
- The individual partner's death or other incapacity; or
- If the partner is a trust or estate, the distribution of the trust's or estate's entire transferable interest.

A partner has the power to dissociate at any time; this power cannot be varied in the partnership agreement. Corp C §§16103(b)(6), 16602(a). If the dissociation is wrongful, however, the partner will be liable to the partnership and the other partners for any resulting damage. Corp C §16602(c). A partner's dissociation is wrongful if it is in breach of the partnership agreement or, in the case of a partnership formed for a particular undertaking, it occurs before the undertaking is completed. Corp C §16602(b).

On a dissociation, the partnership must purchase the dissociated partner's interest if the remaining partners elect to continue the partnership rather than dissolve it. Corp C §16701. On dissolution, see §5.36.

The partner's right to participate in management terminates on dissociation, as does the dissociated partner's duty of loyalty and care to the partnership for post-dissociation events. Corp C §16603. The dissociated partner remains liable for partnership obligations incurred before dissociation, but except in certain circumstances, the dissociated partner is not liable for partnership obligations incurred after the partner's dissociation. Corp C §16703(a)-(b). See §5.25. A dissociated partner may file a statement of dissociation with the Secretary of State to cut off certain liabilities. Corp C §16704.

For further discussion, see *Advising California Partnerships*, chap 14 (3d ed Cal CEB 1999) (on the tax impact of partner dissociation) and *Advising Partners*, chap 16 (on partner dissociation generally).

**Source:** Business Law/Selecting and Forming Business Entities/5 General Partnerships/§5.36 F. Dissolving Partnership

**§5.36 F. Dissolving Partnership**

A partnership may dissolve on the happening of an event set forth in the partnership agreement (Corp C §16801(3)), or an event that makes it unlawful to carry on the business, unless cured within 90 days of notice (Corp C §16801(4)).

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**§5.37 1. Partnership at Will**

An at-will partnership (see Corp C §16101(11)) requires the affirmative vote of the partners to dissolve. Dissolution will occur on the vote of at least half of the partners. The voting partners include any partner who dissociated within the preceding 90 days, except for wrongfully dissociating partners. Corp C §16801(1). See Corp C §16103(b)(8).

A partner may petition the court for a court order to dissolve the partnership if the purpose of the partnership is likely be frustrated, or if another partner has engaged in conduct that makes carrying on the business in partnership with that partner "not reasonably practicable." Corp C §16801(5). See, e.g., *Navarro v Perron* (2004) 122 CA4th 797, 19 CR3d 198 (dissolution was only option when relationship between partners completely deteriorated). A partnership with a specific term or undertaking will dissolve on application by a transferee of a partner's interest if a court finds it equitable to wind up the partnership business after the expiration of the term or completion of the undertaking. Corp C §16801(6).

**Source:** Business Law/Selecting and Forming Business Entities/5 General Partnerships/§5.38 2. Partnership for Definite Term or Particular Undertaking

**§5.38            2. Partnership for Definite Term or Particular Undertaking**

A partnership for a definite term or a particular undertaking will dissolve on the completion of its term or undertaking unless there is a vote to continue. Corp C §16801(2). Unless a majority in interest of the partners votes to continue the partnership within 90 days, the partnership dissolves and is wound up by the bankruptcy, death, or wrongful dissociation of a partner. Corp C §16801(2)(A). The express will of all partners, the expiration of the partnership's term, and the occurrence of an event of dissolution in the partnership agreement also trigger dissolution and winding up. Corp C §16801(2)(B)-(C).

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**§5.39            3. Winding Up Process**

A partnership continues after dissolution only for the purpose of winding up its business, and is terminated when the winding up is completed. Corp C §16802. Before the completion of the winding up, all of the partners, including dissociating partners (other than wrongfully dissociating partners), may waive their rights to have the business wound up and the partnership terminated (Corp C §16802(b)), and the partnership will resume its business as if the dissolution did not occur. See Corp C §16805 (impact of filing a statement of dissolution).

The persons eligible to wind up the partnership are specified in Corp C §16803. A partnership is bound by a partner's act after dissolution that is appropriate for winding up the partnership business and would otherwise have bound the partnership before dissolution if the other party lacked notice of the dissolution. Corp C §16804. For the scope of a partner's liability to other partners after dissolution of the partnership, see Corp C §16806.

**§5.40 4. Allocating Assets and Debts**

Absent agreement of the parties, partnership assets are liquidated and partnership debts are paid as part of the winding up process. Corp C §16807(a). Profits and losses are credited and charged to the partners' accounts. Corp C §16401. Any credits in excess of the partnership charges must be distributed to the partners. A partner must contribute sums if the charges exceed available credits; the remaining partners must make up any deficit not contributed by any partner, in proportion to their loss-sharing ratios. Corp C §16807(b)-(c). Partners (including the estate of the deceased partner) remain liable to contribute additional sums if there are partnership obligations that were not known when the accounts were settled. Corp C §16807(d)-(e).

The foregoing is only a brief overview of the issues. For further discussion, see *Advising California Partnerships*, chap 14 (3d ed Cal CEB 1999) (on the tax impact of partnership liquidation) and *Advising Partners*, chap 17 (on the law applicable to liquidations and dissolutions).

## **§5.41 G. Resolving Disputes Without Litigation**

The partnership agreement may provide for dispute resolution in a number of ways:

- Management authority may be vested in a managing general partner or in a management committee.
- Substantial partnership actions may require approval by a vote of the majority of the partners; this procedure is particularly effective if the partnership has either an odd number or a large number of partners, thus making it unlikely that there will be an even split.
- The partners may provide for alternative dispute resolution, such as mediation or arbitration.

If there is no other recourse or if the partnership contains sufficiently few partners so that deadlock is likely, the partnership agreement may provide a dissenting partner with an optional right to sell his or her partnership interest to one or more of the remaining partners.

If the partners do not provide any form of dispute resolution, the dissenting partner may choose to dissociate from the partnership. See §5.35. Except as otherwise provided in the partnership agreement, a dissociating interest must be bought out at a price equal to the amount that would have been distributed to the dissociating partner on dissolution and winding up (after payment of all creditors' claims) if, on the date of dissociation, the assets of the partnership were sold at a price equal to the greater of the liquidation value or the value based on the sale of the entire business as a going concern (without the dissociated partner) and the partnership was wound up as of that date. Corp C §16701(b).

**NOTE:** These buy-out provisions do not apply to any partner who dissociates within 90 days of the partnership dissolution; such a partner is treated as any other partner and must wait for the partnership to wind up. See Corp C §§16701-16701.5.

**Source:** Business Law/Selecting and Forming Business Entities/5 General Partnerships/ VI. FORMATION OF PARTNERSHIP/§5.41A A. Nature of Partnership; Who May Form; When Formed

## **VI. FORMATION OF PARTNERSHIP**

### **§5.41A A. Nature of Partnership; Who May Form; When Formed**

A general partnership is an association of two or more persons to carry on a business for profit as co-owners. Corp C §§16101(9), 16202. Two or more individuals, corporations, business trusts, estates, trusts, partnerships, limited partnerships, LLCs, associations, joint ventures, governments (and subdivisions, agencies, and instrumentalities), and other legal or commercial entities may form a general partnership. See Corp C §16101(9), (13). A partnership is formed when the partners make a written or oral agreement to operate the business. See §§5.42-5.43. The partnership may also file a statement of partnership authority. See §§5.44, 5.48.

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## **B. Partnership Agreement**

### **§5.42 1. Issues to Include in Agreement**

At a minimum, a partnership agreement should cover the funding of the partnership (*e.g.*, by contributions or loans), how money is disbursed (*e.g.*, salary, distributions, payment priorities), management of partnership affairs, and the terms on which partners may join or withdraw from the partnership. The practitioner should consider the following points in drafting provisions regarding management and control:

- Which participants will manage the business and by what means?
- Will day-to-day management of business be separated from long-range policy-making decisions and decisions on major transactions?
- Will each participant be entitled to one vote or will voting will be proportionate to the respective ownership interests?
- What circumstances give a participant veto power over partnership decisions?
- How can changes in control be made?
- What are the limitations on the authority of one or more participants in an agreement between themselves and third parties?
- What matters require special authority to bind the partnership?
- What specific duties should be assigned to each participant?
- What amount of time must each participant devote to the business and how much time may each participant devote to outside business activities?

## **§5.43 2. Issues Not Affected by Agreement**

Certain provisions of RUPA may not be altered by agreement. Thus, the partnership agreement may not (Corp C §16103(b)):

- Vary the rights and duties regarding the filing of partnership statements (see Corp C §16105), except to eliminate the duty to provide copies of the statements to all partners.
- Unreasonably restrict the right of access to books and records (see Corp C §16403(b)) or the right to be furnished with partnership information (see Corp C §16403(c)) regarding the partnership's business and affairs reasonably required for proper exercise of a partner's rights and duties or any other information concerning the partnership's business and affairs, unless the demand or the information demanded is unreasonable or improper under the circumstances.

**NOTE:** A partnership may keep its books and records in writing or in any other form capable of being converted into tangible form, and may transmit its books and records by electronic transmission. Corp C §16403(a), (c). "Electronic transmission" is defined in Corp C §16101(4)-(5).

- Eliminate the partners' duties of loyalty, care, or good faith and fair dealing (see Corp C §§16404(b)-(d), 16603(3); see §§5.12-5.14 on reasonably modifying these duties).
- Vary the power to dissociate as a partner (see Corp C §16602), except to provide that notice of dissociation given by a partner under Corp C §16601(1) must be in writing.
- Vary the right of a court to expel a partner if the partner (Corp C §16601(5)):
  - Engaged in wrongful conduct that adversely and materially affected the partnership business;
  - Willfully or persistently committed a material breach of the partnership agreement or of a fiduciary duty owed to the partnership or the other partners; or
  - Engaged in conduct relating to the partnership business that makes it not reasonably practicable to carry on the business in partnership with the partner.
- Vary the requirement to wind up the partnership business (see Corp C §16801(4)-(6); §5.36).
- Restrict the rights of third parties under RUPA.
- Vary the law applicable to limited liability partnerships (see Corp C §16106(b); chap 7).

Ordinarily, a partner's liability to third parties for partnership obligations cannot be altered by agreement among the partners, but the parties are free to allocate such third party obligations among themselves. See Corp C §16401(k).

**Source:** Business Law/Selecting and Forming Business Entities/5 General Partnerships/§5.44 C. Statement of Partnership Authority

**§5.44 C. Statement of Partnership Authority**

A partnership may limit the partners' ability to bind the partnership by filing a statement of partnership authority (Secretary of State Form GP-1) with the California Secretary of State containing the specific information set forth in Corp C §16303. See form in §5.48. A filed statement of partnership authority is conclusive in favor of a purchaser for value of personal property, unless a subsequent filing limited or canceled the partner's authority, or the purchaser knew that the partner was not authorized to transfer the property. Corp C §16303(d)(1). A certified copy of the filing statement recorded in the office of the county recorder where real property is located is conclusive in favor of a purchaser for value of real property. Corp C §16303(d)(2). Subject to these provisions and Corp C §§16704 and 16805, a nonpartner is not considered to know of a limitation on a partner's authority merely because the limitation is set forth in the statement of partnership authority. Corp C §16303(f).

The statement of partnership authority may designate an agent for service of process. Corp C §16309. Corporations Code §16310 contains provisions on how service may be accomplished on the designated agent.

**Source:** Business Law/Selecting and Forming Business Entities/5 General Partnerships/§5.45 D. Statement of Address and Principal Place of Business

**§5.45 D. Statement of Address and Principal Place of Business**

A partnership is treated like a corporation for venue purposes under CCP §395.2 if it files a statement pursuant to Corp C §18200 designating the location and complete address of the partnership's principal office in California. See form in §5.49. Once the form is filed, a partnership (like a corporation) may assert venue at the location of its principal office.

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**Source:** Business Law/Selecting and Forming Business Entities/5 General Partnerships/§5.46 E. Other Partnership Filings

#### **§5.46 E. Other Partnership Filings**

A person named in a filed statement of partnership authority or in a list of partners maintained by an agent under Corp C §16303(b) may file a statement of denial, in which the person may deny his or her status or authority as a partner. Corp C §16304.

A dissociated partner or the partnership may file a statement of dissociation, which limits the dissociated partner's authority. Corp C §16704. A properly filed statement of dissolution, statement of conversion, or certificate of partnership merger similarly limits an individual's authority to bind the partnership.

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**§5.47 VII. CHECKLIST FOR PLANNING INITIAL CONTRIBUTIONS AND CAPITAL STRUCTURE**

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- Examine the current capitalization of any existing business that may become a partnership.
- Determine who will contribute capital on formation and who will lend money to the partnership.
- Ascertain the amount of capital or loans needed for operation of the partnership business.
- Determine whether participants will contribute services, cash, or appreciated or depreciated property, and advise the clients of the tax impact of such contributions.
- Determine what constitutes an acceptable debt-equity ratio for operation of the business.
- Identify the rights or obligations to make current or future capital contributions and the penalties for failure to make such contributions.
- Determine if partners will be entitled to make deferred contributions.

*Comment:* This is a checklist of tasks that the practitioner, in consultation with the client, should consider performing when determining the initial capital structure of the partnership. For a discussion of tax considerations on formation of the partnership and the tax impact of contributions of property or services, see *Advising California Partnerships*, chap 3 (3d ed Cal CEB 1999).

**Source:** Business Law/Selecting and Forming Business Entities/5 General Partnerships/ VIII. FORMS/§5.48 A. Form: Statement of Partnership Authority (Secretary of State Form GP-1)

## **VIII. FORMS**

### **§5.48 A. Form: Statement of Partnership Authority (Secretary of State Form GP-1)**





**State of California  
Secretary of State**

GP-1

File # \_\_\_\_\_

Document # \_\_\_\_\_

**STATEMENT OF PARTNERSHIP AUTHORITY**

A \$70.00 filing fee must accompany this form.

**IMPORTANT – Read instructions before completing this form.**

This Space For Filing Use Only

**PARTNERSHIP NAME**

1. NAME OF PARTNERSHIP

**OFFICE ADDRESSES** (Do not abbreviate the city. Items 2 and 3 cannot be P.O. Boxes.)

2. STREET ADDRESS OF CHIEF EXECUTIVE OFFICE CITY AND STATE ZIP CODE

3. STREET ADDRESS OF CALIFORNIA OFFICE, IF ANY CITY STATE ZIP CODE  
**CA**

**NAMES & ADDRESSES OF PARTNERS** (Complete Item 4 with the names and mailing addresses of all the partners (attach additional pages if necessary) OR leave Item 4 blank and proceed to Item 5. Any attachments to this document are incorporated herein by this reference.)

4. NAME ADDRESS CITY AND STATE ZIP CODE

NAME ADDRESS CITY AND STATE ZIP CODE

NAME ADDRESS CITY AND STATE ZIP CODE

**APPOINTED AGENT** (If Item 4 was not completed, complete Item 5 with the name and mailing address of an agent appointed and maintained by the partnership who will maintain a list of the names and mailing addresses of all the partners. If Item 4 was completed, leave Item 5 blank and proceed to Item 6.)

5. NAME ADDRESS CITY AND STATE ZIP CODE

**AUTHORIZED PARTNERS** (Enter the name(s) of all the partners authorized to execute instruments transferring real property held in the name of the partnership. Attach additional pages if necessary. Any attachments to this document are incorporated herein by this reference.)

6. PARTNER NAME: PARTNER NAME:

PARTNER NAME: PARTNER NAME:

PARTNER NAME: PARTNER NAME:

**ADDITIONAL INFORMATION**

7. ADDITIONAL INFORMATION SET FORTH ON THE ATTACHED PAGES, IF ANY, IS INCORPORATED HEREIN BY THIS REFERENCE AND MADE PART OF THIS DOCUMENT.

**EXECUTION** (If additional signature space is necessary, the dated signature(s) with verification(s) may be made on an attachment to this document. Any attachments to this document are incorporated herein by this reference.)

8. I CERTIFY UNDER PENALTY OF PERJURY UNDER THE LAWS OF THE STATE OF CALIFORNIA THAT THE FOREGOING IS TRUE AND CORRECT OF MY OWN KNOWLEDGE.

SIGNATURE OF PARTNER DATE TYPE OR PRINT NAME OF PARTNER

SIGNATURE OF PARTNER DATE TYPE OR PRINT NAME OF PARTNER

## INSTRUCTIONS FOR COMPLETING THE STATEMENT OF PARTNERSHIP AUTHORITY (FORM GP-1)

For easier completion, this form is available on the Secretary of State's website at <http://www.ss.ca.gov/business> and can be viewed, filled in and printed from your computer. The completed form can be mailed to Secretary of State, Document Filing Support Unit, P.O. Box 944225, Sacramento, CA 94244-2250 or delivered in person to the Sacramento office, 1500 11<sup>th</sup> Street, 3<sup>rd</sup> Floor, Sacramento, CA 95814. If you are not completing this form online, please type or legibly print in black or blue ink. This form should not be altered. This form is only filed in the Sacramento office.

Statutory filing provisions are found in California Corporations Code section 16303. All statutory references are to the California Corporations Code, unless otherwise stated.

- Unless otherwise provided in the Partnership Agreement, a person who files a Statement of Partnership Authority (Form GP-1) pursuant to Section 16105 shall promptly send a copy of the statement to every non-filing partner and to any other person named as a partner in the statement. (Sections 16103(b)(1) and 16105(e).)
- In order for a statement to be effective for real estate transfers, a certified copy of the statement issued by the Secretary of State must be recorded in the office for recording transfers of real property. (Section 16105(b).)

**FEES:** The fee for filing Form GP-1 is \$70.00. There is an additional \$15.00 special handling fee for processing a document delivered in person to the Sacramento office. The special handling fee must be remitted by separate check for each submittal and will be retained whether the document is filed or rejected. The preclearance and/or expedited filing of a document within a guaranteed time frame can be requested for an additional fee (in lieu of the special handling fee). Please refer to the Secretary of State's website at <http://www.ss.ca.gov/business/precexp.htm> for detailed information regarding preclearance and expedited filing services. The special handling fee or preclearance and expedited filing services are not applicable to documents submitted by mail. Check(s) should be made payable to the Secretary of State.

**COPIES:** The Secretary of State will certify two copies of the filed document(s) without charge, provided that the copies are submitted to the Secretary of State with the document(s) to be filed. Any additional copies submitted will be certified upon request and payment of the \$8.00 per copy certification fee.

### Complete Form GP-1 as follows:

- Item 1.** Enter the name of the partnership.
- Item 2.** Enter the complete street address, including the zip code, of the chief executive office of the general partnership. Please do not enter a P.O. Box or abbreviate the name of the city.
- Item 3.** Enter the complete street address of an office in California if the chief executive office entered in Item 2 is not located in California. Please do not enter a P.O. Box or abbreviate the name of the city.
- Items 4 & 5.** The partnership must provide either of the following: (Item 4) the names and mailing addresses of all of the partners; OR (Item 5) the name and mailing address of an agent appointed and maintained by the partnership to provide the names and mailing addresses of all the partners pursuant to the provisions of Section 16303(b). Attach additional pages, if necessary.
- Item 6.** Enter the names of all partners authorized to execute instruments transferring real property held in the name of the partnership. Attach additional pages, if necessary.
- Item 7.** Attach any other information to be included in the Statement of Partnership Authority, provided that the information is not inconsistent with law.
- Item 8.** Form GP-1 must be executed by at least two partners. (Section 16105(c).) If additional signature space is necessary, the signatures may be made on an attachment to the document.

Any attachments to Form GP-1 are incorporated by reference. All attachments should be 8 ½" x 11", one-sided and legible.

1.pdf. On the use of this form, see §5.44.

The California Secretary of State has preclearance and expedited services for all business entity documents filed with the Secretary of State under the California Corporations Code. "Preclearance service" allows a customer to submit a business entity document in person at the Sacramento office before filing to determine if the document conforms to law and to receive a preclearance response within a guaranteed time frame. Only one copy of the document need be submitted. "Expedited filing" allows a customer to submit a business entity document in person in the Sacramento office and receive a filing response within a guaranteed time frame. For further information, consult the website at <http://www.sos.ca.gov/business/precexp.htm>.

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**Source:** Business Law/Selecting and Forming Business Entities/5 General Partnerships/§5.49 B. Form: Statement by Unincorporated Association (Secretary of State Form UA-100)

**§5.49 B. Form: Statement by Unincorporated Association (Secretary of State Form UA-100)**





**State of California  
Secretary of State**

**STATEMENT BY UNINCORPORATED ASSOCIATION**  
(Corporations Code section 18200)

A \$25.00 filing fee must accompany this form.

**IMPORTANT – Read instructions before completing this form.**

This Space For Filing Use Only

**ENTITY NAME**

1. NAME OF UNINCORPORATED ASSOCIATION

**PRINCIPAL OFFICE ADDRESS IN CALIFORNIA, IF ANY** (If the association has a principal office address in California, complete Item 2 and proceed to Item 4 (leave Item 3 blank.) If the association has no principal office address in California, leave Item 2 blank and proceed to Item 3.)

2. PRINCIPAL OFFICE ADDRESS CITY STATE ZIP CODE  
CA

**MAILING ADDRESS** (If Item 2 was not completed, complete Item 3 with the address to which the Secretary of State shall send any required notices.)

3. MAILING ADDRESS CITY AND STATE ZIP CODE

**AGENT FOR SERVICE OF PROCESS** (If Item 2 was completed, the association **may** designate an agent for service of process. If, however, Item 3 was completed, the association **must** designate an agent for service of process. If the agent is an individual, the agent must reside in California and both Items 4 and 5 must be completed. If the agent is a corporation, the agent must have on file with the California Secretary of State a certificate pursuant to Corporations Code section 1505 and Item 4 must be completed (leave Item 5 blank).)

4. NAME OF AGENT FOR SERVICE OF PROCESS

5. IF AN INDIVIDUAL, CALIFORNIA ADDRESS OF AGENT FOR SERVICE OF PROCESS CITY STATE ZIP CODE  
CA

**AMENDED FILING** (If the unincorporated association filed a previous statement with the Secretary of State, enter the Secretary of State file number in Item 6, and if the name under which the unincorporated association previously filed differs from the name entered in Item 1, enter the former name of the unincorporated association in Item 7. If the last statement filed by the association has expired, or if no prior statements have been filed, leave Items 6 and 7 blank and proceed to Item 8.)

6. SECRETARY OF STATE FILE NUMBER

7. FORMER NAME OF UNINCORPORATED ASSOCIATION (if different from the name in Item 1 above)

**EXECUTION**

8. THE INFORMATION CONTAINED HEREIN IS TRUE AND CORRECT.

\_\_\_\_\_  
SIGNATURE OF PERSON COMPLETING THIS FORM

\_\_\_\_\_  
TITLE OF PERSON COMPLETING THIS FORM

\_\_\_\_\_  
TYPE OR PRINT THE NAME OF PERSON COMPLETING THIS FORM

\_\_\_\_\_  
DATE

## INSTRUCTIONS FOR COMPLETING THE STATEMENT BY UNINCORPORATED ASSOCIATION (FORM UA-100)

For easier completion, this form is available on the Secretary of State's website at <http://www.ss.ca.gov/business> and can be viewed, filled in and printed from your computer. The completed form along with the applicable fees can be mailed to Secretary of State, Document Filing Support Unit, P.O. Box 944225, Sacramento, CA 94244-2250 or delivered in person to the Sacramento office, 1500 11th Street, 3rd Floor, Sacramento, CA 95814. If you are not completing this form online, please type or legibly print in black or blue ink. This form should not be altered.

Statutory filing requirements are found in California Corporations Code section 18200. All statutory references are to the California Corporations Code, unless otherwise stated.

**FEES:** The fee for filing the Statement by Unincorporated Association is \$25.00. A \$15.00 special handling fee is applicable for processing documents delivered in person to the Sacramento office. The \$15.00 special handling fee must be remitted by separate check for each submittal and will be retained whether the documents are filed or rejected. The special handling fee does not apply to documents submitted by mail. Check(s) should be made payable to the Secretary of State. Statements by Unincorporated Association are not filed in the regional offices.

- After the Statement by Unincorporated Association has been filed, the association may at any time file a new statement superseding the last previously filed statement. If the new statement does not designate an agent for service of process, the filing of the new statement operates to revoke a process agent previously designated.
- The Statement by Unincorporated Association expires 5 years from December 31 following the date of filing with the Secretary of State, unless previously superseded by the filing of a new statement.

### Complete the Statement by Unincorporated Association (Form UA-100) as follows:

- Item 1. Enter the name of the unincorporated association.
- Item 2. If the association has a principal office address in California, enter the complete address, including zip code, and proceed to Item 4 (leave Item 3 blank.) If the association has no principal office address in California, leave Item 2 blank and proceed to Item 3.
- Item 3. If the unincorporated association has no principal office in California, enter the complete address of the unincorporated association to which the Secretary of State shall send any notices required under Sections 18210 and 18215.
- Item 4. An agent for service of process **may** be designated by the unincorporated association if the association has a principal office address in California, and **must** be designated by the unincorporated association if the association has no principal office address in California. The person named as agent must be a resident of California or a corporation that has filed a certificate pursuant to Section 1505. If an individual is designated as agent, both Items 4 and 5 must be completed. If a corporation is designated, complete Item 4 and proceed to Item 6 (do not complete Item 5). An Agent for Service of Process is an individual or corporation designated by an unincorporated association to accept service of process if the unincorporated association is sued.  
  
**Please note:** An unincorporated association cannot name itself as agent for service of process. Further, no domestic or foreign corporation may file pursuant to Section 1505 unless the corporation is currently authorized to engage in business in California and is in good standing on the records of the Secretary of State.
- Item 5. If an individual is designated as the agent for service of process, enter the agent's business or residential address in California. Please do not enter "in care of" (c/o) or abbreviate the name of the city. Please do not enter an address if a corporation is designated as the agent for service of process.
- Item 6. If the unincorporated association filed a previous statement, enter the file number issued by the Secretary of State. If the last statement filed by the association has expired, or no prior statements have been filed, leave Item 6 blank and proceed to Item 8.
- Item 7. If the unincorporated association filed a previous statement under a name other than the name entered in Item 1, enter the former name of the association exactly as it is of record with the Secretary of State. If the name has not changed, or the last statement filed by the association has expired, or no prior statements have been filed, leave Item 7 blank and proceed to Item 8.
- Item 8. Type or print the name and title of the person completing this form and enter the date this form was completed.

*Comment:* This form is available from the Secretary of State's website at

<http://www.sos.ca.gov/business/other/forms/lp-ua-100.pdf>. On the use of this form, see §5.45. For information on the Secretary of State's preclearance and expedited filing services, see Comment to the form in §5.48.

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**Source:** Business Law/Selecting and Forming Business Entities/5 General Partnerships/ IX. PARTNERSHIP AGREEMENT/§5.50 A. Form: Parties, Date, and Recitals

## **IX. PARTNERSHIP AGREEMENT**

### **§5.50 A. Form: Parties, Date, and Recitals**

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §5.50 and ends in §5.124

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5.50-1 Parties, date, recitals

### **PARTNERSHIP AGREEMENT FOR \_\_[NAME OF PARTNERSHIP]\_\_**

**THIS PARTNERSHIP AGREEMENT is entered into and effective as of \_\_[date]\_\_, by \_\_[names]\_\_ (referred to individually as a Partner and collectively as the Partners).**

**The Partners intend to form a general partnership under the laws of the State of California for the purposes and on the terms and conditions stated in this Agreement.**

*Comment:* The recitals should be revised if the partners are amending or restating an existing partnership agreement, or amending the partnership agreement to reflect the admission of new members.

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**Source:** Business Law/Selecting and Forming Business Entities/5 General Partnerships/ B. Organizational Matters/  
§5.51 1. Form: Basic Operative Clause

## **B. Organizational Matters**

### **§5.51 1. Form: Basic Operative Clause**

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §5.50 and ends in §5.124

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5.51-1 Basic operative clause

## **ARTICLE I**

### **ORGANIZATIONAL MATTERS**

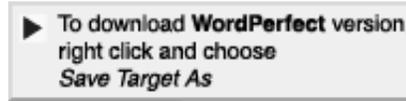
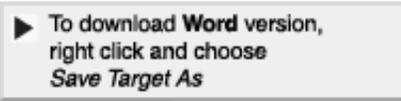
**A. *Partnership Declaration.* By this Agreement, the Partners form a general partnership under the laws of the State of California, on the following terms and conditions.**

*Comment:* This provision establishes that the association of the parties is intended to be a general partnership and not some other form of venture. On the factors distinguishing a partnership from a joint venture, agency, or co-ownership of property, see Corp C §16202(c), discussed in §§5.3-5.6. On choice of entity, see chap 2.

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**§5.52 2. Form: Firm Name**

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §5.50 and ends in §5.124



5.52-1 Firm name

**B. Name of Partnership.** The name of the Partnership is \_\_ *[name]* \_\_.

*Comment:* Because the name of a general partnership is typically a fictitious business name for purposes of Bus & P C §17900, the parties should file a fictitious business name statement. A partnership name that does not include the surname of each general partner or one that suggests the existence of additional owners constitutes a fictitious business name. Bus & P C §17900(b)(2). See §§3.8-3.12; see also §5.57.

**Source:** Business Law/Selecting and Forming Business Entities/5 General Partnerships/§5.53 3. Form: Place of Business

### §5.53 3. Form: Place of Business

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §5.50 and ends in §5.124

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5.53-1 Place of business

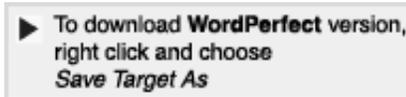
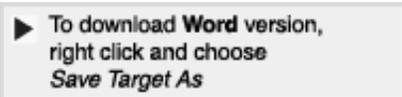
**C. Place of Business.** The Partnership's principal office and place of business shall be at \_\_[address]\_\_, in \_\_[name]\_\_ County, California. The principal place of business may be changed from time to time, and other offices may be established by the Partners, in accordance with the terms and conditions of this Agreement.

*Comment:* The address of the principal place of business is necessary for any fictitious business name or business license filing. Unless otherwise agreed by the parties, the partnership books must be kept at the principal place of business whether the books are in writing or in a form capable of being converted into writing. Corp C §16403(a).

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#### §5.54 4. Form: Term of Partnership

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §5.50 and ends in §5.124



5.54-1 Term of partnership

[Add one of the following alternatives]

[Alternative 1: Definite term]

**D. Term of Partnership.** The Partnership shall begin on the date of this Agreement and shall continue until \_\_[date]\_\_, unless it is terminated earlier as provided in this Agreement. On the expiration of its term, the Partnership shall be dissolved and its affairs shall be wound up.

[Alternative 2: Indefinite term]

**D. Term of Partnership.** The Partnership shall begin on the date of this Agreement and shall continue until dissolved and terminated by mutual agreement of Partners holding at least \_\_[number]\_\_ percent of the Partnership interests, or as otherwise provided for in this Agreement.

[Alternative 3: Indefinite term subject to election to dissolve]

**D. Term of Partnership.** The Partnership shall begin on the date of this Agreement and shall continue until one or more of the Partners shall, after \_\_[date]\_\_, provide written notice to the Partnership and to the other Partners of an election to dissolve the Partnership. On the last day of the calendar month first occurring \_\_[e.g., 60]\_\_ days after the notice is provided, the Partnership shall dissolve and its affairs shall be wound up, unless it is terminated earlier as provided in this Agreement.

[Alternative 4: Year-to-year continuation]

**D. Term of Partnership.** The Partnership shall begin on the date of this Agreement and shall continue for \_\_[number]\_\_ years. At the end of that period, the Partnership shall continue from year to year unless one or more of the Partners shall provide the Partnership and the other Partners at least \_\_[number]\_\_ days' written notice of an election to dissolve the Partnership as of the next anniversary of the Partnership's commencement date. If the notice is given, the Partnership shall dissolve on that anniversary and its affairs shall be wound up, unless it is terminated earlier as provided in this Agreement.

*Comment:* Unless otherwise agreed, a partnership at will (Alternative 2) dissolves and must be wound up on the vote of at least one-half of the partners, including partners other than wrongfully dissociating partners who dissociated within the prior 90 days. See Corp C §16801(1), discussed in §5.37.

## §5.55 5. Form: Purposes Clause

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §5.50 and ends in §5.124

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5.55-1 Purposes clause

*[Add one of the following alternatives]*

*[Alternative 1: General purposes clause]*

**E. Purposes of Partnership.** The purposes of the Partnership are to engage in the business of \_\_ *[specify]* \_\_ and to do all things reasonably incidental to or in furtherance of the business.

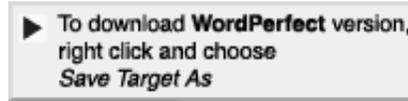
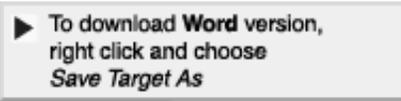
*[Alternative 2: Specific purposes clause for acquisition and development of real property]*

**E. Purposes of Partnership.** The purposes of the Partnership are to acquire that real property located in \_\_ *[name of city]* \_\_, \_\_ *[state]* \_\_, whose legal description is \_\_ *[provide description]* \_\_; to construct, furnish, and operate a multi-tenant commercial office building consisting of \_\_ *[e.g., 10 floors]* \_\_ with related facilities; to borrow money and issue evidences of indebtedness in connection with that project; to secure the payment of that indebtedness; and to do all things incidental to or in furtherance of these enumerated purposes.

*Comment:* A partnership organized for a definite purpose may be forced to dissolve on completion of the purpose. See §5.36.

**§5.56 6. Form: Powers**

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §5.50 and ends in §5.124



5.56-1 Powers

**F. Powers.** The Partnership is empowered to do any and all things necessary, appropriate, or convenient for the furtherance and accomplishment of its purposes and for the protection and benefit of the Partnership and its properties, including but not limited to the following:

1. Entering into and performing contracts of any kind;
2. Acquiring, constructing, operating, maintaining, owning, transferring, renting, or leasing any property, real, personal, or mixed;
3. Borrowing money and issuing evidences of indebtedness, and securing any such indebtedness by mortgage, deed of trust, pledge, lien, or other security interest in or on any Partnership properties;
4. Applying for and obtaining governmental authorizations and approvals;
5. Bringing and defending actions at law or equity; and
6. Subject to the express provisions of this Agreement, purchasing the interest of any Partner.

*Comment:* If a partnership has passive or inactive members, a powers clause without any limitations or restrictions may be useful as a guide to the active or managing partners. Because RUPA does not specifically grant or limit the powers of a partnership, a powers clause may prove useful when counsel is asked to give a creditor or third party an opinion on the validity of a partnership transaction.

## §5.57 C. Form: Statutory Filings

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §5.50 and ends in §5.124

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5.57-1 Statutory filings

### ARTICLE II

#### STATUTORY FILINGS

**A. Fictitious Name Filing.** The Partners, or any one of them, on the Partnership's behalf, shall sign and cause to be filed and published an appropriate fictitious business name statement under the California Fictitious Business Name Act within 40 days after the Partnership begins doing business, within 40 days after any subsequent change in its membership, and before the expiration of any previously filed statement. Each Partner appoints \_\_[name]\_\_ as his or her agent and attorney-in-fact to execute on his or her behalf any fictitious business name statement relating to this Partnership.

*[If applicable, add one or more of the following options]*

*[Option 1: Optional filing of statement under Corp C §18200]*

**B. Agent for Service of Process.** The Partnership shall execute and file with the California Secretary of State a statement under Corporations Code §18200 that designates the location and complete address of the Partnership's principal office in California and the Partnership's agent for service of process.

*[Option 2: Optional filing of statement of partnership authority]*

**[C.] Statement of Partnership Authority.** Promptly after the date the Partnership begins and after the date of any subsequent change in its membership, the Partners shall sign, acknowledge, and verify a statement of Partnership authority as provided in Corporations Code §§16105 and 16303, and cause it to be recorded in each county in California in which the Partnership owns or contemplates owning real property or any interest in real property. That statement shall include a statement that any conveyance, encumbrance, or transfer of an interest in the Partnership's real property must be signed on behalf of the Partnership by \_\_[e.g., at least two of the Partners, who must include either John Doe or Jane Roe]\_\_.

*Comment:* If a partnership files the statement under Corp C §18200 (see form in §5.49), it is treated like a corporation for venue purposes and may assert venue at the location of its principal office. The statement of partnership authority need not be filed, but title insurance companies typically require it for real estate partnerships. On the ability of a partner to file a statement of denial under Corp C §16304, see §5.45. For a form of fictitious business name statement, see §3.33.

**Source:** Business Law/Selecting and Forming Business Entities/5 General Partnerships/ D. Capital/ 1. Capital Contributions/§5.58 a. Form: Initial Contributions in Money or Property

## D. Capital

### 1. Capital Contributions

#### §5.58 a. Form: Initial Contributions in Money or Property

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §5.50 and ends in §5.124

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5.58-1 Initial contributions

## ARTICLE III

### CAPITAL CONTRIBUTIONS

*[Add one of the following alternatives]*

*[Alternative 1: Cash; partners contribute equally]*

**A. Initial Contributions of Cash.** Each Partner shall initially contribute to the Partnership's capital \$ \_\_ *[amount]* \_\_ in cash. Each Partner's contribution shall be paid in full within \_\_ *[number]* \_\_ days after the date of this Agreement.

*[Alternative 2: Cash; partners contribute unequally]*

**A. Initial Contributions of Cash.** The Partnership's initial capital shall consist of cash to be contributed by the Partners in the following amounts: \_\_ *[specify]* \_\_. Each Partner's contribution shall be paid in full within \_\_ *[number]* \_\_ days after the date of this Agreement.

*[Alternative 3: Property]*

**A. Initial Contributions of Property.** The Partnership's initial capital shall consist of the properties shown in Exhibit \_\_ *[specify number or letter]* \_\_ to this Agreement, which exhibit sets forth the market values of the respective items of property and identifies the Partners who will contribute the respective items of property to the Partnership. The market values are the amounts of the initial capital contributions of the Partners contributing the respective properties. Each Partner's contribution to the Partnership shall be conveyed within \_\_ *[number]* \_\_ days after the date of this Agreement.

*[Alternative 4: Cash and property]*

**A. Initial Contributions of Cash and Property.** The Partnership's initial capital shall consist of cash and the properties shown in Exhibit \_\_ *[specify number or letter]* \_\_ to this Agreement, which exhibit sets forth the capital contributions to be made by the respective Partners, the nature and quality of their respective contributions, and for contributions consisting of property, the market values of the respective items. Each Partner's contribution to the Partnership shall be paid in full or conveyed within \_\_ *[number]* \_\_ days after the date of this Agreement.

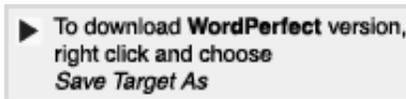
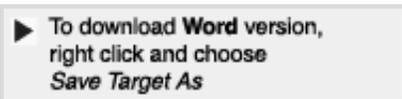
*Comment:* Absent agreement to the contrary, a partner is entitled to a properly maintained capital account (1) credited with the amount of money and the value of other property, net of any liabilities, that the partner contributes, plus the partner's share of profits, and (2) charged with the amount of money and the value of any property, net of liabilities, distributed to the partner, plus the partner's share of losses. Corp C §16401(a).

If there is a difference between the agreed value and the tax basis of any item of property, the agreement should contain additional provisions, and the exhibit should contain additional information, to reflect any resulting special tax allocations. See §5.60.



**§5.59            b. Form: Initial Contributions of Service**

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §5.50 and ends in §5.124



5.59-1            Initial contributions of service

**B. Initial Contributions of Service.** Partner   [name]   has rendered services in the formation and organization of the Partnership and in making the arrangements necessary for the acquisition of its properties, the financing of those acquisitions, and the commencement of its business operations.   [He/She]   shall contribute those services to the Partnership in consideration for the interest   [he/she]   is to have in the Partnership as described in this Agreement.

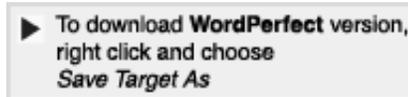
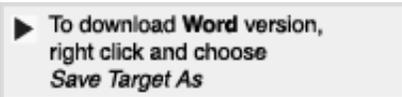
*Comment:* Receipt of an interest in partnership capital in exchange for services is generally a taxable event, but receipt of a profits interest in consideration for services may not be taxable under certain circumstances. See Rev Proc 93-27, 1993-2 Cum Bull 343, clarified by Rev Proc 2001-43, 2001-34 Int Rev Bull 191 (contributions of services in exchange for a profits interest). See also Advising California Partnerships, chap 3 (3d ed Cal CEB 1999).

A proposed elective "safe harbor" for a partnership's transfers of interests is set forth in Prop Treas Reg §1.83-3(l). The proposed safe harbor, and related IRS proposals, would render Rev Proc 93-27 and Rev Proc 2001-43 obsolete. Until the proposals become final, however, taxpayers may continue to rely on current law, including Rev Proc 93-27 and Rev Proc 2001-43. See Notice 2005-43, 2005-24 Int Rev Bull 1.

The Uniform Partnership Act (RUPA) (Corp C §§16100-16962) does not regulate the character of a partner's contribution to a general partnership; it is not uncommon for one partner to contribute capital in the form of money or property while another partner contributes its skills and services.

## §5.60 2. Form: Basis of Contributions

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §5.50 and ends in §5.124



5.60-1 Basis of contributions

**C. Basis of Contributions.** For certain items of property to be contributed to the Partnership's capital, Exhibit \_\_[specify number or letter]\_\_ to this Agreement shows the basis of those items for federal income tax purposes in the hands of the respective Partners who are to contribute them and the amounts that the Partners agree are the market values of the respective items. Notwithstanding any other provisions of this Agreement, income, gain, loss, and deductions with respect to the contributed property shall be allocated among the Partners to reflect the difference between the basis of the property contributed for tax purposes and its fair market value, in accordance with Internal Revenue Code §704(c) and the regulations thereunder.

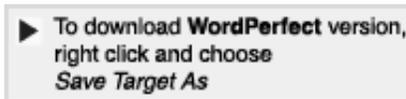
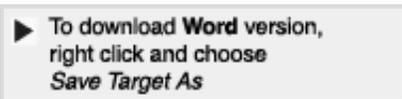
*Comment:* This clause is designed to ensure that a partner who contributes property with a tax basis different than its fair market value is allocated any income, gain, loss, or deductions associated with that partner's contribution. The remaining partners who contribute money equal in amount to the value of the contributing partner's property obtain a corresponding tax benefit associated with their contributions.

There is more than one method of allocating income, gain, loss, and deductions under IRC §704(c); the partners may wish to identify the method to be used. See *Advising California Partnerships*, chap 3 (3d ed Cal CEB 1999).

Note that under the American Jobs Creation Act of 2004 (Pub L 108-357, 118 Stat 1418), IRC §704(c)(1)(C) requires that any built-in loss be taken into account only in determining allocations to the contributing partner, *i.e.*, partners may not transfer losses among themselves. In determining the amount of items allocated to partners other than the contributing partner, the basis of the contributed property is deemed to be its fair market value. As a result, if the contributing partner's interest is transferred or liquidated, the partnership's basis in the property is its fair market value at contribution, eliminating the built-in loss as to the partnership. See H Conf Rep 108-755, 108th Cong, 2d Sess (2004), reprinted in 2005 US Code Cong & Ad News 1673.

### §5.61 3. Form: Failure to Make Initial Contribution

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §5.50 and ends in §5.124



5.61-1 Failure to make initial contribution

*[Add one of the following alternatives]*

*[Alternative 1: Partnership dissolves]*

**D. Failure to Make Initial Contribution.** If any Partner fails to pay or convey his or her initial contribution to the Partnership's capital at the time and in the form and amount required by this Agreement, the Partnership shall immediately dissolve and each Partner who has paid or conveyed all or any portion of his or her initial contribution to the Partnership's capital shall be entitled to a return of the funds and properties that he or she contributed. If the Partners shall have entered into a written agreement requiring an alternative procedure for continuing the Partnership, however, the alternative procedure shall be followed.

*[Alternative 2: Partnership continues without additional contributions]*

**D. Failure to Make Initial Contribution.** If any Partner fails to pay or convey his or her initial contribution to the Partnership's capital at the time and in the form and amount required by this Agreement \_\_ *[and the amounts in default are \_\_ *[number]* \_\_ percent or less of all initial capital contributions required by this Agreement]* \_\_, the Partnership shall not dissolve or terminate, but it shall continue as a Partnership of only the Partners who have made their initial capital contributions as required. The share in the Partnership's profits and losses allocated under this Agreement to any Partner who has failed to make his or her initial contribution shall be reallocated to the remaining Partners in proportion to their respective shares of Partnership profits and losses as specified in this Agreement.

If the failure to pay initial capital contributions required under this Agreement relates to more than the above-specified percentage of all required initial capital contributions, the Partnership shall immediately dissolve. Each Partner who has paid all or any portion of his or her initial or any additional capital contribution shall then be entitled to a return of the funds and properties he or she contributed.

*[Alternative 3: Additional contributions required for continuation]*

**D. Failure to Make Initial Contribution.** If any Partner fails to pay his or her initial contribution to the Partnership's capital at the time and in the form and amount required by this Agreement \_\_ *[and the amounts in default are \_\_ *[number]* \_\_ percent or less of all initial capital contributions required under this Agreement]* \_\_, the Partnership shall not dissolve or terminate, but it shall continue as a Partnership of only the Partners who have made their initial capital contributions, but only if those Partners pay the initial capital contribution that was to have been made by each noncontributing Partner, as follows:

1. The Partnership shall promptly give written notice of the failure to all Partners who have not failed to make their initial capital contributions, specifying the amount not paid.

2. Within \_\_ *[number]* \_\_ days after the notice is given, the remaining Partners shall pay the amount of the defaulted contribution in proportion to the respective amounts that they are required to contribute to the Partnership's capital under this Agreement.

3. Each noncontributing Partner's share in the Partnership's profits and losses shall be reallocated to the remaining Partners in proportion to their respective shares of Partnership profits and losses under this Agreement.

If the failure to pay initial capital contributions required under this Agreement relates to more than the

above-specified percentage of all required initial capital contributions, the Partnership shall immediately dissolve. Each Partner who has paid all or any portion of his or her initial or any additional capital contribution shall then be entitled to a return of the funds and properties he or she contributed.

[Alternative 4: Partners or outsiders may purchase defaulted share]

**D. Failure to Make Initial Contribution.** If any Partner fails to pay any contribution to the Partnership's capital at the time and in the form and amount required by this Agreement \_\_ [and the amounts in default are \_\_ [number]\_\_ percent or less of all initial capital contributions required under this Agreement] \_\_, the Partnership shall not dissolve or terminate, but it shall continue as a Partnership of only the Partners who have made their capital contributions and any purchaser of the interest of any Partner who shall have failed to do so, but only if the defaulting Partner's interest in the Partnership is acquired as follows:

1. The Partnership shall promptly give written notice of the failure to make payment, specifying the amount not paid, to all Partners who have made their required capital contributions. Any or all of the remaining Partners shall be entitled to elect to acquire the Partnership interest of the Partner who has failed to make the required contribution by giving written notice of election to the Partnership within \_\_ [number]\_\_ days after the Partnership gives notice of the default.

2. Within \_\_ [number]\_\_ days after the Partnership gives notice of default, the electing Partners shall pay to the Partnership the amount of the defaulted contribution and shall pay to the defaulting Partner any credit balance then in his or her capital account.

3. If only one Partner elects to acquire the interest, that Partner shall make the entire payment and acquire the entire interest. If more than one Partner elects to acquire the interest, each shall share in the payments and in the interest acquired in the same proportion that the amount required to be paid to the Partnership's capital by that Partner under this Agreement bears to the aggregate amounts required to be paid to the Partnership's capital by all participating Partners under this Agreement.

4. If no Partner elects to acquire the interest of a defaulting Partner, that interest may be offered to other parties, subject to the approval of a majority in capital interest of the Partners who have not defaulted, at a price equal to the sum of (a) the unpaid contribution of the defaulting Partner, which shall be payable to the Partnership, plus (b) any credit balance then in the defaulting Partner's capital account, which shall be payable to the defaulting Partner.

5. On a purchase of a defaulting Partner's interest, the purchaser's capital account shall be credited with the amount of the defaulting Partner's unpaid contribution paid to the Partnership by that purchaser plus any credit balance in the defaulting Partner's capital account that has not been paid to the defaulting Partner.

*Comment:* Alternative 1 of this form is often the most workable, unless the number of proposed partners is so large that it would be difficult for them to meet promptly and decide how to handle defaults. The partners may make the failure to contribute an event of dissolution under Corp C §16801(3). Alternative 2 is suitable for a large partnership in which the failure to make an initial contribution will not seriously affect operation of the partnership. Alternative 3 allows the partnership to continue if the remaining partners make the contributions of a defaulting partner. Alternative 4 applies to a failure to make an initial capital contribution as well as any other contribution during the life of the partnership.

## §5.62 4. Form: Deferred Contributions

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §5.50 and ends in §5.124

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5.62-1 Deferred contributions

**E. Deferred Contributions.** \_\_[Name]\_\_ shall be a Partner, but shall not make any contribution in cash or property to the Partnership's initial capital, and no amount shall be credited initially to \_\_[his/her]\_\_ capital account. \_\_[He/She]\_\_ shall subsequently contribute to the Partnership capital, and \_\_[his/her]\_\_ capital account shall be credited, as follows:

[Add one of the following alternatives]

[Alternative 1: Monthly installments]

\_\_[Name]\_\_ shall contribute \$ \_\_[amount]\_\_ to the Partnership capital on or before the first day of each month, beginning on \_\_[date]\_\_ and continuing until \_\_[he/she]\_\_ shall have contributed the aggregate sum of \$ \_\_[amount]\_\_.

[Alternative 2: Contributions from profits]

\_\_[Name]\_\_ shall contribute to the Partnership the lesser of \$ \_\_[amount]\_\_ or \_\_[number]\_\_ percent of \_\_[his/her]\_\_ distributive share of the Partnership's profits for each fiscal year, beginning with the year ending \_\_[date]\_\_ and continuing until \_\_[he/she]\_\_ shall have contributed the aggregate sum of \$ \_\_[amount]\_\_. These contributions shall be made on or before the date on which the respective year's distributive shares of profits are distributed in full and may be made by not withdrawing the specified portion or amount of Partnership profits.

*Comment:* A partner may not begin to enjoy any of the tax benefits associated with the partnership until the partner actually has made a contribution to the capital of the partnership, because the partner may not have sufficient basis for tax purposes (see IRC §704(d)) or the partner may not have any amounts "at risk" (IRC §465).

## §5.63 5. Form: Additional Capital

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §5.50 and ends in §5.124

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5.63-1 Additional capital

**F. Additional Capital.** Each Partner shall annually contribute to the Partnership's capital, for a period of \_\_[number]\_\_ years, the lesser of \$ \_\_[amount]\_\_ or \_\_[number]\_\_ percent of that Partner's share of each year's profits by not withdrawing the specified portion or amount of Partnership profits.

Whenever it is determined by the written agreement of Partners holding \_\_[e.g., a majority]\_\_ in capital interest of the Partnership that its capital is or is presently likely to become insufficient for the conduct of its business, those Partners may, by written notice to all Partners, call for additional contributions to capital. These contributions shall be payable in cash no later than the date specified in the notice and no sooner than \_\_[number]\_\_ days after the notice is given. Each Partner shall be liable to the Partnership for that Partner's share of the aggregate contributions duly called for under this section. Each Partner's share shall be in proportion to his or her share of the Partnership's profits, but no Partner shall be required to contribute more than \$ \_\_[amount]\_\_.

No Partner may make any voluntary contribution of capital to the Partnership without the consent of all the Partners.

*Comment:* The power to call for additional capital could be given to a managing partner or a committee of partners rather than a majority in number of partners. The ceiling on each partner's obligation for additional capital also may be expressed as a formula, such as a percentage of the credit balance in the partner's capital account. The power to call for additional capital should be used with caution and avoided if the partnership consists of relatively few partners who can readily meet and decide unanimously how to respond to possible deficiencies in the partnership's capital.

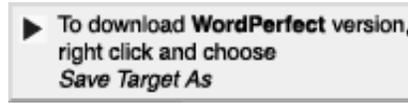
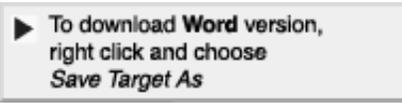
The restriction on voluntary contributions may be necessary to prevent overreaching if profit-sharing or control is geared to balances in capital accounts or interest will be paid on capital. For a clause providing that there will be no interest on capital contributions, see §5.65.

In practice, one or more partners generally make short-term loans to the partnership to enable the business to weather a crisis. See §5.66.

**Source:** Business Law/Selecting and Forming Business Entities/5 General Partnerships/§5.64 6. Form: Withdrawals of Capital

**§5.64 6. Form: Withdrawals of Capital**

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §5.50 and ends in §5.124



5.64-1 Withdrawals of capital

**G. *Withdrawals of Capital.* No Partner may withdraw capital from the Partnership without the consent of all the Partners.**

*Comment:* This clause preserves the partnership capital.

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**Source:** Business Law/Selecting and Forming Business Entities/5 General Partnerships/§5.65 7. Form: No Interest on Capital Contributions

## §5.65 7. Form: No Interest on Capital Contributions

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5.65-1 No interest on capital contributions

**H. *No Interest on Capital Contributions.* No Partner shall be entitled to receive any interest on his or her capital contribution, except that, if a Partner is entitled to repayment of his or her contribution, the Partner shall be entitled to interest on the contribution not repaid at the rate of \_\_[number]\_\_ percent per annum from the date when repayment should have been made.**

*Comment:* If a partnership obligation results from a partner's dissociation, the partner is entitled to interest only from the date of dissociation through the date of actual payment. If it is contemplated that the partners' relative capital account balances may not always coincide with partners' relative profit-sharing percentages, the practitioner should consider payment of interest on capital accounts.

**Source:** Business Law/Selecting and Forming Business Entities/5 General Partnerships/§5.66 8. Form: Loans to Partnership

## §5.66 8. Form: Loans to Partnership

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §5.50 and ends in §5.124

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5.66-1 Loans to partnership

**I. Loans to Partnership.** No Partner shall lend or advance money to or for the Partnership's benefit without the approval of \_\_[all/a majority in capital interest of the]\_\_ Partners. If any Partner, with the requisite consent of the other Partners, lends any money to the Partnership in addition to his or her contribution to its capital, the loan shall be a debt of the Partnership to that Partner and shall bear interest at the rate of \_\_[number]\_\_ percent per annum. This liability shall not be regarded as an increase in the lending Partner's capital and shall not entitle the lending Partner to any increased share of the Partnership's profits.

Any loan by a Partner to the Partnership shall be evidenced by a promissory note delivered to the lending Partner and executed in the name of the Partnership by the managing Partner.

*Comment:* All sums treated as loans to the partnership accrue interest from the date of payment or advance unless otherwise agreed to by the partners. Corp C §16401(e). It is therefore proper to restrict the right to make these advances without the consent of the other partners.

**Source:** Business Law/Selecting and Forming Business Entities/5 General Partnerships/§5.67 E. Form: Division of Profits and Losses

## §5.67 E. Form: Division of Profits and Losses

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §5.50 and ends in §5.124

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5.67-1 Division of profits and losses

### ARTICLE IV

#### ALLOCATIONS AND DISTRIBUTIONS

*[Alternative 1: Division based on initial capital contribution of profit and losses]*

**A. Division of Profits and Losses.** The Partnership's profits and losses shall be allocated among the Partners in the same proportions that their initial capital accounts bear to each other. No additional share of profits or losses shall inure to any Partner because of fluctuations in the Partners' capital accounts.

*[Alternative 2: Division based on average capital account balance]*

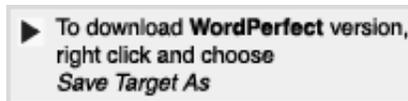
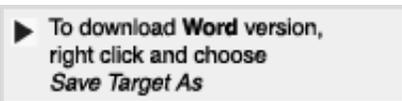
**A. Division of Profits and Losses.** The Partnership's profits and losses shall be allocated among the Partners in the same proportions that their average capital account balances during the fiscal year bear to each other. No Partner shall make contributions or withdrawals from his or her capital account without unanimous written approval of all Partners.

*Comment:* For a discussion of profit and loss sharing, see §5.32.

## F. Distributions to Partners

### §5.68 1. Form: Distribution of Profits

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §5.50 and ends in §5.124



5.68-1 Distribution of profits

[Add one of the following alternatives]

[Alternative 1: Distributions in proportion to initial capital contributions]

**B. Distribution of Profits.** The Partnership may distribute to the Partners any cash in excess of amounts reasonably necessary to the conduct of the business of the Partnership. Except as provided in sections \_\_ [specify number or letter] \_\_, distributions shall be made to the Partners in proportion to their initial capital contributions.

[Alternative 2: Distributions based on profit]

**B. Distribution of Profits.** Within \_\_ [number] \_\_ days after the end of each fiscal year of the Partnership, the Partnership shall distribute in cash to the Partners, in proportion to their respective shares in the Partnership's profits, an amount equal to the Partnership's profit for that fiscal year as computed under this Agreement.

[Alternative 3: Distributions based on cash flow]

**B. Distribution of Profits.** Within \_\_ [number] \_\_ days after the end of each fiscal year of the Partnership, the Partnership shall distribute in cash to the Partners, in proportion to their respective shares in the Partnership's profits, an amount equal to:

1. The Partnership's profit for that fiscal year as computed under this Agreement;
2. Increased by the amounts deducted for that fiscal year as depreciation or cost recovery, depletion, or amortization on the Partnership's federal income tax return;
3. Increased by the amount of any payments received, and reduced by the amount of any payments made, by the Partnership during that fiscal year on account of the principal of all debt obligations, other than obligations for which provision was made in computing profit; and
4. Reduced by a reserve reasonably retained for the operating and capital requirements of the Partnership's business.

*Comment:* The cross-reference in Alternative 1 is to the provisions for reductions of capital accounts in §5.74 and for indemnification in §5.107. It provides the easiest form of distribution and parallels the method of allocating partnership income and deductions set forth in §5.67. For a discussion of distributions, see §5.33. On the tax impact of distributions, see *Advising California Partnerships*, chap 13 (3d ed Cal CEB 1999). The agreement may also provide for a partner's drawing account in certain instances (e.g., for a professional partnership), although the modern tendency is to accomplish this objective through the use of distributions.

In many enterprises, profit does not have a direct correlation to cash available for distribution. Distributions based on cash flow, as provided in Alternative 3, are used in real estate ventures or other businesses in which depreciation or similar charges not involving cash outlays significantly reduce net income. Exclusion of principal payments on debt from the cash flow adjustments in computing profit covers collections of accounts receivable and payments of accounts payable that represent income or expenses already taken into account in computing net income.



## §5.69 2. Form: Distributions of Proceeds From Sale of Capital Assets

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §5.50 and ends in §5.124

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5.69-1 Distributions of proceeds from sale of capital assets

**C. Distributions from Sales of Assets.** If \_\_ [description or other identification of asset] \_\_ is sold, simultaneously with the distribution of the Partnership's profits for each fiscal year during which the Partnership is paid all or any part of the proceeds of that sale, the Partnership shall also distribute in cash to the Partners an amount equal to the cash proceeds realized by the Partnership during that year on the sale, including payments on account of the principal of any purchase money obligation received by the Partnership in the sale but excluding interest on that obligation. Such proceeds shall be allocated for distribution to the Partners in a manner that will result in the distribution to the Partners of the Partnership's gain or loss from the sale being proportionate to their respective shares in the gain or loss from the sale reportable by them for federal income tax purposes, except as otherwise expressly provided in this Agreement. Each Partner's share of the distributions of proceeds from any sale of capital assets shall be charged to his or her capital account.

*Comment:* This provision is particularly appropriate for real estate partnerships that dispose of their property. Any sale of the underlying real estate triggers other tax-reporting obligations. The practitioner should be aware of potential allocations to the partner contributing the property being sold. See IRC §704(c). These provisions must be coordinated with the provisions regarding distributions based on profits from operation of the partnership. For example, if a capital asset is sold for \$1 million in cash with gain of \$400,000, this provision would control the distribution rather than the provisions controlling distributions of profits, and the \$1 million amount realized, rather than \$400,000 in profit, would be distributed.

Note that IRC §704(c)(1)(C) requires that any built-in losses can be used only by the contributing partner; therefore partners may not transfer losses among themselves. See Comment in §5.60.

**Source:** Business Law/Selecting and Forming Business Entities/5 General Partnerships/§5.70 3. Form: Limit on Distributions

### §5.70 3. Form: Limit on Distributions

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §5.50 and ends in §5.124

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5.70-1 Limit on distributions

[Add one of the following alternatives]

[Alternative 1: General limitation]

**D. Limit on Distributions.** Notwithstanding anything in this Agreement to the contrary, the aggregate amounts distributed to the Partners from the Partnership's profits shall not exceed the amount of cash available for distribution, taking into account the Partnership's reasonable working capital needs as determined by a majority in capital interest of the Partners.

[Alternative 2: Specific limitation]

**D. Limit on Distributions.** Notwithstanding anything in this Agreement to the contrary, the aggregate amounts distributed to the Partners from the Partnership's profits during any fiscal year of the Partnership shall not exceed    [dollar amount/    [number]    percent of the aggregate positive balances of all capital accounts]    as of the close of the Partnership's immediately preceding fiscal year.

*Comment:* Alternative 2 withholds from distributions each year the income in excess of the specified percentage of the partnership's capital. This limitation could be expressed in specific dollar amounts or as a percentage of income. Any amounts withheld may nevertheless represent partnership income on which the partners must pay taxes. See Treas Reg §1.702-1(a). See also Advising California Partnerships, chap 13 (3d ed Cal CEB 1999).

## G. Accounting

### §5.71 1. Form: Fiscal Year of Partnership

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5.71-1 Fiscal year of partnership

## ARTICLE V

### ACCOUNTING

*[Add one of the following alternatives]*

*[Alternative 1: Fiscal year is calendar year]*

**A. Fiscal Year.** The fiscal year of the Partnership shall be the calendar year.

*[Alternative 2: Fiscal year is noncalendar year]*

**A. Fiscal Year.** The fiscal year of the Partnership shall end on \_\_ *[month and day]* \_\_ of each year.

*Comment:* Generally, the partnership should avoid a variation between its fiscal year for purposes of internal accounting and its taxable year. A partnership's taxable year must be the same as that shared by partners who have a greater than 50 percent interest in partnership profits and capital. If there is no such taxable year, the partnership's taxable year must be that of all its principal partners (partners having an interest of 5 percent or more in partnership profits or capital). If there is no such taxable year, the partnership's taxable year must be the calendar year or any other year prescribed by Internal Revenue Service regulations. See generally IRC §706(b).

**Source:** Business Law/Selecting and Forming Business Entities/5 General Partnerships/§5.72 2. Form: Accounting Method

## §5.72 2. Form: Accounting Method

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5.72-1 Accounting method

**B. Accounting Method.** The Partnership books shall be kept on the \_\_ [e.g., *accrual/cash*]\_\_ basis.

*Comment:* The choice of accounting method used in keeping the books of the partnership depends on a number of factors, including the unique aspects of the business; whether a C corporation is a partner (IRC §448(a)(2)); the determination that the partnership is a tax shelter (IRC §448(a)(3)); or the effect of using that method of accounting in determining the taxable income of the partnership. The partnership may elect any method of accounting otherwise allowable as long as it clearly reflects income.

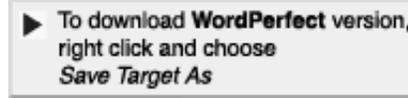
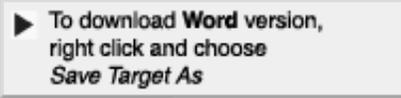
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**Source:** Business Law/Selecting and Forming Business Entities/5 General Partnerships/ 3. Capital Accounts/§5.73 a.  
**Form:** Capital Accounts--Initial Contributions

### 3. Capital Accounts

#### §5.73 a. Form: Capital Accounts—Initial Contributions

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §5.50 and ends in §5.124



5.73-1 Capital accounts—initial contributions

**C. Capital Accounts.** An individual capital account shall be maintained for each Partner and the Partner's initial capital contribution in cash or property shall be credited to that account. Capital accounts shall be maintained in accordance with Treasury Regulation §1.704-1(b)(2)(iv). No additional share of profits or losses shall inure to any Partner because of changes or fluctuations in the Partner's capital account.

*Comment:* If profits and losses are shared on the basis of fluctuating capital accounts, the last sentence in this provision should be omitted. Capital accounts must be maintained in accordance with the cited regulations if an allocation of income, gain, profit, or loss is to have substantial economic effect. See §5.32.

## §5.74 b. Form: Adjustment of Capital Accounts

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### 5.74-1 Adjustment of capital accounts

**1. Capital Account Credits.** The capital account for each Partner shall be credited with or increased by the following:

(a) Any additional capital contributions made by the Partner from time to time as authorized by this Agreement;

(b) The Partner's share under this Agreement of the Partnership's profits; and

(c) On the Partnership's dissolution and in its winding up, the credits authorized by the provisions of this Agreement that relate to adjustments of capital accounts in connection with liquidation.

**2. Capital Account Debits.** The capital account for each Partner shall be debited with or reduced by the following:

(a) Distributions to the Partner of cash or property, which property shall be valued for this purpose at its fair market value;

(b) The Partner's share under this Agreement of the Partnership's losses and of any items then required under applicable tax laws, rules, and regulations to be debited to capital accounts of Partners, to the extent and in the manner so required; and

(c) On the Partnership's dissolution and in its winding up, the debits authorized by the provisions of this Agreement that relate to adjustments of capital accounts in connection with liquidation.

**3. Capital Account Adjustments.** In connection with the actual liquidation of the Partnership's properties on its dissolution and winding up, the capital account for each Partner shall be adjusted to reflect the following:

(a) The results of operations for the fiscal period then ended;

(b) The results of transactions in connection with the liquidation;

(c) Unrealized gain or loss on Partnership property that is to be or has been transferred to creditors on account of their claims or distributed to Partners on account of their interests in the Partnership. The amount of such unrealized gain or loss shall be computed by comparing the fair market value of any such property to its adjusted basis for federal income tax purposes. The unrealized gain or loss shall be allocated to the Partners' capital accounts in the same manner as the gain or loss from the actual sale of such property would have been allocated; and

**4. Capital Account Deficits.** The distribution of cash or property to Partners made on the liquidation.

If there is a deficit in any Partner's capital account after the capital accounts have been adjusted in connection with the liquidation of the Partnership properties, that Partner (and not any predecessor) shall contribute the amount of such deficit to the Partnership before the end of the taxable year of the liquidation or by such earlier date as may be required to complete the liquidation in accordance with a duly adopted plan of liquidation. Amounts thus contributed shall be distributed to or among the creditors and Partners in accordance with the then-applicable provisions for distribution of Partnership property on dissolution, winding

## **up, and liquidation.**

*Comment:* These provisions provide the required capital account maintenance rules necessary for tax purposes under the test for substantial economic effect and should be included in the partnership agreement; if the partnership agreement makes any special allocation among the partners of partnership income, gain, loss, deduction, or credit, those items will be reallocated for tax purposes in accordance with the respective partners' "interests" in the partnership unless the capital account maintenance rules are followed and the special allocation otherwise has "substantial economic effect." For further discussion, see *Advising California Partnerships*, chap 13 (3d ed Cal CEB 1999).

In lieu of a deficit make-up obligation requirement, the partnership agreement may include a "qualified income offset" and corresponding "loss limitation" provision in compliance with Treas Reg §1.704-1(b)(2)(ii)(b), (d). For form language on qualified income offsets, see §6.91. For discussion of qualified income offsets and capital account deficit make-up provisions, see *Advising Partners* §§13.26-13.27. Likewise, partnerships that use nonrecourse financing must include language regarding minimum gain chargebacks and allocations of nonrecourse deductions. For form language on nonrecourse debt, see §§6.60 and 6.87-6.92; for discussion, see *Advising Partners* §§13.32-13.34.

#### §5.75 4. Form: Determination of Profit and Loss

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##### 5.75-1 Determination of profit or loss

**D. Profit and Loss Determination.** The Partnership's net profit or net loss for each fiscal year shall be determined as soon as practicable after the close of that fiscal year in accordance with the accounting principles employed in the preparation of the federal income tax return filed by the Partnership for that year, but without any special provisions for tax-exempt or partially tax-exempt income. If the Partnership assets include assets subject to Internal Revenue Code §704(c), the adjustments required under Internal Revenue Code §704(c) in the determination of any item of income, gain, loss, deduction, or credit shall not be taken into account in determining the same for book purposes.

##### 5.75-2 Definitions of "profit" and "loss"

"Profit" and "loss" for all purposes of this Agreement shall be determined in accordance with the accounting method followed by the Partnership for federal income tax purposes and otherwise in accordance with generally accepted accounting principles and procedures applied in a consistent manner. The calculation of profit and loss shall take into account Partnership income exempt from federal income tax and Partnership expenses and costs not deductible or properly chargeable to capital for federal income tax purposes. Every item of income, gain, loss, deduction, credit, or tax preference entering into the computation of profit or loss shall be considered as allocated to each Partner in the same proportion as profit is allocated to that Partner for any year in which the Partnership operates at a profit, and in the same proportion as loss is allocated to that Partner for any year in which the Partnership operates at a loss. Any increase or reduction in the amount of any item of income, gain, loss, or deduction attributable to an adjustment to the basis of Partnership property made under a valid election under Internal Revenue Code §754 and under the corresponding provisions of applicable state and local income tax laws shall be charged or credited, as the case may be, and any increase or reduction in the amount of any item of credit or tax preference attributable to any such adjustment shall be allocated to the capital accounts of those Partners entitled to them under such code or laws.

*Comment:* The reference to "generally accepted accounting principles" should be included only if the partnership reports its federal income tax on an accrual basis or intends to keep its books on that basis.

**Source:** Business Law/Selecting and Forming Business Entities/5 General Partnerships/ H. Records and Reports/§5.76  
1. Form: Partnership Books

## H. Records and Reports

### §5.76 1. Form: Partnership Books

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5.76-1 Partnership books

**E. *Partnership Books.*** The Partnership shall keep proper and complete books of account of its business at its chief executive office. The Partnership shall provide its Partners and their agents and attorneys access to the books and records, and provide to former Partners and their agents and attorneys access to books and records pertaining to the period during which they were Partners. This right of access includes the opportunity to inspect and copy books and records during ordinary business hours. The Partnership may impose reasonable charges covering the cost of labor and material for copies of documents furnished. The accounting records shall be maintained in accordance with generally accepted bookkeeping practices for this type of business.

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**Source:** Business Law/Selecting and Forming Business Entities/5 General Partnerships/§5.77 2. Form: Annual Report to Partners

## §5.77 2. Form: Annual Report to Partners

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5.77-1 Annual report to partners

**F. Annual Reports.** Within \_\_[number]\_\_ days after the end of each fiscal year, the Partnership shall furnish to each Partner an annual report consisting of at least:

- 1. A copy of the Partnership's federal and state income tax returns for that fiscal year;**
- 2. A supporting statement of income or loss;**
- 3. A balance sheet showing the Partnership's financial position as of the end of that fiscal year; and**
- 4. Any additional information that the Partners may require for the preparation of their individual federal and state income tax returns.**

*Comment:* The nature and frequency of financial reports by the partnership to its partners depends on the partnership's business, the number of partners, and whether all the partners are actively engaged in the partnership's business.

## I. Management

### §5.78 1. Form: Control of Business

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5.78-1 Control of business

## ARTICLE VI

### MANAGEMENT AND CONTROL

*[Add one of the following alternatives]*

*[Alternative 1: Vote based on partners' interest]*

**A. Control of Partnership Business.** Each Partner shall participate in the control, management, and direction of the Partnership's business. In exercising this control, management, and direction, each Partner's vote shall be in proportion to the Partner's interest in the Partnership's profits and losses.

*[Alternative 2: All partners have equal votes]*

**A. Control of Partnership Business.** Each Partner shall participate in the control, management, and direction of the Partnership's business. In exercising this control, management, and direction, each Partner shall have the same vote as each other Partner.

*[Alternative 3: Control by managing partner]*

**A. Control of Partnership Business.** The managing partner shall be \_\_[name]\_\_. \_\_[He/She]\_\_ shall have control over the business of the Partnership and assume direction of its business operation until replaced by a vote of \_\_[number]\_\_ percent of the Partnership interests. The managing partner shall consult and confer as far as practicable with the nonmanaging Partners, but the power of decision shall be vested in the managing partner. The managing partner's duties shall include control over the Partnership's books and records and hiring any independent certified public accountants \_\_[he/she]\_\_ considers necessary for this purpose and for the preparation of such reports as may be necessary or required to advise the other Partners of the Partnership's operations. Except as otherwise expressly provided in this Agreement, all things to be done by the Partnership shall be done under the managing partner's control and supervision. The managing partner shall devote such time to the business of the Partnership as \_\_[he/she]\_\_ determines is necessary in \_\_[his/her]\_\_ sole discretion. The managing partner shall be entitled to retain such consultants and agents as are reasonably necessary to provide services for operation of the Partnership, provided they remain under the ultimate control of the managing partner, and provided further that the managing partner does not delegate to such consultants or agents responsibilities charged to the managing partner. The managing partner shall be entitled to reimbursement monthly, on the submission of an itemized account, of any sums \_\_[he/she]\_\_ shall have expended for the benefit of the Partnership's business. On the managing partner's death, removal, resignation, or other disability, a successor managing partner shall be selected by a majority in capital interest of the Partners.

*Comment:* When the partnership agreement confirms that all partners will participate in the management of the partnership's business, as in these forms, the partners acknowledge the consequences of the resulting agency relationship as it affects their obligations to each other. Alternative 3 modifies the default provisions of Corp C §16401(h), which provides that a partner is not entitled to compensation for services performed for the partnership other than reasonable compensation for services rendered in winding up the business of the partnership. The managing partner's authority may be restricted by provisions requiring majority approval for certain acts. Such

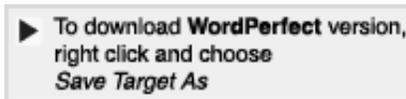
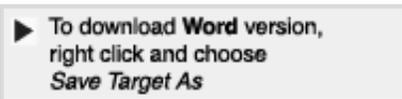
restrictions and provisions on management and control should be reflected in the partnership agreement and in the statement of partnership authority. See §5.44

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**Source:** Business Law/Selecting and Forming Business Entities/5 General Partnerships/§5.79 2. Form: Acts Requiring Majority Consent

## §5.79 2. Form: Acts Requiring Majority Consent

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5.79-1 Acts requiring majority consent

**B. Majority Consent.** The following acts may be done only with the consent of a majority in \_\_ *[number/capital interest/profit interest]* \_\_ of the Partners:

1. Borrowing money in the Partnership's name, other than in the ordinary course of the Partnership's business or to finance any part of the purchase price of the Partnership's properties;
2. Transferring, hypothecating, compromising, or releasing any Partnership claim except on payment in full;
3. Selling, leasing, or hypothecating any Partnership property or entering into any contract for any such purpose, other than in the ordinary course of the Partnership's business and other than any hypothecation of Partnership property to secure a debt resulting from any transaction permitted under (1); or
4. Knowingly suffering or causing anything to be done whereby Partnership property may be seized or attached or taken in execution, or its ownership or possession otherwise endangered.

*Comment:* These limitations establish the partners' obligations to each other; they may be expanded or restricted to meet the needs of the particular partnership. Unauthorized acts by partners in "apparently carrying on in the ordinary course the business of the partnership" may still expose the partnership to liability to third persons who have no knowledge of these limitations. Corp C §16301.

**§5.80 3. Form: Handling Funds**

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5.80-1 Handling funds

*[Add one of the following alternatives]*

*[Alternative 1: Funds handled by all partners]*

**C. Handling Funds. All Partnership funds shall be deposited in the Partnership's name and shall be subject to withdrawal only on the signatures of at least \_\_[number]\_\_ Partners.**

*[Alternative 2: Managing partner handles funds]*

**C. Handling Funds. All Partnership funds shall be deposited in the Partnership's name and shall be subject to withdrawal only on the signature of the managing partner.**

#### 4. Partners' Remuneration

##### §5.81 a. Form: Remuneration to Partners

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5.81-1 Remuneration to partners

*[Add one of the following alternatives]*

*[Alternative 1: Partners entitled to remuneration]*

**D. Partner Remuneration.** Each Partner shall be entitled to

**1. Monthly remuneration as follows:** \_\_ *[list names and amounts]* \_\_; or

**2. Other amounts as may from time to time be determined by the written consent or agreement of all the Partners.**

**Remuneration shall be treated as a Partnership expense in determining the Partnership's profits or losses.**

*[Alternative 2: No remuneration]*

**D. Partner Remuneration.** No Partner shall be entitled to remuneration for acting in the Partnership business.

*[Alternative 3: Remuneration to managing partner]*

**D. Partner Remuneration.** The managing Partner shall be entitled to monthly remuneration of \$ \_\_ *[amount]* \_\_ or such other amount as may from time to time be determined by the unanimous written consent or agreement of the Partners. That remuneration shall be treated as a Partnership expense in determining the Partnership's profits or losses.

*Comment:* Unless the partnership agreement provides otherwise, no partner is entitled to remuneration for acting in the ordinary partnership business, except for reasonable compensation for services rendered in winding up the business of the partnership. Corp C §16401(h). Alternative 1 is appropriate when all partners will work in the partnership. For tax considerations in providing remuneration to partners, see *Advising California Partnerships*, chap 13 (3d ed Cal CEB 1999).

**Source:** Business Law/Selecting and Forming Business Entities/5 General Partnerships/§5.82 b. Form: Effect of Assignment of Interest

**§5.82            b. Form: Effect of Assignment of Interest**

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5.82-1            Effect of assignment of interest

**E. *Effect of Assignment.* Any assignment or hypothecation of a Partner's interest in the Partnership shall terminate that Partner's right to receive remuneration from the Partnership.**

*Comment:* A purchaser of a partnership interest is entitled to receive only the profits to which his or her assignor would otherwise be entitled. Corp C §16503(b). By terminating a partner's right to the salary, this clause prevents a profits assignment from including salary.

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## J. Partner's Fiduciary Duty

### §5.83 1. Form: Duty of Loyalty

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5.83-1 Duty of loyalty

## ARTICLE VII

### FIDUCIARY DUTIES

**A. *Duty of Loyalty.*** Each Partner owes a duty of loyalty to the Partnership and the other Partners, which duty includes the following:

1. To account to the Partnership and hold as trustee for it any property, profit, or benefit derived by the Partner in the conduct and winding up of the Partnership business or derived from a use by the Partner of Partnership property or information, including the appropriation of a Partnership opportunity.

2. To refrain from competing with the Partnership in the conduct or winding up of the Partnership business as or on behalf of a party having an interest adverse to the Partnership.

3. To refrain from competing with the Partnership in the conduct of the Partnership business before the dissolution of the Partnership.

*[Add one of the following alternatives]*

*[Alternative 1: Noncompeting outside activities permitted]*

Any Partner may engage in one or more businesses, other than the business of the Partnership, but only to the extent that this activity does not compete or materially interfere with the Partnership's business and does not conflict with that Partner's obligations under this Agreement. Neither the Partnership nor any other Partner shall have any right to any income or profit derived by a Partner from any business activity permitted under this section.

*[Alternative 2: Outside activities restricted]*

While   *[name]*   is required to participate in the control, management, and direction of the Partnership business,   *[he/ she]*   shall devote   *[his/her]*   full time and attention to the conduct of that business and shall not be actively engaged in the conduct of any other business for compensation or a share in profits as an employee, officer, agent, proprietor, partner, or stockholder. This prohibition shall not prevent   *[him/her]*   from being a passive investor in any enterprise, however, if   *[he/she]*   is not actively engaged in its business and does not exercise control over it. Neither the Partnership nor any other Partner shall have any right to any income or profit derived from any such passive investment.

*[Alternative 3: Specific enumeration of permitted outside activities]*

A Partner shall be permitted to engage in the following conduct without being in violation of this Agreement:  
  *[Specify type of conduct to be permitted]*  .

*[Continue]*

Any act of a Partner that otherwise would violate the fiduciary duties owed by a Partner to the Partnership may be approved by the written consent of   *[e.g., 51 percent]*   of the remaining Partners who do not

**participate in such act on full disclosure of all material facts by the Partner whose conduct otherwise is deemed to breach such fiduciary duties.**

*Comment:* A partnership agreement may not eliminate the duty of loyalty, but, if not manifestly unreasonable, it may either identify specific activities that do not violate the duty of loyalty or allow for all of the partners (or some percentage identified in the partnership agreement) to authorize or ratify, after full disclosure of all material facts, a specific act or transaction that otherwise would violate that duty. Corp C §16103(b)(3).

The provision following Alternative 3 provides for the informed consent of all disinterested partners to any act by one partner that would otherwise violate the fiduciary duty to the partnership when the partnership agreement does not otherwise provide guidance on allowable conduct. The authorization must be unanimous unless another percentage (which itself is not "manifestly unreasonable") is specifically set forth in the partnership agreement.

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## §5.84 2. Form: Duty of Care

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5.84-1 Duty of care

**B. *Duty of Care.*** During the conduct of any Partnership business or when the Partnership is being wound up, no Partner shall be liable to the Partnership or any other Partner for losses sustained or liabilities incurred, unless it is determined that such conduct is grossly negligent or reckless, or intentional misconduct, or a knowing violation of law.

*Comment:* This provision provides the minimum standard of care. See Corp C §16404(c). The partners may increase the standard of care to one of an ordinarily prudent person or higher if they choose. The partnership agreement may contain provisions releasing a partner from liability for actions taken in good faith and in the honest belief that the actions are in the best interest of the partnership, while indemnifying the partner against any good faith belief that he or she has the power to act. See §5.107 for a form of indemnification.

**Source:** Business Law/Selecting and Forming Business Entities/5 General Partnerships/§5.85 3. Form: Duty of Good Faith and Fair Dealing

**§5.85            3. Form: Duty of Good Faith and Fair Dealing**

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5.85-1            Duty of good faith and fair dealing

***C. Duty of Good Faith and Fair Dealing.* Each Partner shall discharge its duties to the Partnership and the other Partners and exercise any rights consistently with the obligation of good faith and fair dealing.**

*Comment:* A partnership agreement may not eliminate the obligation of good faith and fair dealing but may prescribe the standards by which performance of that obligation is to be measured, if they are not manifestly unreasonable. Corp C §16103(b)(5). For example, the partners may specify that exercise of their rights under any provisions in the partnership agreement are manifestly reasonable, such as any rights to expel a partner or to otherwise purchase a partner's interest under controlling terms of the partnership agreement.

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**Source:** Business Law/Selecting and Forming Business Entities/5 General Partnerships/§5.86 4. Form: Furtherance of Partner's Own Interests

**§5.86 4. Form: Furtherance of Partner's Own Interests**

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §5.50 and ends in §5.124

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5.86-1 Furtherance of partner's own interests

**D. *Partner's Own Interests.* A Partner does not violate a duty or obligation under this Agreement or controlling law merely because the Partner's conduct furthers the Partner's own interest.**

*Comment:* See Corp C §16404(e). A partner as such is not a trustee and is not held to the same standards as a trustee.

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**Source:** Business Law/Selecting and Forming Business Entities/5 General Partnerships/ K. Changes in Membership and Partner Dissociation/§5.87 1. Form: New Partners

## **K. Changes in Membership and Partner Dissociation**

### **§5.87 1. Form: New Partners**

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5.87-1 New partners

## **ARTICLE VIII**

### **MEMBERSHIP CHANGES**

**A. New Partners.** A new Partner may be admitted to the Partnership \_\_ \_\_[as of the beginning of any fiscal year of the Partnership]\_\_ \_\_, but only with the written approval of \_\_ \_\_[all/a majority in capital interest of the]\_\_ \_\_ Partners. Each new Partner shall be admitted only if the new Partner shall have executed this Agreement or an appropriate supplement to it in which the new Partner agrees to be bound by the terms and provisions of this Agreement as they may be modified by that supplement. Admission of a new Partner shall not cause dissolution of the Partnership. Any new Partner so admitted to the Partnership shall contribute capital to the Partnership as agreed by all Partners.

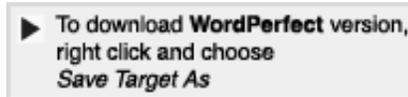
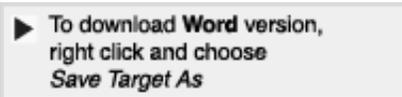
5.87-2 Consent of spouse

**B. Consent of Spouse.** Within 20 days after any individual becomes a Partner, or a Partner marries, the Partner shall have the Partner's spouse execute a consent substantially in the form attached as Exhibit \_\_ \_\_[specify number or letter]\_\_ \_\_, unless the Partner's spouse is already a Partner.

*Comment:* A new partner's liability for partnership obligations is governed by Corp C §§16306-16307. The consent of a spouse is needed any time a partner marries. Although an interest in a partnership predating marriage may be that partner's separate property, all or part of that interest may become community property if the partner renders significant services after marriage. See generally Fam C §1100. See form in §5.124.

## §5.88 2. Form: Partner's Dissociation

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §5.50 and ends in §5.124



5.88-1 Partner's dissociation

**B. Dissociation. A Partner is dissociated from the Partnership on the occurrence of any of the following events:**

**1. Delivery of written notice by the Partner setting forth the Partner's intention to withdraw as a Partner on the date set forth in the notice but in no event earlier than \_\_[e.g., 30 days]\_\_ after receipt by the Partnership.**

**2. As otherwise provided in this Agreement.**

**3. The Partner's expulsion as provided in this Agreement.**

**4. The Partner (a) becomes a debtor in bankruptcy; (b) executes an assignment for the benefit of creditors; (c) seeks, consents to, or acquiesces in the appointment of a trustee, receiver, or liquidation of that Partner or of all or substantially all of that Partner's property; or (d) fails to have vacated or stayed the appointment of a trustee, receiver, or liquidator of the Partner or of all or substantially all of the Partner's property obtained without the Partner's consent or acquiescence, within 90 days after the appointment or within 90 days after the expiration of a stay.**

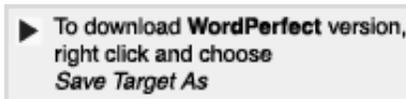
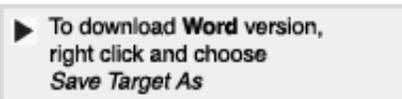
**5. For any individual Partner, on (a) the Partner's death; (b) the appointment of a guardian or general conservator for the Partner; or (c) a judicial determination that the Partner has otherwise become incapable of performing the Partner's duties under the Partnership Agreement.**

*Comment:* See Corp C §16601. In general, a partner has the power to dissociate at any time, and, although this power cannot be varied by the partnership agreement, the remaining partners may require that written notice be given. Corp C §§16103(b)(6), 16602(a). For form provisions regarding expulsion, see §§5.89-5.90. The partnership agreement may eliminate any power of expulsion. Corp C §16103(a).

There is some uncertainty whether the provisions regarding mandatory dissociation on the partner's becoming a debtor in bankruptcy are enforceable. 11 USC §§365(e), 541(c)(1). These provisions may invalidate any provisions that cause a termination or modification of the debtor's rights on the happening of a bankruptcy filing. Special rules applicable to trusts, estates, and business entities are provided in Corp C §16601(8)-(10).

### §5.89 3. Form: Partner's Expulsion by Partner Vote

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5.89-1 Partner's expulsion by partner vote

[Add one of the following alternatives]

[Alternative 1: Expulsion by partner votes in accordance with RUPA]

**C. Expulsion by Partner Vote.** A Partner may be expelled from the Partnership by the vote of the other Partners holding at least \_\_[number]\_\_ percent in capital interest of the Partnership (excluding the interest of the Partner to be expelled) if, by that vote, it is determined in the sole discretion of those Partners that:

1. It is unlawful to carry on the Partnership business with that Partner;
2. There has been a transfer of all or substantially all of that Partner's transferable interest in the Partnership, except a transfer for security purposes or issuance of a court's charging order, neither of which have been foreclosed on;
3. Within 90 days after the Partnership notifies a corporate Partner that it will be expelled because it has filed a certificate of dissolution or the equivalent, its charter has been revoked, or its right to conduct business has been suspended by the jurisdiction of its incorporation, there is no revocation of such certificate of dissolution or no reinstatement of its charter or its right to conduct business; or
4. A partnership, limited partnership, or limited liability company Partner has been dissolved and its business is being wound up.

[Alternative 2: Expulsion by partnership agreement]

**C. Expulsion by Partner Vote.** A Partner may be expelled from the Partnership by the vote of the other Partners holding at least \_\_[number]\_\_ percent in capital interest of the Partnership (excluding the interest of the Partner to be expelled) if, by that vote, it is determined in the sole discretion of those Partners that the Partner to be expelled has materially breached or is unable to perform that Partner's material obligations under this Agreement or that the continued association of that Partner with the Partnership is detrimental to the best interests of the Partnership's business.

[Continue]

Expulsion shall become effective when written notice of expulsion is served on the expelled Partner. When the expulsion becomes effective, the expelled Partner's rights, powers, and authority as a Partner of the Partnership, including its rights to participate in the Partnership's profits and to draw any salary, shall terminate.

*Comment:* See Corp C §16601(3)-(4). Absent agreement to the contrary, expulsion requires the unanimous vote of the other partners. Expulsion of a partner under these conditions results in its dissociation from the partnership.

**Source:** Business Law/Selecting and Forming Business Entities/5 General Partnerships/§5.90 4. Form: Expulsion by Judicial Determination

#### **§5.90 4. Form: Expulsion by Judicial Determination**

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5.90-1 Expulsion by judicial determination

**D. *Expulsion by Judicial Determination.*** On application by the Partnership or another Partner, a Partner may be expelled from the Partnership by judicial determination because of any of the following:

- 1. The Partner engaged in wrongful conduct that adversely and materially affected the Partnership business.**
- 2. The Partner willfully or persistently committed a material breach of the Partnership agreement or of a duty owed to the Partnership or the other Partners.**
- 3. The Partner engaged in conduct relating to the Partnership business that makes it not reasonably practicable to carry on the business in Partnership with the Partner.**

*Comment:* See Corp C §16601(5). This provision may not be amended or varied. Corp C §16103(b)(7).

**Source:** Business Law/Selecting and Forming Business Entities/5 General Partnerships/ 5. Retirement/§5.91 a. Form: Retirement From Partnership Management

## 5. Retirement

### §5.91 a. Form: Retirement From Partnership Management

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5.91-1 Retirement from partnership management

**E. Retirement from Management.** At the end of the Partnership's fiscal year, any Partner who has reached his or her \_\_[e.g., 70th]\_\_ birthday during that fiscal year shall retire from active participation in the control, management, and direction of the Partnership's business. Subject to the provisions of this Agreement regarding dissociation and dissolution, such a retirement shall not affect the retiring Partner's interest in the Partnership, its properties, or its profits and losses.

*Comment:* Any provision for mandatory retirement must be examined in light of California and federal age discrimination legislation. See Age Discrimination in Employment Act (29 USC §§621-634); Govt C §§12941-12942, discussed in Advising California Employers and Employees §§15.21-15.27, 18.5 (Cal CEB 2005).

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**Source:** Business Law/Selecting and Forming Business Entities/5 General Partnerships/§5.92 b. Form: Retirement From Partnership

## §5.92      b. Form: Retirement From Partnership

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5.92-1      Retirement from partnership

*[Add one of the following alternatives]*

*[Alternative 1: Voluntary retirement from partnership]*

**F. Retirement from Partnership.** After his or her \_\_[e.g., 70th]\_\_ birthday, any Partner may voluntarily retire from the Partnership after giving at least \_\_[number]\_\_ days' prior notice to the Partnership. On such retirement, the Partner shall be deemed dissociated from the Partnership.

*[Alternative 2: Mandatory retirement from partnership]*

**F. Retirement from Partnership.** After his or her \_\_[e.g., 70th]\_\_ birthday, any Partner may be compelled to retire from the Partnership by a vote of a majority in \_\_[number/capital interest]\_\_ of the other Partners. On such retirement, the Partner shall be deemed dissociated from the Partnership.

*Comment:* The partners may make retirement an act of dissociation.

## §5.93 6. Form: Noncompetition Covenant

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5.93-1 Noncompetition covenant

[Add one of the following alternatives]

[Alternative 1: Noncompetition covenant with a time limit]

**G. Noncompetition Covenant.** Following dissociation of a Partner or the dissolution of the Partnership, the dissociated Partner or the Partner causing the dissolution shall not carry on a business similar to the business of the Partnership within the \_\_[cities/counties]\_\_ of \_\_[names]\_\_ for a period of \_\_[number]\_\_ years as long as any other member of the Partnership, or any person deriving title to the business or its goodwill from any other member of the Partnership, carries on a like business there.

[Alternative 2: Noncompetition covenant without time limit]

**G. Noncompetition Covenant.** Following dissociation of a Partner or the dissolution of the Partnership, the dissociated Partner or the Partner causing the dissolution shall not carry on a business similar to the business of the Partnership within the \_\_[cities/counties]\_\_ of \_\_[names]\_\_ as long as any other member of the Partnership, or any person deriving title to the business or its goodwill from any other member of the Partnership, carries on a like business there.

*Comment:* Noncompetition covenants "upon or in anticipation of a dissolution of a partnership or the dissociation of a partner from the partnership" are authorized but limited by Bus & P C §16602. Such provisions must be carefully and narrowly drafted. See, e.g., *Kelton v Stravinski* (2006) 138 CA4th 941, 41 CR3d 877 (covenant not to compete between partners was unenforceable as it was not entered into in connection with sale of goodwill of business or anticipated dissolution of partnership). See also California Business Litigation, chap 3 (Cal CEB 2002).

**Source:** Business Law/Selecting and Forming Business Entities/5 General Partnerships/ 7. Purchase of Dissociated Partner's Interest/§5.94 a. Form: Payment When Business Not Wound Up

## **7. Purchase of Dissociated Partner's Interest**

### **§5.94 a. Form: Payment When Business Not Wound Up**

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5.94-1 Payment when business not wound up

**H. Purchase Price of Dissociated Partner's Interest.** Except as otherwise provided in this Agreement, if a Partner is dissociated from the Partnership and the remaining Partners do not elect to dissolve the Partnership, the Partnership shall cause the dissociated Partner's interest in the Partnership to be purchased on the following terms:

1. The buyout price of a dissociated Partner's interest is the amount that would have been distributable to the dissociating partner under California Corporations Code §16807(b) had the business of the Partnership been wound up if, on the date of dissociation, the assets of the Partnership were sold at a price equal to the greater of the liquidation value or the value based on a sale of the entire business as a going concern without the dissociated Partner and the Partnership was wound up as of that date. Interest shall be paid from the date the amount owed becomes due to the date of payment.

2. Damages for wrongful dissociation under Corporations Code §16602(b) and all other amounts owing from the dissociated Partner to the Partnership, whether or not presently due, shall be offset against the buyout price. Interest shall be paid from the date the amount owed becomes due to the date of payment.

3. The Partnership shall indemnify, defend, and hold the dissociated Partner harmless from any Partnership liabilities, whether incurred before or after the event of dissociation, except liabilities incurred by an act of the dissociated Partner after dissociation (a) when the other party reasonably believed that the dissociated Partner was then a Partner, (b) the other party did not have notice of the Partner's dissociation, or (c) the other party is not deemed to have knowledge of the Partner's dissociation due to filing of a statement of Partnership authority or statement of dissociation.

4. If no agreement is reached for the purchase of the dissociated Partner's interest within 120 days after the dissociated partner's written demand for payment, the Partnership shall pay, or cause to be paid, in cash to the dissociated Partner the amount the Partnership estimates to be the buyout price and accrued interest, reduced by any offsets and accrued interest under this section.

Payment shall be accompanied by all of the following:

(a) A statement of Partnership assets and liabilities as of the date of dissociation.

(b) The latest available Partnership balance sheet and income statement, if any.

(c) An explanation of how the estimated amount of the payment was calculated.

(d) A written notice that the payment is in full satisfaction of the obligation to purchase unless, within 120 days after the written notice, the dissociated partner commences an action to determine the buyout price or to determine any offset, or to decide other terms of the obligations to purchase.

5. Should any dissociation occur within 90 days before the dissolution of a Partnership, then:

(a) All Partners who dissociate within 90 days before the dissolution shall be treated as Partners for purposes of winding up the Partnership's business on a dissolution of the Partnership; and

**(b) Any damage for wrongful dissociation and all other amounts owed by the dissociated Partner to the Partnership, whether or not presently due, shall be taken into account in determining the amount distributable to the dissociated Partner on such dissolution and winding up.**

*Comment:* The buy-out of a dissociated partner in the absence of any agreement to the contrary is governed by Corp C §§16701 and 16701.5. The liability of a partnership and a dissociating partner on an event of dissociation is governed by Corp C §16703.

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**Source:** Business Law/Selecting and Forming Business Entities/5 General Partnerships/§5.95 b. Form: Payment of Purchase Price by Mutual Agreement When Business Not Wound Up

**§5.95            b. Form: Payment of Purchase Price by Mutual Agreement When Business Not Wound Up**

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5.95-1            Payment of purchase price by mutual agreement

**I. *Mutual Agreement on Purchase Price of Dissociated Partner's Interest.* Except as otherwise provided in this Agreement, if a Partner is dissociated from a Partnership and the remaining Partners do not elect to dissolve the Partnership, the Partnership shall cause the dissociated Partner's interest in the Partnership to be purchased for the purchase price determined in accordance this Agreement.**

*Comment:* This provision may be used to change the default provisions of Corp C §§16701 and 16701.5.

**Source:** Business Law/Selecting and Forming Business Entities/5 General Partnerships/ L. Transfer of Partnership Interests/§5.96 1. Form: Definition of Transferable Interest

## **L. Transfer of Partnership Interests**

### **§5.96 1. Form: Definition of Transferable Interest**

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5.96-1 Definition of transferable interest

## **ARTICLE IX**

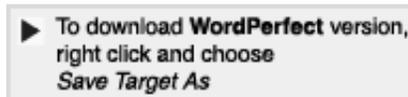
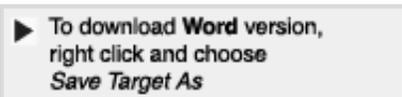
### **TRANSFER OF PARTNERSHIP INTERESTS**

**A. *Interests Transferable.*** The only transferable interest of a Partner in the Partnership is the Partner's share of the profits and losses of the Partnership and the Partner's right to receive distributions.

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## §5.97 2. Form: Transferability of Interest

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5.97-1 Transferability of interest

[Add one of the following alternatives]

[Alternative 1: Transferability of interest without substitution]

**B. Restrictions on Transfers.** A transfer in whole or in part of a Partner's transferable interest in the Partnership shall be permissible, but such a transfer does not:

1. Cause the Partner's dissociation or dissolution and winding up of the Partnership business; or
2. As against the remaining Partners, entitle the transferee, during the continuance of the Partnership, to participate in the management or conduct of the Partnership business, to require access to information concerning the Partnership transactions, or to inspect or copy Partnership books or records.

**C. Transferee's Rights.** Any such transferee has a right only to the following:

1. To receive, in accordance with the transfer, distributions to which the transferor would otherwise be entitled;
2. To receive on the dissolution and winding up of the Partnership business, in accordance with the transfer, the net amount otherwise distributable to the transferor; and
3. To seek a judicial determination that it is equitable to wind up the Partnership business.

**D. Accounting.** In a dissolution and winding up, a transferee is entitled to an account of Partnership transactions only from the date of the latest account agreed to by all of the Partners.

**E. Rights Retained.** On transfer, the transferor retains the rights and duties of a Partner other than the interest in distributions transferred.

**F. Notice of Transfer.** The Partnership shall not give effect to a transferee's rights under this section until the Partnership has notice of the transfer.

[Alternative 2: Nontransferability]

**B. Nontransferability.** A Partner's interest in the Partnership shall not be transferred, in whole or in part, except by intestate succession, testamentary disposition, or through a decree or judgment from a court of competent jurisdiction. Any other purported transfer of all or part of a Partner's interest shall be void and of no effect against the Partnership, any other Partner, any creditor of the Partnership, or any claimant against the Partnership. No such transfer shall constitute the transferee a Partner or entitle the transferee to any of the rights of a Partner, other than the right to receive as much of the transferor's share of Partnership distributions as is transferred to the transferee.

[Alternative 3: Limited transferability]

**B. Limits on Transfers.** A Partner may transfer all or part of his or her interest in the Partnership only as follows:

1. To the Partnership or to any other Partner;

2. By intestate succession or testamentary disposition on the Partner's death;
3. By a gift to the Partner's spouse or children, or to a trustee for the Partner's spouse or children or both;
4. To a corporation if, immediately after the transfer, the Partner making the transfer owns at least 50 percent of that corporation's voting shares; or
5. To any person after the Partner making the transfer has first offered the other Partners their rights of first refusal in accordance with the terms and conditions of this Agreement.

No such transfer shall constitute the transferee a Partner or entitle the transferee to any of the rights of a Partner, other than the right to receive as much of the transferor's share of Partnership distributions as is transferred to the transferee. Until the transferee is admitted to the Partnership in substitution for the transferor under the provisions of this Agreement for admitting new Partners, such a transfer shall not terminate any of the transferor's obligations.

*Comment:* Alternative 1 restates the provisions of Corp C §16503, which control in the absence of any agreement to the contrary. See Corp C §16103(a). Alternatives 2 and 3 prevent and limit, respectively, a transfer of partnership interests entirely and are permissible under Corp C §16503.

### §5.98 3. Form: Transfers on Dissolution of Marriage

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5.98-1 Transfers on dissolution of marriage

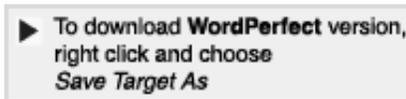
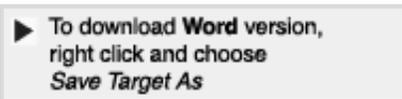
**[G.] *Transfers on Marriage Dissolution.*** In this section, "Partner" refers to the party named in the beginning of this Partnership agreement as a Partner and "Spouse" refers to the spouse of that Partner. In the event of a dissolution of marriage of any married Partner decreed by a court of competent jurisdiction, the interest of the Partner in the Partnership shall be allocated and distributed between the Partner and Spouse as the court may decree; provided, however, that:

- 1. No spouse shall become a partner of the Partnership by virtue of any allocation or distribution of the interest of such Partner in any such dissolution proceeding;**
- 2. The spouse shall have only the status of an assignee of the Partner's right to receive profits and losses of the Partnership under the provisions of Corporations Code §16503;**
- 3. As between the Partner and Spouse, the Partner shall continue to have the exclusive right and authority to act as a partner on behalf of and bind the Partnership as specified in this Agreement; and**
- 4. Any action, consent, or approval taken or given or any document or instrument executed by the Partner on his or her own behalf (and on behalf of Spouse as an assignee under this Agreement) shall be binding on the Partner and Spouse, and the other Partners and any third party shall be entitled to rely on any action so taken by such Partner in accordance with this Agreement.**

*Comment:* This form specifically sets out the spouse's rights in the event of a dissolution of marriage. It does not enlarge or diminish the rights or limitations given by Corp C §16503, but it may be useful in conjunction with the consent of spouses form (§5.124) to refute an argument that the spouse was not informed of the consequences of his or her action in signing the consent.

#### §5.99 4. Form: Right of First Refusal

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §5.50 and ends in §5.124



5.99-1 Right of first refusal

**[H.] *Right of First Refusal.*** If any Partner receives an offer, whether or not solicited by that Partner, from a person not then a Partner to purchase all or any portion of the Partner's interest in the Partnership, and, if the Partner receiving the offer is willing to accept it, the Partner may transfer the interest or portion specified in the offer only after he or she has afforded the Partnership and the other Partners the following rights of first refusal:

1. The Partner desiring to make the transfer must first notify the Partnership and each of the other Partners in writing of the interest or portion the Partner proposes to transfer, the price and terms on which it is proposed to be transferred, and the identity of the proposed transferee.

2. The Partnership shall have the option to purchase that interest or portion from the Partner at a price equal to the lesser of (a) the value of the interest or portion, computed under the provisions of this Agreement for valuing Partnership interests as of the date the notice of the proposed transfer is received by the Partnership, payable as provided in this Agreement, or (b) the same price and on the same terms as those specified in the notice of the proposed transfer. The Partnership shall exercise its option to purchase the interest or portion by written notice from the Partnership to the Partner, given within   [number]   days after the Partnership receives the Partner's notice of his or her desire to transfer.

3. If the Partnership does not exercise its option to purchase the interest or portion within the time provided, then, within   [number]   days after the Partnership receives the Partner's notice of the proposed transfer, any of the other Partners desiring to purchase all or any part of that interest or portion may deliver to the Partner who proposed to make the transfer and to each of the other Partners written notice of election to purchase all or a specified part of the interest or portion.

4. If the aggregate parts of the interest or portion specified in notices of election timely made by other Partners equal or exceed the entire offered interest or portion, the Partner desiring to transfer his or her interest or portion shall sell, and the Partners electing to purchase shall purchase, the interest or portion at a price equal to the lesser of (a) the value, as of the date the notice of the proposed transfer is received by the Partnership, of the interest or portion computed under the provisions of this Agreement for valuing Partnership interests, payable as provided in this Agreement, or (b) the same price and on the same terms as those specified in the notice of the proposed transfer. If the aggregate parts of the interest specified in the notices of election timely made exceed the entire interest or portion proposed to be transferred, each Partner making this election shall purchase such part of the offered interest and be liable for such part of the total amount of the purchase price as the part of the interest or portion specified in that Partner's notice of election bears to the total of all parts of the interest or portion specified in all the notices of election timely made by Partners.

5. If the Partnership does not exercise its option to purchase the interest within the time provided and if the aggregate parts of the interest or portion specified in the notices of election timely made by Partners are less than the entire interest or portion proposed to be transferred, all of the elections shall be ineffective and the Partner proposing to make the transfer shall not be obligated to sell, nor shall any of the other Partners electing to purchase be entitled or obligated to purchase, all or any part of the offered interest or portion. The Partner proposing to transfer an interest or portion may then, at any time within   [number]   days following the expiration of the   [number]  -day period referred to in paragraph 3, transfer the specified interest or portion to the transferee specified in the notice on terms no more favorable to the purchaser than the terms stated in the notice and at no lower a price than the price stated in the notice.

*Comment:* This clause allows both the partnership and the individual partners to purchase the selling partner's interest and keep unwanted third parties from management, control, and operation of the partnership. This advantage must be balanced, however, against the possible hardship on a selling partner who might be prevented from obtaining the highest available price for his or her interest.

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## §5.100 5. Form: Valuation of Interest

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §5.50 and ends in §5.124

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### 5.100-1 Valuation of interest

*[Add one of the following alternatives]*

*[Alternative 1: Value of partner's interest based on capital account]*

**6. Valuation of Interest.** The value of a Partner's interest in the Partnership for purposes of this Agreement shall be calculated by taking into account the following items as of the date the value is to be determined, as these items are reflected on the Partnership's regularly maintained accounting books and records:

- (a) The balance in the Partner's capital account;
- (b) Plus the Partner's proportionate share of the Partnership's net profit for the current fiscal year to the date as of which the computation is made and not yet reflected in the Partner's capital or drawing account;
- (c) Less the Partner's proportional share of any loss shown by the Partnership operations for that period;
- (d) Plus any debt or other amount due to the Partner from the Partnership; but
- (e) Less any debt owed by the Partner to the Partnership.

*[Alternative 2: Valuation of partner's interest by agreement]*

**6. Valuation of Interest.** The value of a Partner's interest in the Partnership for purposes of this Agreement shall be calculated by applying that Partner's proportional interest in \_\_ *[e.g., current profits/aggregate capital]* \_\_ to the value of the Partnership, which shall be determined as follows:

(a) Within \_\_ *[number]* \_\_ days after the end of each fiscal year of the Partnership, the Partners shall, after due consideration of all factors they consider relevant, determine the Partnership's value by unanimous written agreement. That value shall remain in effect for the purposes of this Agreement from the date of that written determination until the next such written determination, except as otherwise provided below. The valuation shall be entered on Exhibit \_\_ *[specify number or letter]* \_\_ and all Partners shall initial the entry.

(b) Should the Partners be unable to agree on a value or otherwise fail to make any such determination, the Partnership's value shall be the greater of (a) the value last established under this section, or (b) the Partnership's net worth, determined in accordance with generally accepted accounting principles using the accrual method of accounting, consistently applied, as of the end of the Partnership's next preceding fiscal year.

(c) Until it is otherwise determined under this section, the Partnership's value shall be the aggregate initial capital contributions required under this Agreement and actually paid or conveyed to the Partnership.

*[Alternative 3: Valuation of partner's interest by appraisal]*

**6. Valuation of Interest.** The value of a Partner's interest in the Partnership for purposes of this Agreement shall be determined by appraisal as follows:

(a) Within \_\_ *[number]* \_\_ days after the event requiring appraisal or within \_\_ *[number]* \_\_ days after appointment of a Partner's personal representative following the Partner's death or legal disability, the Partnership and the Partner whose interest is to be appraised (or that Partner's personal representative) shall

jointly appoint an appraiser for this purpose, or, failing this joint action, shall each separately designate an appraiser and within   [number]   days after their appointment, the two designated appraisers shall jointly designate a third appraiser. The failure of either the Partnership or the Partner whose interest is being appraised (or that Partner's personal representative) to appoint an appraiser within the time allowed shall be deemed equivalent to appointment of the appraiser appointed by the other party. No person shall be appointed or designated an appraiser unless that person is then a member of   [name of trade association or other qualifying body]  .

(b) If, within   [number]   days after the appointment of all appraisers, a majority of the appraisers concur on the value of the interest being appraised, that appraisal shall be binding and conclusive. If a majority of the appraisers do not concur within that period, the determination of the appraiser whose appraisal is neither highest nor lowest shall be binding and conclusive. The Partnership and the Partner whose interest is to be appraised, or that Partner's estate or successors, shall share the appraisal expenses equally.

(c) A Partner's interest in the Partnership so appraised shall be based on that Partner's proportional interest in the Partnership's   [e.g., current profits/aggregate capital]  .

(d) In arriving at a valuation figure, the appraisers shall evaluate the business as a going concern and observe the following standards but not be limited to them in computing the Partnership's value:

(1) Inventory shall be valued at the lower of cost or fair market value.

(2) Buildings and land shall be valued at fair market value.

(3) Machinery and equipment shall be valued at replacement cost.

(4) The existence of a willing purchaser shall be assumed when determining fair market value.

(5) A valuation shall be placed on items of substantial value not carried on the Partnership's books.

(6) Investment securities owned by the Partnership for which there is an established trading market shall be valued at the market price on the effective date of valuation. For this purpose, market price means (a) for securities listed on any national securities exchange or for which sales are reported on NASDAQ, the last reported sales price on that date (or, if no sales on that date are reported, on the next preceding day for which sales were reported), and (b) for other publicly traded securities, the mean between the highest bid and lowest asked prices reported for these securities on that date (or, if no such prices are reported on that date, on the next preceding day for which such prices were reported).

(7) Investment securities owned by the Partnership for which there is no established trading market shall be valued at the amounts at which they are carried on the Partnership's books in accordance with generally accepted accounting principles, including the equity method under Opinion 18 of the Accounting Principles Board to the extent applicable.

(8) Contingent items shall not be specifically deducted from the valuation figure, but they shall be considered in assessing the value of the Partnership's goodwill.

(9) Goodwill, including trademarks, trade names, and other intangibles of commercial value such as patents, shall be considered in arriving at a valuation figure.

(10) Past, present, and prospective earnings, including the existing and prospective economic condition of the industry, shall be considered in arriving at a valuation figure.

(11) Adjustments shall be made for the federal and state income tax effect on the differences between tax bases and the market values determined by the appraisers.

[Alternative 4: Put/call option setting price]

**6. Valuation of Interest.** Either Partner (the "Offering Partner") may give written notice to the other Partner (the "Accepting Partner") of the Offering Partner's intent to sell its interests in the Partnership in accordance with these provisions, stating in its written notice the cash purchase price at which the Offering Partner is

**willing to sell its interest in the Partnership. On receipt of such written notice, the Accepting Partner shall then be obligated to either (a) purchase all of the interest of the Offering Partner for cash at a price equal to the purchase price set forth in the written notice; or (b) sell its interest for cash to the Offering Partner at a price equal to the purchase price set forth in the written notice.**

*Comment:* The book value approach to valuation in Alternative 1 is easy to apply but seldom reflects the real value of a partnership because it fails to take into account the increase in value of any partnership assets, the value of goodwill, the value of other intangibles not appearing on the balance sheet, and other particular undervaluations. Additional provisions may take into account any of these items that may be significant in the particular business of the partnership.

Alternative 2 takes advantage of the partners' unique knowledge of the value of the business, but it does not reflect changes after the annual appraisal date and will not suffice if partners fail to make annual appraisals.

The contemporaneous appraisal approach of Alternative 3 typically avoids most problems inherent in the other forms of appraisals, but because the value is not known in advance, it may be difficult to fund a purchase. If an appraisal is used, the agreement should establish guidelines for it. It may not be necessary to include all the items listed in Alternative 3, but they represent the range of issues for consideration.

The put/call mechanism in Alternative 4 should establish a reasonable and optimal price; the failure to price the interest at its optimum value may result in a forced bargain purchase or sale.

## §5.101 6. Form: Payment of Purchase Price

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §5.50 and ends in §5.124

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### 5.101-1 Payment of purchase price

*[Add one or more of the following alternatives]*

*[Alternative 1: Cash]*

**[I.] Payment.** Except as otherwise provided, whenever the Partnership is obligated or, having the right to do so, chooses to purchase a Partner's interest, it shall pay for the interest in cash within   *[number]*   days after the date on which the Partnership's obligation to pay has become fixed.

*[Alternative 2: Cash or note]*

**[I.] Payment.** Except as otherwise provided, whenever the Partnership is obligated or, having the right to do so, chooses to purchase a Partner's interest, it shall pay for that interest, at its option, in cash or by promissory note of the Partnership, or partly in cash and partly by note. Any promissory note shall be dated as of the effective date of the purchase, shall mature in not more than   *[number]*   years, shall be payable in installments that come due not less frequently than annually, shall bear interest at the rate of   *[number]*   percent per annum, and may, at the Partnership's option, be subordinated to existing and future debts to banks and other institutional lenders for money borrowed.

*[If applicable, add the following option]*

*[Option: Limiting amount due]*

After adding back all direct and indirect Partner remuneration,   *[number]*   percent of the Partnership's taxable income may be used for payment of a Partner's or Partners' interests. Any payment deferred under this section shall bear interest at the same rate applicable to the balance of the note. If deferred payments under this section are not paid within   *[number]*   years of deferral, the Partnership shall be dissolved and the proceeds of dissolution shall be used to liquidate the balance due on the note.

*Comment:* The subordination clause in Alternative 2 is useful to prevent interference with the partnership's ongoing credit relationships. The partners may agree to provide security for the payment obligation, provided the arrangement does not unduly interfere with other partnership credit arrangements, as is otherwise required under Corp C §16701(f) and (h). It also may be appropriate to provide language that limits the dollar amount due in any one year to take into account cash flow reasonably available from partnership operations.

Appropriate language should be added if the remaining partners are purchasing a departing partner's interest.

**Source:** Business Law/Selecting and Forming Business Entities/5 General Partnerships/§5.102 7. Form: Assumption of Outstanding Partnership Liabilities

## §5.102 7. Form: Assumption of Outstanding Partnership Liabilities

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5.102-1 Assumption of outstanding partnership liabilities

**[J.] Assumption of Liabilities.** Except as otherwise provided, the Partnership shall pay, as they mature, all Partnership obligations and liabilities that exist on the effective date of a Partner's termination and shall hold the terminating Partner harmless from any action or claim arising or alleged to arise from those obligations or from liabilities accruing after that date.

*Comment:* On the liability of a dissociated partner, see §5.25.

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## M. Dissolution and Termination

### §5.103 1. Form: Dissolution

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5.103-1 Dissolution

## ARTICLE X

### DISSOLUTION AND TERMINATION

**A. Dissolution.** The Partnership shall be dissolved, and its business shall be wound up, only on the occurrence of any of the following events:

*[Add one of the following alternatives]*

*[Alternative 1: Dissolution of partnership at will by one-half of the partners]*

1. The express will to dissolve and wind up the Partnership business of at least one-half of the Partners, including Partners other than wrongfully dissociating Partners who have dissociated within the preceding 90 days, and for which purpose dissociation notice from such Partners constitutes an expression of those Partners' will to dissolve and wind up the Partnership business.

*[Alternative 2: Dissolution of partnership at will by all partners]*

1. The express will of all of the Partners to wind up the Partnership business.

*[Continue]*

2. The expiration of the Partnership term or completion of the undertaking if the Partnership is organized for a specific undertaking.

3. On expiration of 90 days after a Partner's dissociation by death, bankruptcy, incapacity, distribution by a trust or estate Partner of its entire interest, or termination of any entity Partner, or by a Partner's wrongful dissociation, unless before that time a majority in interest of the Partners agree to continue the Partnership.

4. Any event that makes it unlawful for all or substantially all of the Partnership business to be continued if such event is not cured within 90 days after notice to the Partnership of the event.

5. On application by a Partner, a judicial determination that any of the following apply:

(a) The economic purpose of the Partnership is likely to be unreasonably frustrated.

(b) Another Partner has engaged in conduct relating to the Partnership business that makes it not reasonably practicable to carry on the business in partnership with that Partner.

(c) It is not otherwise reasonably practicable to carry on the Partnership business in conformity with the Partnership Agreement.

6. As otherwise set forth in this Partnership Agreement.

*Comment:* Many of the events that trigger dissociation can become instead events that cause dissolution if agreed to

by the partners. See §5.36.

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**Source:** Business Law/Selecting and Forming Business Entities/5 General Partnerships/§5.104 2. Form: Termination of Partnership After Dissolution; Waiver of Termination

## §5.104 2. Form: Termination of Partnership After Dissolution; Waiver of Termination

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5.104-1 Termination of partnership after dissolution; waiver of termination

**B. *Termination of Partnership.*** Except as provided in this Agreement, the Partnership continues after dissolution only for the purpose of winding up its business. The Partnership is terminated when the winding up of its business is completed.

**C. *Waiver of Termination.*** At any time after the dissolution of the Partnership and before the winding up of its business is completed, all of the Partners, including any dissociating Partner (other than a wrongfully dissociating Partner) may waive the right to have the Partnership's business wound up and the Partnership terminated. On such event, both of the following shall occur:

1. The Partnership resumes carrying on its business as if dissolution had never occurred, and any liability incurred by the Partnership or a Partner after the dissolution and before the waiver is determined as if dissolution had never occurred; and

2. The rights of any third party accruing after commencement of dissolution or arising out of conduct in reliance on the dissolution before the third party knew or received a notification of the waiver may not be adversely affected.

*Comment:* This provision mirrors the requirements under Corp C §16802 regarding the impact of winding up and any waiver of the right to wind up. See §5.36.

**Source:** Business Law/Selecting and Forming Business Entities/5 General Partnerships/§5.105 3. Form: Persons Eligible to Wind Up Partnership

### §5.105 3. Form: Persons Eligible to Wind Up Partnership

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5.105-1 Persons eligible to wind up partnership

**D. *Persons Eligible to Wind Up Partnership.*** The following persons may participate in winding up the partnership.

**1.** After dissolution, a Partner who has not dissociated may participate in winding up the Partnership's business, subject to the right of a Partner or its legal representative to petition the court, for good cause shown, for judicial supervision.

**2.** The legal representative of the last surviving Partner may wind up a Partner's business.

**E. *Person Winding Up.*** The person winding up the Partnership business shall have all of the powers given by law to wind up the affairs of the Partnership.

**F. *Statement of Dissolution.*** On dissolution, the Partnership shall cause to be filed a statement of dissolution under California Corporations Code §16805.

*Comment:* The necessary powers for winding up the business of the partnership include the right to preserve the partnership business or property as a going concern for a reasonable time; prosecute and defend actions and proceedings, whether civil, criminal, or administrative; settle and close the partnership's business; dispose of and transfer its property; discharge its liabilities; distribute its assets; settle any partner disputes by mediation or arbitration; and perform other necessary acts. Corp C §16803(c).

#### §5.106 4. Form: Distribution of Assets

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §5.50 and ends in §5.124

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5.106-1 Distribution of assets

**G. Distribution of Assets.** On the winding up of the Partnership's business, the partnership's assets shall be distributed as follows:

1. The assets of the Partnership, including any contributions by the Partners required in this Agreement, shall be applied to discharge its obligations to creditors, including to the extent permitted by law Partners who are creditors. Any surplus shall be applied to pay in cash the net amount distributable to Partners in accordance with their rights to distributions under this Agreement.

2. Each Partner shall be entitled to a settlement of all Partnership accounts on winding up the Partnership business. In settling accounts among the Partners, the profits and losses that result from liquidation of the Partnership assets shall be credited and charged to the Partners' accounts. The Partnership shall make a distribution to a Partner in an amount equal to any excess of the credits over the charges in the Partner's account. A Partner shall contribute to the Partnership an amount equal to any excess of the charges over the credits in the Partner's account.

3. If a Partner fails to contribute the full amount that the Partner is obligated to contribute under this section, all of the other Partners shall contribute, in the proportions in which those Partners share Partnership losses, the additional amount necessary to satisfy the Partnership obligations. A Partner or its legal representative shall be entitled to recover from the other Partners any contribution the Partner makes to the extent the amount contributed exceeds that Partner's share of the Partnership obligations for which the Partner is personally liable. The estate of a deceased Partner shall remain liable for that Partner's obligations to contribute to the Partnership.

4. After the settlement of accounts, each Partner shall contribute, in the proportion in which the Partner shares the Partnership losses, the amount necessary to satisfy Partnership obligations that were not known at the time of settlement for which the Partner is personally liable.

*Comment:* Requiring distributions to partners in proportion to the balances in their respective capital accounts and requiring a deficit make-up provision constitute part of the "substantial economic effect" test. See Advising California Partnerships, chap 13 (3d ed Cal CEB 1999).

## §5.107 N. Form: Indemnification

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §5.50 and ends in §5.124

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### 5.107-1 Indemnification

**H. *Indemnification.* Except as otherwise provided in this Agreement, a Partner shall not be liable to, and the Partnership shall indemnify and hold the Partner harmless from, any and all expense and liability resulting from or arising out of any negligence or misconduct on the Partner's part to the extent that the amount is not covered by the applicable insurance carried by the Partnership; provided, however, that there shall be no indemnification if it is determined that the Partner's conduct is grossly negligent or reckless or if the Partner engages in any willful and material breach of any other obligations under this Agreement.**

*Comment:* This clause is advisable because partners are jointly and severally liable for the wrongful acts or omissions of any partner acting in the ordinary course of the partnership business. Corp C §16306. The partnership agreement should typically indemnify a partner for conduct that falls within the standard of care set forth in the agreement. See §§5.83-5.85. The form indemnification should be modified accordingly if a different standard of care is used.

**Source:** Business Law/Selecting and Forming Business Entities/5 General Partnerships/ O. Miscellaneous Provisions/  
§5.108 1. Form: Amendments

## **O. Miscellaneous Provisions**

### **§5.108 1. Form: Amendments**

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5.108-1 Amendments

## **ARTICLE XI**

### **MISCELLANEOUS PROVISIONS**

**A. Amendments.** This Agreement may be altered, amended, or repealed only by a writing signed by each person who is then a Partner.

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## §5.109 2. Form: Notices

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5.109-1 Notices

**B. Notices.** Any written notice to any of the Partners required or permitted under this Agreement shall be deemed to have been duly given (a) on the date of service if served personally on the party to whom notice is to be given, or (b) on the \_\_[e.g., *second*]\_\_ day after mailing if mailed to the party to whom notice is to be given, first-class postage prepaid, return receipt requested, and addressed to the addressee at the address stated opposite his or her name below or at the most recent address specified by written notice given to the sender by the addressee under this clause. Notices to the Partnership shall be similarly given, and addressed to it at its principal place of business.

### §5.110 3. Form: Counterparts

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §5.50 and ends in §5.124

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#### 5.110-1 Counterparts

**C. Counterparts.** This Agreement may be executed in one or more counterparts, each of which shall be deemed an original, but all of which together shall constitute one and the same instrument, and shall become effective when there exist copies of this Agreement which, when taken together, bear the authorized signatures of each of the parties to it. Only one such counterpart signed by the party against whom enforceability is sought needs to be produced to evidence the existence of this Agreement.

**§5.111 4. Form: Governing Law**

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §5.50 and ends in §5.124

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5.111-1 Governing law

**D. Governing Law.** This Agreement shall be governed by and construed in accordance with the laws of the State of California. Any action to interpret or enforce this Agreement shall be brought solely in the State of California. To the extent permitted by law, the parties agree that the sole venue for such an action shall be \_\_[county]\_\_, California. The parties each consent to the jurisdiction of California courts.

**Source:** Business Law/Selecting and Forming Business Entities/5 General Partnerships/§5.112 5. Form: Successors and Assigns

**§5.112 5. Form: Successors and Assigns**

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §5.50 and ends in §5.124

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5.112-1 Successors and assigns

**E. *Successors and Assigns.* This Agreement shall be binding on and inure to the benefit of the parties and their heirs, legal representatives, successors and assigns.**

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**§5.113 6. Form: Severability**

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5.113-1 Severability

**F. Severability.** If any provision of this Agreement is determined by any court of competent jurisdiction or arbitrator to be invalid, illegal, or unenforceable to any extent, that provision shall, if possible, be construed as though more narrowly drawn, if a narrower construction would avoid invalidity, illegality, or unenforceability or, if that is not possible, the provision shall, to the extent of the invalidity, illegality, or unenforceability, be severed, and the remaining provisions of this Agreement shall remain in effect.

**Source:** Business Law/Selecting and Forming Business Entities/5 General Partnerships/§5.114 7. Form: Titles and Headings

## **§5.114 7. Form: Titles and Headings**

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5.114-1 Titles and headings

**G. *Titles and Headings.*** The article, section, and paragraph titles and headings contained in this Agreement are inserted as a matter of convenience and for ease of reference only and shall be disregarded for all other purposes, including the construction or enforcement of this Agreement or any of its provisions.

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**Source:** Business Law/Selecting and Forming Business Entities/5 General Partnerships/§5.115 8. Form: Further Assurances

## **§5.115 8. Form: Further Assurances**

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5.115-1 Further assurances

**H. Further Assurances.** The parties to this Agreement shall promptly execute and deliver any and all additional documents, instruments, notices, and other assurances, and shall do any and all other acts and things, reasonably necessary in connection with the performance of their respective obligations under this Agreement, to carry out the intent of the parties.

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**Source:** Business Law/Selecting and Forming Business Entities/5 General Partnerships/§5.116 9. Form: Waiver of Action for Partition

## §5.116 9. Form: Waiver of Action for Partition

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5.116-1 Waiver of action for partition

**I. Waiver of Action for Partition.** Each of the parties to this Agreement irrevocably waives, during the term of the Partnership, any right that it may have to maintain any action for partition with respect to the Partnership properties.

*Comment:* See Corp C §16204 (acquisition of partnership property), Corp C §16405 (partner's rights to bring an action against partnership or another partner).

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**§5.117 10. Form: Construction**

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5.117-1 Construction

**J. Construction.** In construing this Agreement, no consideration shall be given to the fact or presumption that any party had a greater or lesser hand in drafting it.

**Source:** Business Law/Selecting and Forming Business Entities/5 General Partnerships/§5.118 11. Form: Number and Gender

## **§5.118 11. Form: Number and Gender**

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5.118-1 Number and gender

**K. *Number and Gender.*** Whenever used in this Agreement, the singular shall include the plural and the plural shall include the singular, and the neuter gender shall include the male and female as well as a trust, firm, company, or corporation, all as the context and meaning of this Agreement may require.

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**Source:** Business Law/Selecting and Forming Business Entities/5 General Partnerships/§5.119 12. Form: Incorporation by Reference

## §5.119 12. Form: Incorporation by Reference

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5.119-1 Incorporation by reference

**L. *Incorporation by Reference.* Every exhibit, schedule, and other appendix attached to and referred to in this Agreement is incorporated in this Agreement by reference.**

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## §5.120 13. Form: Attorney Fees

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5.120-1 Attorney fees

**K. Attorney Fees.** If any party requires the services of an attorney to secure the performance of this Agreement or otherwise on the breach or default of another party to this Agreement, or if any judicial remedy or arbitration is necessary to enforce or interpret any provision of this Agreement or the rights and duties of any person in relation to it, the prevailing party shall be entitled to reasonable attorney fees, costs, and other expenses, in addition to any other relief to which such party may be entitled. Any award of damages following judicial remedy or arbitration as a result of the breach of this Agreement or any of its provisions shall include an award of prejudgment interest from the date of the breach at the maximum amount of interest allowed by law.

**Source:** Business Law/Selecting and Forming Business Entities/5 General Partnerships/§5.121 14. Form: Entire Agreement

## §5.121 14. Form: Entire Agreement

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5.121-1 Entire agreement

**L. *Entire Agreement.*** This Agreement, including any Exhibits and Schedules attached to it, constitutes the whole and entire agreement of the parties with respect to the subject matter of the Agreement, and it shall not be modified or amended in any respect except by a written instrument executed by all the parties. This Agreement replaces and supersedes all prior written and oral agreements by and among the Partners \_\_ *[and the Partnership]* \_\_. No party to this Agreement shall be bound to the other in any manner by any warranties, representations, or covenants with respect to the subject matter of this Agreement except as specifically set forth in it.

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## §5.122 15. Form: Arbitration

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §5.50 and ends in §5.124

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### 5.122-1 Arbitration

**M. Arbitration.** Any controversy among the Partners involving the construction or application of any provision of this Agreement shall be submitted to arbitration at \_\_ *[location]* \_\_, California, on the request of any Partner. Arbitration shall comply with and be governed under the provisions of the \_\_ *[e.g., California Arbitration Act/commercial arbitration rules of the American Arbitration Association]* \_\_.

*Comment:* Corporations Code §16405 allows any partner procedural access to the courts (and arbitration) for all issues relating to the partnership; an action for an accounting is no longer the sole remedy for resolving partnership disputes. See §5.23.

Under a broad arbitration provision like the one in this form, claims for dissolution may be subject to resolution by arbitration. See *Larkin v Williams, Woolley, Cogswell, Nakazawa & Russell* (1999) 76 CA4th 227, 90 CR2d 195.

**§5.123 P. Form: Execution**

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right click and choose  
*Save Target As*

5.123-1 Execution

**IN WITNESS WHEREOF, the Partners have executed this Agreement effective as of the date set forth above.**

**Date:** \_ \_ \_ \_ \_                      \_\_[Signature]\_\_  
  \_ \_[Typed name]\_ \_

**Date:** \_ \_ \_ \_ \_                      \_\_[Signature]\_\_  
  \_ \_[Typed name]\_ \_

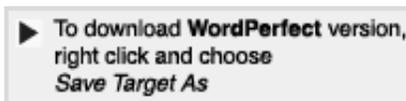
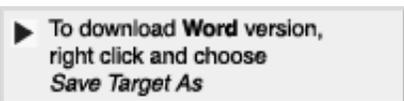
**Date:** \_ \_ \_ \_ \_                      \_\_[Signature]\_\_  
  \_ \_[Typed name]\_ \_

**Date:** \_ \_ \_ \_ \_                      \_\_[Signature]\_\_  
  \_ \_[Typed name]\_ \_

*Comment:* A separate signature line should be provided for each partner.

**§5.124 Q. Form: Consent of Spouses**

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §5.50 and ends in §5.124



5.124-1 Consent of spouses

Exhibit \_ \_*[specify number or letter]*\_ \_

**Consent of Spouses**

**We certify that:**

**1. We are the spouses of the persons who signed the foregoing Partnership Agreement and who constitute the members of the Partnership described in that Agreement.**

**2. We have read and approve the provisions of that Partnership Agreement, including but not limited to those relating to the purchase, sale, or other disposition of the interest of a deceased, retiring, withdrawing, or terminating Partner.**

**3. We agree to be bound by and accept those provisions of that Partnership Agreement in place of all other interests we, or any of us, may have in that Partnership, whether the interest may be community property or otherwise.**

**4. Our spouses shall have full power of management of their interests in the Partnership, including any portion of those interests that are our community property, and they have the full right, without our further approval, to exercise their voting rights as Partners in the Partnership, to execute any amendments to the Partnership Agreement, and to sell, transfer, encumber, and deal in any manner with those Partnership interests, including any portion of those interests that are our community property.**

Executed on \_ \_*[date]*\_ \_ , at \_ \_*[location]*\_ \_ , California.

\_\_*[Signature of spouse]*\_\_  
\_ \_*[Typed name]*\_ \_

*Comment:* This clause is intended to establish informed consent and eliminate the later assertion that one spouse signed for both spouses as manager of the community property. A separate signature line should be provided for each spouse.

## 6

# Limited Partnerships

Edward Gartenberg  
Ellis G. Wasson

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**§6.1 I. SCOPE OF CHAPTER**

This chapter discusses the relevant law and the formation of California limited partnerships. It defines a limited partnership, discusses permissible businesses in which a limited partnership may engage, and covers applicable tax and securities laws. See §§6.1-6.8. The chapter also discusses the rights and liabilities of general and limited partners and requirements concerning partnership books and records. See §§6.9-6.17. Considerations with respect to forming a California limited partnership are addressed in §§6.18-6.34. The chapter includes checklists of preformation and formation issues, as well as the Secretary of State forms necessary for forming a limited partnership (see §§6.35-6.41). It contains a detailed, annotated, long form of partnership agreement (see §§6.42-6.150), and a separate property waiver and acknowledgment (see §6.151).

The chapter is based on the Uniform Limited Partnership Act of 2008 (Re-RULPA) (Corp C §§15900-15912.07), applicable as of January 1, 2010, to all limited partnerships in California, and discussed in §6.4.

## **II. NATURE OF LIMITED PARTNERSHIP**

### **§6.2 A. Definitions**

A partnership is an association of two or more parties formed to carry on as co-owners a business for a profit, regardless of whether the parties intend to form a partnership. Corp C §16202(a). A limited partnership is a partnership formed under the laws of California between two or more persons with one or more general partners and one or more limited partners. Corp C §15901.02(q). On the distinctions between general partners and limited partners, see §§6.9-6.14.

**§6.3 B. Permissible Businesses**

A limited partnership may engage in any lawful business activity, whether or not for profit, except the banking business, the business of issuing policies of insurance and assuming insurance risks, or trust company business. Corp C §15901.04(b). Thus, under Re-RULPA, a limited partnership may be formed for nonprofit purposes. See Corp C §15901.04(b).

**Source:** Business Law/Selecting and Forming Business Entities/6 Limited Partnerships/§6.4 C. California Partnership Law

## **§6.4 C. California Partnership Law**

California has enacted the Uniform Limited Partnership Act of 2008 (Re-RULPA) (Corp C §§15900-15912.07). Effective January 1, 2010, Re-RULPA applies to all California limited partnerships, with some limited transition provisions described in Corp C §§15912.01-15912.07. Corp C §15912.06(b).

Prior to the enactment of Re-RULPA, California limited partnerships was as follows:

- Limited partnership formed before July 1, 1984, were subject to the Uniform Limited Partnership Act (ULPA) (Corp C §§15501-15533).
- Limited partnerships formed on or after July 1, 1984, were subject to the California Revised Limited Partnership Act (CRLPA) (Corp C §§15611-15723).
- California's Uniform Partnership Act of 1994 (RUPA) (Corp C §§16100-16962) applied to limited partnerships with respect to any matter not addressed by CRLPA.

Effective January 1, 2010, Re-RULPA replaced both CRLPA and ULPA. Corp C §15912.06(b).

Unlike CRLPA, Re-RULPA was designed to be a stand-alone act. It is based on the Uniform Limited Partnership Act (2001) adopted by the National Conference of Commissioners on Uniform State Laws (NCCUSL). The NCCUSL reasoned that a stand-alone statute would be more convenient, would avoid confusion arising from linkage to the general partnership act, and would help rationalize future case law. Re-RULPA also includes a limited number of substantive changes in the law governing limited partnerships in California.

**Source:** Business Law/Selecting and Forming Business Entities/6 Limited Partnerships/ 1. Tax Law/ a. Federal Taxation/§6.5 (1) Tax Treatment

**1. Tax Law**

**a. Federal Taxation**

**§6.5 (1) Tax Treatment**

The provisions governing the federal income taxation of partnerships are set forth in IRC §§701-761 and Treas Reg §§1.701-1—1.761-2. For federal income tax purposes, a partnership is not a separate taxpaying entity. Therefore, it is not subject to tax at the entity level. IRC §701. Instead, the partners report their respective distributive shares of partnership income, gain, loss, deduction, and credit on their individual federal income tax returns. IRC §702(a). This pass-through tax treatment often renders a partnership a more popular choice of entity than a corporation, which is subject to taxation at both the entity level and the shareholder level.

For comprehensive discussions of federal partnership taxation, consult Friedland & Petersen, *California Partnerships and Proprietorships: Practice and Compliance Guide* (1992); McKee, Nelson & Whitmire, *Federal Taxation of Partnerships and Partners* (4th ed 2007); Willis, Pennell & Postlewaite, *Partnership Taxation* (6th ed 1997); and Bonn, *Taxation of Partnerships* (1987).

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**Source:** Business Law/Selecting and Forming Business Entities/6 Limited Partnerships/§6.6 (2) Tax Classification

**§6.6 (2) Tax Classification**

The IRS has issued "check-the-box" regulations for noncorporate entities. See Treas Reg §§301.7701-1—301.7701-4. The rules provide that an entity formed as a limited partnership for California purposes may elect to be taxed as a partnership. See Treas Reg §301.7701-3. California has generally conformed its entity classification laws to federal law. See Rev & T C §23038(b)(2)(B).

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**Source:** Business Law/Selecting and Forming Business Entities/6 Limited Partnerships/§6.7 b. California Taxation

**§6.7            b. California Taxation**

In general, California has conformed its entity classification rules to the federal law with respect to the income taxation of limited partnerships. Thus, limited partnerships are ordinarily not subject to tax at the entity level; rather, items of partnership income, gain, loss, deduction, and credit flow through and are reported on the partners' individual federal income tax returns. Rev & T C §§17024.5, 17851. However, like corporations, limited liability partnerships, and limited liability companies, limited partnerships are subject to an annual franchise tax of \$800 for the privilege of doing business in California. Rev & T C §§17935(a), 23153. The partnership is liable for the tax until a certificate of cancellation is filed with the Secretary of State. Rev & T C §17935(b)(1).

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**§6.8            2. Securities Laws**

The offer and sale of securities in California are subject to concurrent regulations under the federal Securities Act of 1933 (15 USC §§77a-77aa) and the California Corporate Securities Law of 1968 (Corp C §§25000-25707) and to federal jurisdiction under the Securities Exchange Act of 1934 (15 USC §§78a-78oo). A limited partner's ownership interest in a limited partnership constitutes a security for federal and state law purposes. See Corp C §25019; 15 USC §77b(a)(1); see also *People v Simon* (1995) 9 C4th 493, 499, 37 CR2d 278. Accordingly, offers and sales of such interests must satisfy the registration or qualification requirements of these federal and California Acts unless an exemption applies. Filings may be required either to qualify an offering and sale or to receive an exemption. See Corp C §25000-25707; 10 Cal Code Regs §§250.9-260.617.

For information on the registration and qualification process, as well as the various exemptions available for offers and sales of securities, see *Financing and Protecting California Businesses*, chaps 18-20 (Cal CEB 2006). For a brief discussion of federal and state exemptions commonly applicable to limited partnerships, see *Advising California Partnerships*, chap 11 (3d ed Cal CEB 1999).

### **III. RIGHTS AND LIABILITIES OF PARTNERS**

#### **§6.9 A. Rights of General Partners**

In a limited partnership, the general partners have control over and manage the limited partnership's business. A general partner of a limited partnership has substantially the same rights and powers and is subject to the same restrictions as a general partner of a general partnership. See Corp C §15904.06. Each general partner has equal rights in the management and conduct of the limited partnership's activities. Corp C §15904.06(a). Further, except as otherwise expressly provided in Re-RULPA, any matter relating to the activities of the limited partnership may be exclusively decided by the general partner or, if there is more than one general partner, by a majority of the general partners. Corp C §15904.06(a).

On the rights, powers, and restrictions of general partners in general partnerships, see chap 5.

**§6.10 B. Liability of General Partners for Partnership Obligations**

Partnerships are entities separate and distinct from their partners. Corp C §15901.04(a).

A general partner is in most circumstances jointly and severally liable for all partnership obligations. Corp C §15904.04(a). A general partner's liability to third parties for partnership obligations cannot ordinarily be altered by agreement among the partners; however, partners may agree to allocate these liabilities among themselves. See Corp C §15904.04(a).

General partners owe fiduciary duties to the limited partnership and its partners. Those duties include at least the fiduciary duties of loyalty and the duty of care. Corp C §15904.08(a). The duties of loyalty include:

- To account to the limited partnership and hold as trustee for it any property, profit, or benefit derived by the general partner (Corp C §15904.08(b)(1));
- To refrain from dealing with the limited partnership as or on behalf of a party having an interest adverse to the limited partnership (Corp C §15904.08(b)(2)); and
- To refrain from competing with the limited partnership (Corp C §15904.08(b)(3)).

In addition, the general partner's duty of care is limited to refraining from engaging in grossly negligent or reckless conduct, intentional misconduct, or a knowing violation of law. Corp C §15904.08(c).

The general partner is required to discharge these duties and the general partner's other duties under the partnership consistently with the obligation of good faith and fair dealing. Corp C §15904.08(d).

It is possible under California case law to argue that the general partner's fiduciary duties extend beyond the duty of care and the duty of loyalty. See *BT-I v Equitable Life Assur. Soc'y* (1999) 75 CA4th 1406, 89 CR2d 811. For a fuller discussion of partners' fiduciary duties, see Gartenberg and King, *Fiduciary Duties in Partnerships and Limited Liability Companies Under California Law*, 18 Cal Bus L Prac 93 (Fall 2003).

To limit a general partner's personal liability, the general partner can be structured as a corporation or a limited liability company. The shareholders and members of the respective entity ordinarily are not personally liable for the debts and obligations of the entity. See chaps 8, 11.

## **§6.11 C. Rights of Limited Partners**

Unlike general partners, limited partners are passive investors who possess neither the right to participate in the management of the limited partnership's business nor the power to bind the limited partnership under any agreement or undertaking. Corp C §15903.02. To protect the interests of limited partners, Re-RULPA sets forth mandatory and presumptive limited partner rights, including the following:

- **Right to inspect documents.** The limited partnership must maintain, and the limited partners have the right to inspect and copy, the following items: financial statements, income tax returns, the limited partnership agreement and amendments, the certificate of limited partnership and amendments, books and records relating to the internal affairs of the partnership, and a list of the partners' names and addresses with each partner's contribution and share in profits and losses. Corp C §§15901.11, 15903.04.
- **Right to call meetings.** The limited partners do not lose their liability protection as limited partners by calling partnership meetings. Corp C §15903.03(b)(10).
- **Litigation rights.** The limited partners may take any action required or permitted by law to pursue, settle, or terminate a derivative action on behalf of the limited partnership without incurring the liability of a general partner. Corp C §15903.03(b)(11).

## **D. Liability of Limited Partners**

### **§6.12 1. Limited Partners as Generally Not Liable**

Unlike general partners, limited partners are not ordinarily personally liable for the debts and obligations of the limited partnership; they are liable only to the extent of their respective capital contributions. See Corp C §15903.03(a). However, a limited partner may be held liable by the limited partnership or a third party creditor for payment of his or her agreed capital contribution. Corp C §15905.02. In addition, a limited partner may be required to return distributions received from the limited partnership if it did not have sufficient assets to satisfy its liabilities at the time of the distribution. See Corp C §15905.08.

**NOTE:** General partners who consent to an improper distribution under Corp C §15905.08 are personally liable to the limited partnership for the amount that exceeds the amount that could have been properly distributed if the general partner failed to comply with applicable fiduciary duties. Corp C §15905.09(a); see Corp C §15904.08. Persons who knowingly received improper distributions are also liable to the limited partnership to the extent that the distribution exceeded the proper amount. Corp C §15905.09(b). The statute of limitations is 4 years. Corp C §15905.09(d).

A limited partner will lose the limited partner's liability shield if named as a general partner in the certificate. Corp C §15903.03(a). Further, a limited partner that participates in the control of the partnership's business may become liable for its debts and obligations to persons who transact business with the partnership with actual knowledge of the partner's participation in control and with a reasonable belief that the partner is a general partner at the time of the transaction. Corp C §15903.03(a).

Limited partners also may be held liable if they guarantee debts of the limited partnership. When all limited partners execute guaranties of partnership debt, and there is no express agreement to the contrary, each partner's proportionate obligation for contribution is based on his or her ownership interest in the partnership. *Jans v Nelson* (2000) 83 CA4th 848, 100 CR2d 106.

While a limited partner does not have any fiduciary duty to the partnership solely by being a limited partner, Re-RULPA does require that a limited partner discharge all duties to the partnership consistent with the obligation of good faith and fair dealing. Corp C §15903.05(b).

**NOTE:** Nothing in the liability shield insulates limited partners from liability to third parties for their own participation in tortious conduct. Corp C §15903.03(a).

**§6.13 2. Actions Not Constituting Participation in Management**

Re-RULPA sets forth activities in which a limited partner may engage that will not by themselves undermine the partner's limited liability status. The activities include (Corp C §15903.03(b)):

- Being an employee or agent of or independent contractor for, or transacting business with, the limited partnership or a general partner of the limited partnership;
- Being an officer, director, or shareholder of a corporate general partner of the limited partnership;
- Being a member, manager, or officer of an LLC that is a general partner of the limited partnership;
- Being a limited partner of a limited partnership that is a general partner of the limited partnership;
- Being a trustee, administrator, executor, custodian, or other fiduciary or beneficiary of an estate or trust that is a general partner;
- Being a trustee, officer, advisor, shareholder, or beneficiary of a business trust that is a general partner;
- Consulting with or advising a general partner with respect to the business of the limited partnership;
- Acting as surety for the limited partnership or for a general partner, guaranteeing one or more specific debts of the limited partnership, or providing collateral for the limited partnership or general partner, or borrowing money from the limited partnership or a general partner, or lending money to the limited partnership or a general partner;
- Approving or disapproving an amendment to the partnership agreement;
- Voting on, proposing, or calling a meeting of the partners;
- Winding up the partnership (see Corp C 15908.03);
- Executing and filing a certificate of limited partnership, dissolution, or cancellation;
- Serving on an audit committee or a committee performing the functions of an audit committee;
- Serving on a committee of the limited partnership or the limited partners for the purpose of approving actions of the general partner;
- Calling, requesting, attending, or participating at any meeting of the partners or the limited partners;
- Taking any action required or permitted by law to bring, pursue, settle, or terminate a derivative action on behalf of the limited partnership;
- Serving on the board of directors or a committee of, consulting with or advising, being or acting as an officer, director, stockholder, partner, member, manager, agent, or employee of, or being or acting as a fiduciary for, any person in which the limited partnership has an interest; or
- Exercising any other right or power permitted to limited partners.

The foregoing examples do not mean that any other conduct or the possession or exercise of any other power by a limited partner constitutes participation by the limited partner in the control of the business of the limited partnership. Corp C §15903.03(c).

**Source:** Business Law/Selecting and Forming Business Entities/6 Limited Partnerships/§6.14 3. Does Limited Partner Have Fiduciary Duty to Partnership?

### **§6.14 3. Does Limited Partner Have Fiduciary Duty to Partnership?**

The former California Revised Limited Partnership Act (CRLPA) (Corp C §§15611-15723) did not specify whether a limited partner owed fiduciary duties to the partnership and fellow partners. There was no provision for limited partners comparable to Corp C §15643 governing general partners. California case law had held that a limited partner may have personal liability to the partnership for a breach of fiduciary duty or the duty of care and loyalty. See, e.g., *Milazo v Gulf Ins. Co.* (1990) 224 CA3d 1528, 1538, 274 CR 632 (limited partner may be liable to partnership for misappropriating partnership economic opportunity, asset, or interest). A limited partner may also assume the fiduciary obligation of a general partner by participating in the management of the partnership. See *Tri-Growth Centre City Ltd. v Silldorf, Burdman, Duignan & Eisenberg* (1989) 216 CA3d 1139, 265 CR 330 (court rejected argument that limited partner, as opposed to general partner, can never have fiduciary obligation to limited partnership, but limited partners do not owe such duties in same manner in which general partners do under prior provision of CRLPA).

Re-RULPA at least partially resolved the uncertainty by providing, "A limited partner does not have any fiduciary duty to the limited partnership or any other partner by reason of being a limited partner." Corp C §15903.05(a). However, a limited partner is required to discharge the duties to the other partners under Re-RULPA or under the partnership agreement and exercise any rights consistently with the obligation of good faith and fair dealing. Corp C §15903.05(b).

#### **IV. PARTNERSHIP BOOKS, RECORDS, AND REPORTS**

##### **§6.15 A. Partnership Books and Records**

A limited partnership must maintain the following books and records at its designated office (Corp C §15901.11):

- A current list setting forth the respective names and last known street and mailing address of each partner, separately identifying the general and limited partners, each in alphabetical order;
- A copy of the Certificate of Limited Partnership (Secretary of State Form LP-1), together with any amendments and any executed copies of any powers of attorney under which any certificate was executed;
- A copy of any restatements of the certificate, as well as signed copies of any powers of attorney under which the restatement was signed;
- Copies of the limited partnership's federal, state, and local income tax returns and reports for the six most recent taxable years;
- Copies of the original limited partnership agreement, together with the originals of any amendments;
- Financial statements of the limited partnership for the six most recent fiscal years;
- The limited partnership's books and records, as they relate to the internal affairs of the partnership for at least the current and past three fiscal years;
- A copy of any filed certificate of conversion or merger;
- A copy of any record made by the limited partnership during the preceding three years of any consent given by or vote taken of any partner; and
- A record stating the amount of cash and other benefits contributed (or agreed to be contributed), any additional contribution requirements, and any events that will cause the limited partnership to be dissolved and wound up unless contained in a partnership agreement made in a record.

**PRACTICE TIP:** The limited partnership must also make these items available for inspection, copying, and auditing by each limited partner or his or her agent or attorney. See Corp C §15903.04(k). A limited partner's rights in this regard cannot be waived. Corp C §15901.10(b)(4). See also *Berti v Santa Barbara Beach Props.* (2006) 145 CA4th 70, 51 CR3d 364 (limited partner permitted to recover attorney fees incurred to enforce judgment allowing access to books and records under similar CRLPA provision).

**Source:** Business Law/Selecting and Forming Business Entities/6 Limited Partnerships/ B. Copies and Reports/§6.16 1. Under CRLPA [Deleted]

**B. Copies and Reports**

**§6.16 1. Under CRLPA [Deleted]**

The discussion in this section has been deleted because CRLPA has been repealed, and the provisions of Re-RULPA now govern limited partnerships.

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**§6.17 2. Under Re-RULPA**

Under Re-RULPA, a limited partnership must make the items specified in Corp C §15901.11 (see §6.15) available for inspection, copying, and auditing by each limited partner or his or her agent or attorney. See Corp C §15903.04(a). On 10 days' demand, made in a record received by the limited partnership, a limited partner may, during regular business hours in the partnership's designated office, inspect and copy any information required to be maintained pursuant to §15901.11. Re-RULPA explicitly provides that the "limited partner need not have any particular reason for seeking the information." Corp C §15903.04(a).

A limited partner (or the partner's attorney or agent) may obtain, inspect, and copy from the partnership, during regular business hours and at a reasonable location specified by the limited partnership, information regarding the state of the activities and financial condition of the limited partnership (which may be transmitted via electronic transmission), as well as other information regarding the activities and financial condition of the limited partnership, as is just and reasonable, if (Corp C §15903.04(b), (k)):

- The limited partner seeks the information for a purpose reasonably related to the partner's interest as a limited partner;
- The limited partner makes a demand in a record received by the limited partnership, describing with reasonable particularity the information sought and the purpose for seeking the information; and
- The information sought is directly connected to the limited partner's purpose. Corp C §15903.04(b)(3).

**NOTE:** A dissociated limited partner (or the partner's attorney or agent) may also inspect and copy information during regular business hours in the designated office if, in addition to satisfying the requirements of Corp C §15903.04(b), the information pertains to the time that the person was still a limited partner and the person seeks the information in good faith. Corp C §15903.04(d)-(e), (k).

**NOTE:** The partnership agreement may impose reasonable restrictions on the availability and use of information obtained under Corp C §15903.04 and may define appropriate remedies, including liquidated damages, for a breach of any reasonable restriction on use. Corp C §15901.10(b)(4).

The limited partnership must respond within 10 days after receiving a demand under Corp C §15903.04(b) or (d). Using some form of tangible medium or electronic medium that is retrievable in perceivable form (see Corp C §15901.02(ac)), the limited partnership must inform the limited partner that made the demand (see Corp C §15903.04(c)):

- What information the limited partnership will provide in response to the demand;
- When and where the limited partnership will provide the information; and
- If the limited partnership declines to provide any demanded information, the partnership's reasons for declining.

Notwithstanding this broad description of inspection rights, a limited partnership may keep confidential from limited partners, for a period of time deemed reasonable by the limited partnership, any information that the limited partnership reasonably believes to be in the nature of trade secrets. Further, the limited partnership may similarly limit the disclosure of other information if the limited partnership in good faith believes that disclosure is not in the limited partnership's best interest, could damage the limited partnership or its business, or would violate the limited partnership's duty, imposed by law or by agreement with a third party, to keep certain information confidential. Corp C §15903.04(g). Further, the limited partnership may impose reasonable restrictions on the use of information obtained from the limited partnership. However, the limited partnership bears the burden of proving reasonableness. Corp C §15903.04(h).

**NOTE:** The rights discussed above do not apply to transferees of limited partnership interests, but may be exercised by the legal representative of an individual under legal disability who is a limited partner or a dissociated limited partner. Corp C §15903.04(l).

**§6.18 V. FORMATION REQUIREMENTS**

A limited partnership is formed when the general partners execute, acknowledge, and file a Certificate of Limited Partnership (Secretary of State Form LP-1) with the Secretary of State with the applicable filing fee (see §6.20). Corp C §15902.01; Govt C §12188(b). The certificate must state the name for the limited partnership. See §6.19; chap 3. The partners must also execute a partnership agreement governing the conduct of the partnership's business. See §§6.29-6.31. Although an oral partnership agreement is legally sufficient, a written partnership agreement is recommended for certainty of the terms intended. Corp C §§15902.01, 15901.02(x).

**Source:** Business Law/Selecting and Forming Business Entities/6 Limited Partnerships/§6.19 A. Name of Limited Partnership

**§6.19 A. Name of Limited Partnership**

The name of a limited partnership must contain the words "limited partnership" or must end with either the abbreviation "L.P." or "LP". Corp C §15901.08(b). The name may contain the name of a limited partner. Corp C §15901.08(a). However, the name may not be one that is likely to mislead the public. In addition, it may not be the same as, or resemble so closely as to tend to deceive, a name that is reserved for another limited partnership, the name of a previously formed limited partnership, or the name of a previously registered foreign limited partnership. Corp C §15901.08(d)-(e). The name may not include the words "bank," "insurance," "trust," "trustee," "incorporated," "inc.," "corporation," or "corp." Corp C §15901.08(g).

For further discussion of name requirements, including reservation procedures and fictitious business name statement requirements, see chap 3.

**NOTE:** The filing of a Certificate of Limited Partnership (Secretary of State Form LP-1) (see form in §6.38) or a fictitious business name statement does not necessarily confer the right to use the selected partnership name for all purposes. After determining that a proposed name is available, the practitioner should evaluate whether the partnership should take additional steps to protect its use of the name as a registered trademark, trade name, or service name. See chap 3. See also *Advising California Partnerships*, chap 4 (3d ed Cal CEB 1999) and *California Business Litigation*, chap 6 (Cal CEB 2002).

## **B. Certificate of Limited Partnership**

### **§6.20 1. Filing Requirement**

A limited partnership is formed by filing a Certificate of Limited Partnership (Secretary of State Form LP-1) with the Secretary of State, Limited Partnership Division. See form in §6.38. Corp C §§15902.01(a), 15902.06(a). The limited partnership is considered to be formed on the date on which the Secretary of State files Form LP-1. Corp C §15902.01(c). The Secretary of State endorses the date on the Certificate. Corp C §15902.06. The limited partnership may obtain a certified copy of the Certificate of Limited Partnership to serve as conclusive evidence to third parties (e.g., banks, lenders) of the formation of the limited partnership and prima facie evidence of its existence. Corp C §15902.01.

Form LP-1 *must* include the following information:

- The name of the limited partnership (Corp C §15902.01(a)(1); see §6.19; chap 3);
- The street address of the limited partnership's initial designated office (Corp C §15902.01(a)(2));
- The name and address of each general partner (Corp C §15902.01(a)(3)); and
- The name of the initial corporate agent, or the name and address of the initial individual agent, for service of process in California (Corp C §15902.01(a)(4)).

**NOTE:** Form LP-1 *may* include any other matters that the partners consider to be appropriate. Corp C §15902.01(b). However, because the certificate is a matter of public record, caution should be exercised: Sensitive matters should be addressed in the partnership agreement. Most partners do not want the specifics of their economic arrangement to become public knowledge. To ensure the partners' privacy, the practitioner should use the partnership agreement to address all matters not required to be included in Form LP-1.

A certificate of limited partnership on file with the office of the Secretary of State is notice that the partnership is a limited partnership and the persons designated in the certificate as general partners are general partners. Corp C §15901.03(c). Except as otherwise provided in Corp C §15901.03(d) (concerning notices of dissociation, dissolution, termination, conversion, and merger), the certificate is not notice of any other fact. Corp C §15901.03(c)-(d).

**NOTE:** Re-RULPA changed the language of the former statutory scheme concerning a partner's knowledge, notice, or receipt of notification of a fact relating to the partnership by reference to a "partner's" knowledge, notice, or receipt of notification rather than making distinct reference to a "general partner" and a "limited partner." Compare former Corp C §16102(f) to Corp C §15901.03(h).

**Source:** Business Law/Selecting and Forming Business Entities/6 Limited Partnerships/ 2. Execution and Acknowledgment Requirement/§6.21 a. By General Partners

## **2. Execution and Acknowledgment Requirement**

### **§6.21 a. By General Partners**

All the general partners must execute and acknowledge the Certificate of Limited Partnership (Secretary of State Form LP-1) personally or by attorney-in-fact. Corp C §15902.04(a)(1), (b).

**PRACTICE TIP:** It is essential that the wording of the signature block for each general partner correspond exactly to the name of that general partner as listed in Form LP-1. Otherwise, the Secretary of State will reject the certificate.

**NOTE:** Under Re-RULPA, signing an instrument authorized or required to be filed with the Secretary constitutes an affirmation under the penalties of perjury that the facts stated in the instrument are true. Corp C §15902.08(b).

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**Source:** Business Law/Selecting and Forming Business Entities/6 Limited Partnerships/§6.22 b. By Persons Other Than General Partners

**§6.22            b. By Persons Other Than General Partners**

A person other than the general partners may execute and acknowledge a Certificate of Limited Partnership (Secretary of State Form LP-1) under specified circumstances. Corp C §§15902.04(a)(1), 15902.05(a), (c). If a person other than a general partner executes and acknowledges the certificate, that person must state the statutory authority on which he or she is relying in executing and acknowledging it. Corp C §15902.05(d).

**NOTE:** A person aggrieved by the failure of a person to sign or file an instrument with the Secretary when required may petition the superior court to order that person to sign the instrument or deliver the instrument to the Secretary for filing, or order the Secretary to file the instrument unsigned. Corp C §15902.05(a). In this situation, the certificate is effective without being signed. Corp C §15902.05(c); see Corp C §15902.08(b) (signature is affirmation under penalty of perjury that contents are true).

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**Source:** Business Law/Selecting and Forming Business Entities/6 Limited Partnerships/§6.23 c. Facsimile and Electronic Filing

**§6.23 c. Facsimile and Electronic Filing**

The Certificate of Limited Partnership (Secretary of State Form LP-1) must have a signature by a general partner or other authorized person. Corp C §§15902.04-15902.05; see §§6.21-6.22. Previously, all Forms LP-1 were required to have an original ink signature; copies and facsimiles were not permitted. However, as of January 1, 2004, the Secretary of State accepts facsimile signatures on documents that are delivered by mail or by hand. Corp C §17.1(c). The person on whose behalf the document is submitted must maintain the originally signed document for at least 5 years from the date of filing. Corp C §17.1(d).

**PRACTICE TIP:** The requirement that the Secretary of State accept facsimile signatures on documents that are delivered by mail or by hand enables practitioners to transmit filings by facsimile transmission to a service company, which will file the facsimile filings over the counter.

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**Source:** Business Law/Selecting and Forming Business Entities/6 Limited Partnerships/§6.24 3. Filing Fee

**§6.24 3. Filing Fee**

The prescribed filing fee of \$70 must be paid when a Form LP-1 is filed with the Secretary of State. Govt C §12188(b). If the fee is not paid, the Secretary of State may cancel its filing of the certificate. Corp C §15902.01(f).

**NOTE:** A limited partnership is not required to pay its initial minimum franchise tax on formation. The minimum franchise tax is generally due on the 15th day of the fourth month following the close of the limited partnership's tax year and is included with the limited partnership's annual information return (see §6.4). Rev & T C §§17935, 23153.

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**§6.25 4. Effective Date**

Absent specification of a delayed effective date (or the statement in a certificate that by appropriate action it has become revoked and is null and void), a limited partnership is formed when the Secretary of State files its Certificate of Limited Partnership (Secretary of State Form LP-1). See Corp C §§15902.01(c), 15902.06(b)-(c).

In general, a certificate is filed on the date on which it is submitted for filing. Alternatively, the certificate may be submitted for filing at a future date as long as (Corp C §15902.06):

- The Secretary of State receives it at least 1 business day before the requested filing date, and
- The requested filing date is within 90 days (including weekends and legal holidays) after the Secretary of State receives the certificate.

**CAUTION:** The certificate must be filed before the limited partnership commences business. There is case authority that the partnership is treated as a general partnership until the certificate is filed. See *American Alternative Energy Partners II v Windridge, Inc.* (1996) 42 CA4th 551, 49 CR2d 686. This may have negative financial consequences to the limited partners, because partners of a general partnership have joint and several liability for the wrongful acts and omissions of any partner acting in the ordinary course of partnership business and for all other debts and obligations of the partnership (see §6.10). Corp C §§16305-16306.

**Source:** Business Law/Selecting and Forming Business Entities/6 Limited Partnerships/§6.26 5. Recording Certificate With County Recorder

**§6.26 5. Recording Certificate With County Recorder**

A limited partnership may record a certified copy of its Certificate of Limited Partnership (Secretary of State Form LP-1) in the office of the county recorder of any county in California. Corp C §15902.01(e).

The recording creates a conclusive presumption in favor of any bona fide purchaser or encumbrancer for value of the limited partnership's real property located in the county in which the certified copy has been recorded that the persons named as general partners in the certificate are the general partners and these persons are all the general partners of the limited partnership. Corp C §15902.01(e).

**NOTE:** If the limited partnership desires to obtain a preliminary title report or title policy for its real property, it will be required to either record its certificate or provide the title company with a certified copy of the certificate.

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**Source:** Business Law/Selecting and Forming Business Entities/6 Limited Partnerships/§6.27 6. Liability for Misstatements in Certificate

**§6.27          6. Liability for Misstatements in Certificate**

A person who suffers loss by reliance on false information in the Form LP-1 may recover damages for the loss from (Corp C §15902.08):

- A person who signed the record, or caused another to sign it on the person's behalf, and knew the information to be false at the time the record was signed, and
- A general partner that has notice that the information was false when the record was filed, or has become false because of changed circumstances, if the general partner has notice for a reasonably sufficient time before the information is relied on to enable the general partner to duly effect an amendment (Corp C §15902.02), file a petition to file an instrument with the Secretary (see Corp C §15902.05), or file a certificate of correction (Corp C §15902.07).

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**Source:** Business Law/Selecting and Forming Business Entities/6 Limited Partnerships/§6.28 C. Foreign Limited Partnerships

### **§6.28 C. Foreign Limited Partnerships**

Foreign limited partnerships must register using Secretary of State Form LP-5 (see form in §6.40) before transacting intrastate business in California. Corp C §15909.07.

"Transacting intrastate business" is defined as entering into repeated and successive transactions of business in California, other than interstate or foreign commerce. Corp C §15901.02(ai)(1). The partnership must be engaged in business transactions. Corporations Code §15901.02(ai)(2)-(3) describes factual situations in which a foreign limited partnership is not be considered to be transacting intrastate business. A person will not be considered to be transacting intrastate business solely by reason of his or her status as a limited partner. Corp C §15901.02(ai)(4).

In general, the law of the state or country under which a partnership is organized governs its organization, its internal affairs, and the liability of its limited partners. Corp C §15909.01.

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## **D. Limited Partnership Agreement**

### **§6.29 1. Requirement of Agreement**

Either before or after filing the Certificate of Limited Partnership, the partners must enter into a partnership agreement. Corp C §15902.01(a). The agreement may be oral or written. Corp C §15901.02(x). No specific form is prescribed by law. If and to the extent that the partners do not have an agreement, the provisions of the Corporations Code governing limited partnerships apply. See Corp C §15901.10.

A practitioner should advise his or her client to enter into a formal written agreement for several reasons, including the following:

- A written agreement clearly defines the partners' respective rights, duties, and obligations and thereby minimizes the potential for future disputes.
- A written agreement permits the partners to override any Re-RULPA provisions that are inconsistent with the partners' economic arrangement.
- A written agreement permits the partners to allocate income, gain, loss, deduction, and credit for tax purposes in a manner that not only comports with their financial arrangements but also achieves substantial economic effect (see §§6.85-6.92).

**Source:** Business Law/Selecting and Forming Business Entities/6 Limited Partnerships/ 2. Variation of Statutory Provisions/§6.30 a. Under CRLPA [Deleted]

## **2. Variation of Statutory Provisions**

### **§6.30 a. Under CRLPA [Deleted]**

The discussion in this section has been deleted because CRLPA has been repealed, and the provisions of Re-RULPA now govern limited partnerships.

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**§6.31            b. Under Re-RULPA**

Re-RULPA provides that partners may vary rights, duties, and obligations of the partners of a limited partnership. The partners may vary these provisions by agreement, except for the matters set forth below (Corp C §15901.10):

- The power to sue, be sued, and defend in its own name (Corp C §15901.05);
- Relations among the partners, between the partners and the partnership, and the liability of partners as partners for the obligations of the partnership (Corp C §15901.06);
- Executing and delivering records to the Secretary of State (Corp C §15902.04);
- Maintaining information at the partnership's designated office (Corp C §15901.11) or unreasonably restricting the right to information (Corp C §§15903.04, 15904.07), but the limited partnership agreement may impose:
  - Reasonable restrictions on the availability and use of information obtained under Corp C §§15903.04, 15904.07, and
  - Appropriate remedies, including liquidated damages, for a breach of any reasonable restriction on use.
- The duty of loyalty (Corp C §15904.08; see Corp C §15901.10(b)(5)), but the limited partnership agreement may:
  - Identify specific types or categories of activities that do not violate the duty of loyalty if not manifestly unreasonable, and
  - Specify the number or percentage of partners that may authorize or ratify, after full disclosure to all partners of all material facts, a specific act or transaction that otherwise would violate the duty of loyalty.
- Unreasonably reducing the duty of care (Corp C §15904.08(c));
- The obligation of good faith and fair dealing (Corp C §§15903.05(b), 15904.08(d)), but the limited partnership agreement may prescribe standards by which the performance of the obligation is to be measured;
- Dissociation as a general partner (Corp C §15906.04(a)) except to require that the notice (Corp C §15906.03) be in a record;
- Eliminating the power of the court to decree dissolution (Corp C §15908.02(a));
- Winding up the partnership's business (Corp C §15908.03);
- The right to maintain an action (Corp C §§15910.01-15910.06);
- The right of a partner to approve a conversion or merger;
- Dissenting limited partners' rights under Corp C §§15911.14-15911.33, except to the extent expressly permitted by those provisions; and
- Rights of persons other than a partner or a transferee.

**Source:** Business Law/Selecting and Forming Business Entities/6 Limited Partnerships/ E. Additional Filings/§6.32 1. Federal Employer Identification Number

## **E. Additional Filings**

### **§6.32 1. Federal Employer Identification Number**

Because a limited partnership is a separate entity for tax purposes, it must apply for and obtain a federal employer identification number (FEIN). The FEIN will be required on tax returns and other statements, for withholding and paying wages, and when bank accounts are opened. The practitioner may obtain a FEIN for a limited partnership by completing and filing IRS Form SS-4 (Application for Employer Identification Number). For filing instructions and form, see §§2.200, 2.207.

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**Source:** Business Law/Selecting and Forming Business Entities/6 Limited Partnerships/§6.33 2. Securities Filings

**§6.33            2. Securities Filings**

Unless exempt, all offers and sales of limited partnership interests must satisfy the registration and qualification requirements of the federal Securities Act of 1933 and the California Corporate Securities Law of 1968. For further information, see the reference material cited in §6.8.

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**Source:** Business Law/Selecting and Forming Business Entities/6 Limited Partnerships/§6.34 3. Licensing and EDD Filings

**§6.34 3. Licensing and EDD Filings**

The practitioner must carefully review the client's proposed business activities and ensure that all appropriate filings are made, including those for licenses and permits particular to the business and those required by the Employment Development Department (EDD) for businesses with employees. See §§2.201, 2.208. For examples of the types of filings, see *Organizing Corporations in California*, chap 3 (3d ed Cal CEB 2001); *Advising California Employers and Employees* §§8.31-8.35 (Cal CEB 2005).

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## VI. CHECKLISTS

### §6.35 A. Checklist: Preformation

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*Save Target As*

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right click and choose  
*Save Target As*

#### Preformation

- Name, address, and marital status of each general partner and limited partner.
- Name of limited partnership (see §§6.19, 6.67; see also chap 3).
- Street address of limited partnership's designated office in California and other offices (see §6.68).
- Term of limited partnership (see §6.71).
- Scope of limited partnership's business (see §6.72).
- Business with affiliated entities (see §§6.46, 6.72).
- Financing of partnership's business (see §6.73).
- Partners' respective ownership interests in limited partnership (see §6.64).
- Initial capital contributions (see §6.75).
- Additional capital contributions (see §§6.76-6.77).
- Interest on capital contribution (see §6.79).
- Return of capital (see §6.80).
- Distributions (see §§6.91-6.94).
- Rights and obligations of partners (see §§6.93-6.100 (general partners), §§6.101-6.103 (limited partners)).
- Allocations (see §§6.86-6.92).
- Compensation to partners and affiliates (see §6.95).
- Right to reimbursement of expenses incurred in connection with limited partnership's business (see §6.97).
- Liability and indemnification (see §§6.98, 6.103).
- Time general partners devote to limited partnership business and right of general partners to engage in competing activities (see §6.99).
- Maintenance and accessibility of books and records (see §6.106).
- Tax year (IRC §706; see §6.110).
- Method of accounting (see §6.111).
- Transfers of partnership interests (see §§6.115-6.119).
- Buy-out rights (see §6.118).
- Terms for admitting additional partners (see §6.120).
- Removal of general partner (see §§6.121-6.122).
- Events of dissolution (see §6.125).
- Amendments to partnership agreement (see §6.132).
- Dispute and resolution procedures (see §6.133).

*Comment:* This checklist summarizes the information that must be collected when forming a limited partnership and drafting a limited partnership agreement. It may also be used as an agenda for the initial client meeting.

The items on the checklist correspond to the applicable provisions in the form of a limited partnership agreement set forth in §§6.42-6.150. In many instances, the information will also be required to complete a Certificate of Limited Partnership (Secretary of State Form LP-1) and other documents on behalf of the limited partnership.

This checklist and the formation checklist in §6.34 are not exhaustive; each should serve only as a guide for

identifying general issues that regularly arise and that should be addressed in more specific terms when forming a limited partnership and drafting a corresponding partnership agreement.

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**§6.36 B. Checklist: Formation**

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right click and choose  
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**Partnership Name**

- Contact Secretary of State to ascertain availability of proposed limited partnership name (see §3.5).
- If Secretary of State rejects proposed name because it is too similar to name of existing limited partnership, obtain existing limited partnership's consent to use proposed limited partnership name (see form in §3.34).
- Conduct search for conflicts with existing fictitious business names, unregistered users, and registered trademarks, trade names, and service names (see §§3.8-3.12, 3.13, 3.16-3.17).
- Obtain name reservation certificate from Secretary of State (see §3.15).
- If limited partnership will conduct business under name other than name reflected on Certificate of Limited Partnership (Secretary of State Form LP-1), file fictitious business name statement in each county in which limited partnership will conduct its business (see §3.9).
- Apply for registration of limited partnership's name as trademark, trade name, or service name (see §§3.13, 3.16-3.17).
- File Certificate of Limited Partnership (Secretary of State Form LP-1) with Secretary of State (see §§6.20-6.27).
- Record certified copy of certificate in each county in California in which limited partnership owns real property (see §6.26).

**Agreement of Limited Partnership**

- Prepare and execute written limited partnership agreement (see §§6.42-6.150).
- Prepare and execute spousal consents to limited partnership agreement (see §6.151).

**Additional Filings**

- File Application for Employer Identification Number (IRS Form SS-4) with IRS (see §§2.200, 2.207, 6.32).
- Prepare filings for registration, qualification, and exemptions under applicable securities laws (see §§6.8, 6.33).
- Obtain other permits and make other filings required by business of limited partnership (see §§2.203, 6.34).

**Source:** Business Law/Selecting and Forming Business Entities/6 Limited Partnerships/ VII. FORMS/§6.37 A. Form: Letter to Secretary of State Requesting Filing of Certificate of Limited Partnership

## VII. FORMS

### §6.37 A. Form: Letter to Secretary of State Requesting Filing of Certificate of Limited Partnership

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right click and choose  
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6.37-1 Letter to Secretary of State requesting filing of certificate of limited partnership

\_\_ [Date] \_\_

Secretary of State of California  
Limited Partnership Division  
1500 11th St., Suite 345  
Sacramento, CA 95814

Re: \_\_ [Name of proposed limited partnership] \_\_

Dear Sir or Madam:

Enclosed are the following items regarding the above-referenced limited partnership:

1. One original Certificate of Limited Partnership (Secretary of State Form LP-1) for filing.
2. One copy of the enclosed Form LP-1 for certification.
3. A check in the amount of \$70 to cover the filing fee for the certificate.

[If appropriate, add]

4. A separate check in the amount of \$15 to cover the over-the-counter filing fee.

[Continue]

Please note that I have reserved the name "\_\_ [reserved name for proposed limited partnership] \_\_" (Certificate Number \_\_ [number] \_\_).

If you have any questions regarding this matter, please contact me. Thank you for your time and assistance.

Sincerely,

\_\_ [Signature of applicant] \_\_  
\_\_ [Typed name] \_\_

### Enclosures

*Comment:* For information on filing fees, over-the-counter processing, and preclearance and expedited filing services, see Comment in §6.38. See also §11.30.

§6.38 B. Form: Certificate of Limited Partnership (Secretary of State Form LP-1)

Print

 <p><b>State of California</b> <b>Secretary of State</b></p> <p><b>Certificate of Limited Partnership</b></p> <p>A \$70.00 filing fee must accompany this form. Important – Read instructions before completing this form.</p>	LP-1	File # _____
	This Space For Filing Use Only	
	<b>Entity Name</b> (End the name with the words "Limited Partnership" or the abbreviation "LP" or "L.P.")	
1. NAME OF LIMITED PARTNERSHIP		
<b>Initial Designated Office Address</b> (Do not abbreviate the name of the city.)		
2. ADDRESS OF INITIAL DESIGNATED OFFICE IN CALIFORNIA CITY STATE ZIP CODE		
CA		
<b>Initial Agent For Service of Process</b> (If the initial agent is an individual, the agent must reside in California and both Items 3 and 4 must be completed. If the initial agent is a corporation, the agent must have on file with the California Secretary of State a certificate pursuant to Corporations Code section 1505 and Item 3 must be completed (leave Item 4 blank).)		
3. NAME OF INITIAL AGENT FOR SERVICE OF PROCESS		
4. IF AN INDIVIDUAL, ADDRESS OF INITIAL AGENT FOR SERVICE OF PROCESS IN CA CITY STATE ZIP CODE		
CA		
<b>General Partners</b> (Enter the names and addresses of all the general partners. Attach additional pages, if necessary.)		
5a. NAME ADDRESS CITY STATE ZIP CODE		
5b. NAME ADDRESS CITY STATE ZIP CODE		
<b>Additional Information</b>		
6. ADDITIONAL INFORMATION SET FORTH ON THE ATTACHED PAGES, IF ANY, IS INCORPORATED HEREIN BY THIS REFERENCE AND MADE A PART OF THIS CERTIFICATE.		
<b>Execution</b> (This certificate must be signed by all of the general partners. If additional signature space is necessary, the signatures may be made on an attachment to this certificate.)		
7. I DECLARE I AM THE PERSON WHO EXECUTED THIS INSTRUMENT, WHICH EXECUTION IS MY ACT AND DEED.		
_____ DATE		
_____ SIGNATURE OF GENERAL PARTNER		_____ TYPE OR PRINT NAME OF GENERAL PARTNER
_____ SIGNATURE OF GENERAL PARTNER		_____ TYPE OR PRINT NAME OF GENERAL PARTNER

## Instructions for Completing the Certificate of Limited Partnership (Form LP-1)

**Where to File:** For easier completion, this form is available on the Secretary of State's website at [www.sos.ca.gov/business/be/forms.htm](http://www.sos.ca.gov/business/be/forms.htm) and can be viewed, filled in and printed from your computer. The completed form along with the applicable fees can be mailed to Secretary of State, Document Filing Support Unit, P.O. Box 944225, Sacramento, CA 94244-2250 or delivered in person (drop off) to the Sacramento office, 1500 11th Street, 3rd Floor, Sacramento, CA 95814. If you are not completing this form online, please type or legibly print in black or blue ink. This form is filed only in the Sacramento office.

**Legal Authority:** Statutory filing requirements are found in California Corporations Code section 15902.01. All statutory references are to the California Corporations Code, unless otherwise stated. **Note:** Signing Form LP-1 constitutes an affirmation under penalty of perjury that the facts stated in the certificate are true. (Section 15902.08(b).)

**Fees:** The fee for filing Form LP-1 is \$70.00. A \$15.00 special handling fee is applicable for processing documents delivered in person (drop off) to the Sacramento office. The special handling fee is in addition to the filing fee, should be included in a separate check, and will be retained whether the document is filed or rejected. The preclearance and/or expedited filing of a document *within a guaranteed time frame* can be requested for an additional fee in lieu of the special handling fee. Please refer to the Secretary of State's website at [www.sos.ca.gov/business/be/service-options.htm](http://www.sos.ca.gov/business/be/service-options.htm) for detailed information regarding preclearance and expedited filing services. The special handling fee or preclearance and expedited filings services are not applicable to documents submitted by mail. Check(s) should be made payable to the Secretary of State.

**Copies:** The Secretary of State will certify up to two copies of the filed document without charge, provided that the complete copies with any required attachments are submitted to the Secretary of State with the document to be filed. Any additional copies submitted will be certified with payment of \$8.00 per copy.

**Minimum Tax Requirement:** Filing this document shall obligate most limited partnerships to pay an annual minimum tax of \$800.00 to the Franchise Tax Board pursuant to California Revenue and Taxation Code section 17935.

### Complete the Certificate of Limited Partnership (Form LP-1) as follows:

- Item 1.** Enter the name of the limited partnership. The name must end with the words "Limited Partnership," or the abbreviation "LP" or "L.P." and may not contain the words "bank," "insurance," "trust," "trustee," "incorporated," "inc.," "corporation," or "corp." (Section 15901.08.)
- Item 2.** Enter the address, including the zip code, of the initial designated office in California. Please do not abbreviate the name of the city. The "designated office" address may, but need not, be the place of the limited partnership's activity in California. (Sections 15901.02(e) and 15901.14.)
- Items 3 & 4.** Enter the name of the initial agent for service of process in California. An agent is an individual, whether or not affiliated with the limited partnership, who resides in California or a corporation designated to accept service of process if the limited partnership is sued. The agent should agree to accept service of process on behalf of the limited partnership prior to designation. If a corporation is designated as agent, that corporation must have previously filed with the Secretary of State, a certificate pursuant to Corporations Code section 1505. **Note: A limited partnership cannot act as its own agent** and no domestic or foreign corporation may file pursuant to Section 1505 unless the corporation is currently authorized to engage in business in California and is in good standing on the records of the Secretary of State.
- If an individual is designated as the initial agent, complete Items 3 and 4. If a corporation is designated as the initial agent, complete only Item 3 and proceed to Item 5 (do not complete Item 4).
- Items 5a - 5b.** Enter the name and address of each general partner. Please do not abbreviate the name of the city. The limited partnership must have one or more general partners. (Section 15901.02(q).) If there are more than two general partners, please attach additional pages. Note: If a general partner is a trust, both the name of the trust (including the date of the trust, if applicable) and the trustee should be listed. Example: Mary Todd, trustee of the Lincoln Family Trust U/T/A 5-1-94.
- Item 6.** Attach any other information to be included in Form LP-1 (e.g., the number of general partners' signatures required for filing merger or conversion documents with the California Secretary of State, if less than all) provided that the information is not inconsistent with law.
- Item 7.** Form LP-1 must be signed by all of the general partners. (Section 15902.04.)
- If Form LP-1 is signed by any person other than the general partner(s), the signature must be followed by the words "signature pursuant to Section \_\_\_\_\_" identifying the appropriate statutory authority (Section 15902.05.)
  - If Form LP-1 is signed by an attorney-in-fact, the signature should be followed by the words "Attorney-in-fact for (name of the partner)." (Section 15902.04.)
  - If a trust is designated as a general partner, Form LP-1 should be signed by a trustee as follows: \_\_\_\_\_, trustee for \_\_\_\_\_ trust (including the date of the trust, if applicable). Example: Mary Todd, trustee of the Lincoln Family Trust (U/T/A 5-1-94).
  - If additional signature space is necessary, the signatures may be made on an attachment to Form LP-1.

Any attachments to Form LP-1 are incorporated by reference and made part of Form LP-1. All attachments should be 8 ½" x 11", one-sided and legible.



## LIMITED PARTNERSHIPS

### California Tax Information

Registration of a limited partnership with the California Secretary of State will obligate a limited partnership to pay to the Franchise Tax Board an annual minimum tax of \$800.00. The tax is required to be paid for the taxable year of registration and each taxable year, or part thereof, until a Certificate of Cancellation is filed with the California Secretary of State. (California Revenue and Taxation Code section 17935.)

A limited partnership is not subject to the taxes imposed by Revenue and Taxation Code section 17935 if the limited partnership did no business in California during the taxable year and the taxable year was 15 days or less. (California Revenue and Taxation Code section 17936.)

For further information regarding franchise tax requirements, refer to the Franchise Tax Board's website at [www.ftb.ca.gov](http://www.ftb.ca.gov) or call the Franchise Tax Board at:

From within the United States (toll free) .....	(800) 852-5711
From outside the United States (not toll free).....	(916) 845-6500
Automated Service - From within the United States (toll free).....	(800) 338-0505
Automated Service - From outside the United States (not toll free) .....	(916) 845-6600

LP TAX INFO (REV 01/2008)

*Comment:* This form is available on the Secretary of State's website, <http://www.sos.ca.gov/business/lp/forms/lp-1.pdf>, and may be completed online and downloaded.

The Secretary of State offers a "preclearance" service, which allows a customer to submit a business entity document in person in the Sacramento office before filing to determine if the document conforms to law and to receive a preclearance response within a guaranteed time frame. Only one copy of the document need be submitted. The Secretary of State also permits "expedited filing," which allows a customer to submit a business entity document in person in the Sacramento office and receive a filing response within a guaranteed time frame. Preclearance and

expedited filing services are not available in the regional offices. On occasion, preclearance and expedited filing services may be suspended. For further information, consult the Secretary of State's website at <http://www.sos.ca.gov/business/precexp.htm>. See also §11.30.

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§6.39 C. Form: Amendment to Certificate of Limited Partnership (Secretary of State Form LP-2)

Print

 <p><b>State of California</b> <b>Secretary of State</b></p> <p><b>Amendment To</b> <b>Certificate of Limited Partnership</b></p> <p>A \$30.00 filing fee must accompany this form. <b>IMPORTANT – Read instructions before completing this form.</b></p>		<p>LP-2</p> <p>This Space For Filing Use Only</p>
<p><b>File Number</b></p> <p>1. SECRETARY OF STATE FILE NUMBER</p>	<p><b>Entity Name</b> (Enter the exact name of the limited partnership.)</p> <p>2. NAME OF LIMITED PARTNERSHIP</p>	
<p><b>Items 3 through 13:</b> Complete ONLY the items to be amended or added by this filing. Attach additional pages, if necessary. Any other matters to be included may be made on an attachment to this certificate. Any attachments are incorporated herein by this reference and made part of this certificate.</p>		
<p><b>Entity Name as Amended</b> (End the name with the words "Limited Partnership" or the abbreviation "LP" or "L.P.")</p> <p>3. NAME OF LIMITED PARTNERSHIP</p>		
<p><b>Designated Office Address in California</b></p> <p>4. ADDRESS <span style="float: right;">CITY STATE ZIP CODE</span></p> <p style="text-align: right;"><b>CA</b></p>		
<p><b>Agent for Service of Process</b> (If the agent is an individual, complete both Items 5 and 6. If the agent is a corporation, complete Item 5 and leave Item 6 blank.)</p> <p>5. NAME OF AGENT FOR SERVICE OF PROCESS</p>		
<p>6. IF AN INDIVIDUAL, ADDRESS OF AGENT FOR SERVICE OF PROCESS IN CALIFORNIA <span style="float: right;">CITY STATE ZIP CODE</span></p> <p style="text-align: right;"><b>CA</b></p>		
<p><b>General Partner Information (New Partner, Address Change, Name Change, and/or Dissociation)</b></p>		
<p>7. New Partner NAME ADDRESS CITY STATE ZIP CODE</p>		
<p>8. Address Change NAME ADDRESS CITY STATE ZIP CODE</p>		
<p>9. Name Change FROM: TO:</p>		<p>10. General Partner Dissociation NAME:</p>
<p><b>Dissolution</b> (Item 11 may be checked if the limited partnership has dissolved.)</p> <p>11. <input type="checkbox"/> THE LIMITED PARTNERSHIP IS DISSOLVED.</p>		
<p><b>Authorized Person</b> (Enter the name and address of the person authorized to wind up the affairs of the dissolved limited partnership and check the box in Item 13 to confirm the limited partnership is dissolved and does not have a general partner.)</p>		
<p>12. NAME ADDRESS CITY STATE ZIP CODE</p>		
<p>13. <input type="checkbox"/> THE LIMITED PARTNERSHIP IS DISSOLVED AND DOES NOT HAVE A GENERAL PARTNER.</p>		
<p><b>Execution</b> (This certificate must be signed by at least one general partner unless otherwise provided by law. If additional signature space is necessary, the signatures may be made on an attachment to this certificate.)</p>		
<p>14. I DECLARE I AM THE PERSON WHO EXECUTED THIS INSTRUMENT, WHICH EXECUTION IS MY ACT AND DEED.</p> <p>DATE _____</p> <p>SIGNATURE OF GENERAL PARTNER _____ TYPE OR PRINT NAME OF GENERAL PARTNER _____</p> <p>SIGNATURE OF GENERAL PARTNER _____ TYPE OR PRINT NAME OF GENERAL PARTNER _____</p>		
<p>LP-2 (REV 01/2010)</p>		<p>APPROVED BY SECRETARY OF STATE</p>

## INSTRUCTIONS FOR COMPLETING THE AMENDMENT TO CERTIFICATE OF LIMITED PARTNERSHIP (FORM LP-2)

For easier completion, this form is available on the Secretary of State's website at <http://www.sos.ca.gov/business/> and can be viewed, filled in and printed from your computer. The completed form along with the applicable fees can be mailed to Secretary of State, Document Filing Support Unit, P.O. Box 944225, Sacramento, CA 94244-2250 or delivered in person to the Sacramento office, 1500 11th Street, 3rd Floor, Sacramento, CA 95814. If you are not completing this form online, please type or legibly print in black or blue ink. This form is filed only in the Sacramento office.

**LEGAL AUTHORITY:** Statutory filing requirements are found in California Corporations Code section 15622 or 15902.02. All statutory references are to the California Corporations Code, unless otherwise stated. **Note:** For limited partnerships subject to the Uniform Limited Partnership Act of 2008 (Act of 2008), signing Form LP-2 constitutes an affirmation under penalty of perjury that the facts stated in the certificate are true. (Section 15902.08(b).)

**ACT OF 2008:** A domestic (California) limited partnership is subject to the Act of 2008 (1) if it was formed on or after January 1, 2008; or (2) if it was formed prior to January 1, 2008, and has elected to be governed by the Act of 2008. Effective January 1, 2010, all California limited partnerships will be subject to the Act of 2008 commencing with Section 15900.

**FEES:** The fee for filing Form LP-2 is \$30.00. There is an additional \$15.00 special handling fee for processing a document delivered in person to the Sacramento office. The special handling fee must be remitted separately for each submittal and will be retained whether the document is filed or rejected. The preclearance and/or expedited filing of a document *within a guaranteed time frame* can be requested for an additional fee (in lieu of the special handling fee). Please refer to the Secretary of State's website at <http://www.sos.ca.gov/business/precexp.htm> for detailed information regarding preclearance and expedited filing services. The special handling fee or preclearance and expedited filing services are not applicable to documents submitted by mail. Check(s) should be made payable to the Secretary of State.

**COPIES:** The Secretary of State will certify two copies of the filed document(s) without charge, provided that the copies are submitted to the Secretary of State with the document(s) to be filed. Any additional copies submitted will be certified upon request and payment of the \$8.00 per copy certification fee.

### Complete the Amendment to Certificate of Limited Partnership (Form LP-2) as follows:

- Item 1.** Enter the file number issued to the limited partnership by the California Secretary of State.
- Item 2.** Enter the name of the limited partnership exactly as it is of record with the California Secretary of State.
- Item 3.** Check the box if the limited partnership was formed prior to January 1, 2008 and has elected to be governed by the Act of 2008.
- Items 4 - 14.** Complete ONLY the items to be amended or added by this filing. Attach additional pages, if necessary. Any other matters to be included (e.g., to the extent permitted by law, an amendment to the number of general partners' signatures required to file a particular document with the California Secretary of State) may be made on an attachment to Form LP-2, provided that the information is not inconsistent with law. Any attachments are incorporated by reference and made part of Form LP-2.
- Item 4.** Enter the name of the limited partnership, as amended. The name must end with the words "Limited Partnership," or the abbreviation "L.P." and may not contain the words "bank," "insurance," "trust," "trustee," "incorporated," "inc.," "corporation," or "corp." Note: If the limited partnership is subject to the Act of 2008, the name may also end with the abbreviation "LP". (Section 15612 or 15901.08.)
- Item 5.** Enter the principal executive office address, or if the limited partnership is subject to the Act of 2008, enter the designated office address **in California**. The "designated office" may, but need not, be the place of the limited partnership's activity in California. (Sections 15621, 15902.01, 15901.02(e) and 15901.14.) Please do not abbreviate the name of the city.
- Items 6 & 7.** If designating an individual as the agent for service of process, complete Items 6 and 7. If designating a corporation as the agent for service of process, complete only Item 6 and proceed to Item 8 (do not complete Item 7). If a corporation is designated as agent, that corporation must have previously filed with the California Secretary of State a certificate pursuant to Corporations Code section 1505. The agent should agree to accept service of process on behalf of the limited partnership prior to designation. Note: **A limited partnership cannot act as its own agent** and no domestic or foreign corporation may file pursuant to Section 1505 unless the corporation is currently authorized to engage in business in California and is in good standing on the records of the California Secretary of State.

- Item 8.** Enter the name and address of each new general partner. Please do not abbreviate the name of the city. If there is more than one new general partner, attach additional pages. Note: If a general partner is a trust, both the name of the trust (including the date of the trust, if applicable) and the trustee should be listed. Example: Mary Todd, trustee of the Lincoln Family Trust U/T/A 5-1-94.
- Item 9.** Enter the name and address of each general partner whose address has changed. Please do not abbreviate the name of the city. If more than one general partner has changed their address, attach additional pages.
- Item 10.** Enter the previous and current name of each general partner whose name has changed. If more than one general partner has changed their name, attach additional pages.
- Item 11.** Enter the name of each general partner that has dissociated. If more than one general partner has dissociated, attach additional pages.
- Item 12.** This box may be checked if the limited partnership is subject to the Act of 2008 and has dissolved. If the limited partnership was formed before January 1, 2008 and has not elected to be governed by the Act of 2008, the limited partnership must instead file a Certificate of Dissolution (Form LP-3) pursuant to Section 15623. Note: To cancel the limited partnership, the limited partnership must also file a Certificate of Cancellation (Form LP-4/7). Form LP-3 and Form LP-4/7 are available on the Secretary of State's website at <http://www.sos.ca.gov/business/>.
- Items 13 & 14.** Enter the name and address of the person(s) authorized to wind up the affairs of the limited partnership, and if the dissolved limited partnership is governed by the Act of 2008, check the box in Item 14 to indicate there are no remaining general partners. (Section 15908.03.)
- Item 15.** Form LP-2 must be signed by all general partners or a lesser number as provided in the Certificate of Limited Partnership, or if the limited partnership is subject to the Act of 2008, by at least one general partner. (Section 15624 or 15902.04.)
- Form LP-2 must be signed by each general partner designated in Item 8 as a new partner. (Section 15624 or 15902.04.)
  - If the limited partnership is subject to the Act of 2008, any general partner whose name has been withdrawn (Item 11) must sign Form LP-2 unless that person has filed a Certificate of Dissociation (Form LP-101) with the California Secretary of State. (Section 15902.04.) Form LP-101 is available on the Secretary of State's website at [http://www.sos.ca.gov/business/bpd\\_forms.htm](http://www.sos.ca.gov/business/bpd_forms.htm).
  - If the limited partnership is dissolved and a person other than a general partner has been appointed to wind up the affairs of the limited partnership (Item 13), Form LP-2 must be signed by that person. (Section 15624 or 15902.04.)
  - If Form LP-2 is filed by any person other than the general partner(s), the signature must be followed by the words "signature pursuant to Section \_\_\_\_\_" identifying the appropriate statutory authority. (Section 15625(c) or 15902.05.)
  - If Form LP-2 is signed by an attorney-in-fact, the signature should be followed by the words "Attorney-in-fact for (name of the partner)." (Section 15624 or 15902.04.)
  - If an association is designated as a general partner, the person who signs for the association should state the **exact** name of the association, his/her name and position/title.
  - If a trust is designated as a general partner, Form LP-2 should be signed by a trustee as follows: \_\_\_\_\_ trustee for \_\_\_\_\_ trust (including the date of the trust, if applicable). Example: Mary Todd, trustee of the Lincoln Family Trust (U/T/A 5-1-94).

Any attachments to Form LP-2 are incorporated by reference and made part of Form LP-2. All attachments should be 8 1/2" x 11", one-sided and legible.

*Comment:* This form is available on the Secretary of State's website, <http://www.sos.ca.gov/business/lp/forms/lp-2.pdf>, and may be completed online and downloaded.

For information on the Secretary of State's preclearance and expedited filing services, see Comment in §6.38.

**Source:** Business Law/Selecting and Forming Business Entities/6 Limited Partnerships/§6.40 D. Form: Foreign Limited Partnership Application for Registration (Secretary of State Form LP-5)

**§6.40 D. Form: Foreign Limited Partnership Application for Registration (Secretary of State Form LP-5)**





**State of California  
Secretary of State**

LP-5

File # \_\_\_\_\_

**Foreign Limited Partnership  
Application for Registration**

A \$70.00 filing fee AND a certificate of good standing by an authorized public official of the jurisdiction of formation must accompany this form.

**IMPORTANT – Read instructions before completing this form.**

This Space For Filing Use Only

**Entity Name** (See instructions for name requirements in the State of California.)

1. NAME OF FOREIGN LIMITED PARTNERSHIP

2. ALTERNATE NAME (if the name in Item 1 does not comply with the requirements of California Corporations Code section 15901.08. See instructions)

**Office Addresses** (Please do not abbreviate the name of the city.)

3. ADDRESS OF PRINCIPAL OFFICE CITY STATE ZIP CODE

4. ADDRESS OF OFFICE REQUIRED IN THE JURISDICTION OF FORMATION, IF ANY CITY STATE ZIP CODE

**Date and Place of Organization**

5. THE FOREIGN LIMITED PARTNERSHIP WAS FORMED ON \_\_\_\_\_ - \_\_\_\_\_ - \_\_\_\_\_ UNDER THE LAWS OF \_\_\_\_\_  
(MONTH) (DAY) (YEAR) (STATE OR COUNTRY)

**Initial Agent for Service of Process in California** (If the initial agent is an individual, the agent must reside in California and both Items 6 and 7 must be completed. If the initial agent is a corporation, the agent must have on file with the California Secretary of State a certificate pursuant to Corporations Code section 1505 and Item 6 must be completed (leave Item 7 blank).)

6. NAME OF INITIAL AGENT FOR SERVICE OF PROCESS

7. IF AN INDIVIDUAL, ADDRESS OF INITIAL AGENT FOR SERVICE OF PROCESS IN CA CITY STATE ZIP CODE  
CA

**General Partners** (Enter the names and addresses of all the general partners. Attach additional pages, if necessary. Attachments, if any, are incorporated herein by this reference and made part of this document.)

8a. NAME ADDRESS CITY STATE ZIP CODE

8b. NAME ADDRESS CITY STATE ZIP CODE

**Foreign Limited Liability Limited Partnership**

9.  CHECK THIS BOX IF THE FOREIGN LIMITED PARTNERSHIP IS A FOREIGN LIMITED LIABILITY LIMITED PARTNERSHIP.

**Execution** (This document must be signed by at least one general partner of the foreign limited partnership. If additional signature space is necessary, the signatures may be made on an attachment to this document.)

10. I DECLARE I AM THE PERSON WHO EXECUTED THIS INSTRUMENT, WHICH EXECUTION IS MY ACT AND DEED.

DATE

SIGNATURE OF GENERAL PARTNER

TYPE OR PRINT NAME OF GENERAL PARTNER



## Instructions for Completing the Application for Registration (Form LP-5)

**Where to File:** For easier completion, this form is available on the Secretary of State's website at [www.sos.ca.gov/business/be/forms.htm](http://www.sos.ca.gov/business/be/forms.htm) and can be viewed, filled in and printed from your computer. The completed form along with the applicable fees can be mailed to Secretary of State, Document Filing Support Unit, P.O. Box 944225, Sacramento, CA 94244-2250 or delivered in person (drop off) to the Sacramento office, 1500 11th Street, 3rd Floor, Sacramento, CA 95814. If you are not completing this form online, please type or legibly print in black or blue ink. This form is filed only in the Sacramento office.

**Legal Authority:** Statutory filing requirements are found in California Corporations Code section 15909.02. All statutory references are to the California Corporations Code, unless otherwise stated. **Note:** Signing Form LP-5 constitutes an affirmation under penalty of perjury that the facts stated in the document are true. (Section 15902.08(b).)

**Additional Requirement:** Attach to Form LP-5 a valid certificate of good standing (or other record of similar import) by an authorized public official of the jurisdiction under which the foreign limited partnership is organized.

**Fees:** The fee for filing Form LP-5 is \$70.00. A \$15.00 special handling fee is applicable for processing documents delivered in person (drop off) to the Sacramento office. The special handling fee is in addition to the filing fee, should be included in a separate check, and will be retained whether the document is filed or rejected. The preclearance and/or expedited filing of a document *within a guaranteed time frame* can be requested for an additional fee in lieu of the special handling fee. Please refer to the Secretary of State's website at [www.sos.ca.gov/business/be/service-options.htm](http://www.sos.ca.gov/business/be/service-options.htm) for detailed information regarding preclearance and expedited filing services. The special handling fee or preclearance and expedited filings services are not applicable to documents submitted by mail. Check(s) should be made payable to the Secretary of State.

**Copies:** The Secretary of State will certify up to two copies of the filed document without charge, provided that the complete copies with any required attachments are submitted to the Secretary of State with the document to be filed. Any additional copies submitted will be certified with payment of \$8.00 per copy.

**Minimum Tax Requirement:** Filing this document shall obligate most limited partnerships to pay an annual minimum tax of \$800.00 to the Franchise Tax Board pursuant to California Revenue and Taxation Code section 17935.

### Complete the Application for Registration (Form LP-5) as follows:

- Item 1.** Enter the name of the foreign limited partnership as registered in the foreign jurisdiction.
- Item 2.** If the name in Item 1 does not comply with the requirements of California Corporations Code section 15901.08, then enter an alternate name meeting those requirements (i.e., the name must end with the phrase "Limited Partnership" or the abbreviation "LP" or "L.P." and may not contain the words "bank," "insurance," "trust," "trustee," "incorporated," "inc.," "corporation," or "corp." Note: If the foreign limited partnership is a foreign limited liability limited partnership, the name must contain the phrase "limited liability limited partnership," or the abbreviation "LLLP" or "L.L.L.P." and may not contain the abbreviation "LP" or "L.P.").
- Item 3.** Enter the address, including the zip code, of the principal office. Do not abbreviate the name of the city. (Section 15901.02.)
- Item 4.** Enter the address, including the zip code, of the office required to be maintained by the foreign limited partnership under the laws of the foreign jurisdiction, if any. Do not abbreviate the name of the city.
- Item 5.** Enter the date of formation and the state (or other jurisdiction) under which the foreign limited partnership is organized.
- Items 6 & 7.** Enter the name of the initial agent for service of process in California. An agent is an individual, whether or not affiliated with the limited partnership, who resides in California or a corporation designated to accept service of process if the limited partnership is sued. The agent should agree to accept service of process on behalf of the limited partnership prior to designation. If a corporation is designated as agent, that corporation must have previously filed with the Secretary of State, a certificate pursuant to Corporations Code section 1505. **Note: A limited partnership cannot act as its own agent** and no domestic or foreign corporation may file pursuant to Section 1505 unless the corporation is currently authorized to engage in business in California and is in good standing on the records of the Secretary of State.
- If an individual is designated as the initial agent, complete Items 6 and 7. If a corporation is designated as the initial agent, complete only Item 6 and proceed to Item 8 (do not complete Item 7).
- Items 8a - 8b.** Enter the name and address of each general partner. Do not abbreviate the name of the city. If there are more than two general partners, state the name and address of each additional general partner in an attachment to Form LP-5.
- Item 9.** Check the box if the foreign limited partnership is a foreign limited liability limited partnership.
- Item 10.** Form LP-5 must be signed by at least one general partner of the foreign limited partnership. (Section 15902.04)
- If Form LP-5 is signed by any person other than the general partner(s), the signature must be followed by the words "signature pursuant to Section \_\_\_\_\_" identifying the appropriate statutory authority. (Section 15902.05.)
  - If Form LP-5 is signed by an attorney-in-fact, the signature should be followed by the words "Attorney-in-fact for (name of the partner)." (Section 15902.04)
  - If a trust is designated as a general partner, Form LP-5 should be signed by a trustee as follows: \_\_\_\_\_ trustee for \_\_\_\_\_ trust (including the date of the trust, if applicable). Example: Mary Todd, trustee of the Lincoln Family Trust (U/T/A 5-1-94).
  - If additional signature space is necessary, the signatures may be made on an attachment to Form LP-5.

Any attachments to Form LP-5 are incorporated by reference and made part of Form LP-5. All attachments should be 8 ½" x 11", one-sided and legible.

*Comment:* This form is available on the Secretary of State's website, <http://www.sos.ca.gov/business/lp/forms/lp-5.pdf>, and may be completed online and downloaded. For information on the Secretary of State's preclearance and expedited filing services, see Comment in §6.38.

**Source:** Business Law/Selecting and Forming Business Entities/6 Limited Partnerships/§6.41 E. Form: Foreign Limited Partnership Amendment to Application for Registration (Secretary of State Form LP-6)

**§6.41 E. Form: Foreign Limited Partnership Amendment to Application for Registration (Secretary of State Form LP-6)**





LP-6

# State of California Secretary of State

## Foreign Limited Partnership Amendment to Application for Registration

A \$30.00 filing fee must accompany this form.

**IMPORTANT – Read instructions before completing this form.**

This Space For Filing Use Only

<b>File Number</b>	<b>Entity Name</b> (Enter the exact name of the limited partnership.)
1. CA SECRETARY OF STATE FILE NUMBER	2. NAME UNDER WHICH THE FOREIGN LIMITED PARTNERSHIP CONDUCTS BUSINESS IN CALIFORNIA

**Items 3 through 13:** (Complete ONLY the items to be amended or added by this filing. Attach additional pages, if necessary. Any other matters to be included may be made on an attachment to this document. Any attachments are incorporated herein by this reference and made part of this document.)

**Entity Name as amended** (Complete Item 3 if the actual name of the foreign limited partnership has changed in the foreign jurisdiction. Complete Item 4 if amending or adding an alternate name in California. See instructions.)

3. NAME OF FOREIGN LIMITED PARTNERSHIP AS AMENDED IN THE FOREIGN JURISDICTION

4. ALTERNATE NAME (See instructions before completing Item 4.)

**Office Addresses**

5. ADDRESS OF PRINCIPAL OFFICE CITY STATE ZIP CODE

6. ADDRESS OF OFFICE REQUIRED IN THE JURISDICTION OF FORMATION, IF ANY CITY STATE ZIP CODE

**Agent for Service of Process** (If the agent is an individual, complete both Items 7 and 8. If the agent is a corporation, complete Item 7 and leave Item 8 blank.)

7. NAME OF AGENT FOR SERVICE OF PROCESS

8. IF AN INDIVIDUAL, ADDRESS OF AGENT FOR SERVICE OF PROCESS IN CA CITY STATE ZIP CODE  
**CA****General Partner Information (New Partner, Address Change, Name Change, and/or Withdrawn Partner(s))**

9. New Partner NAME ADDRESS CITY STATE ZIP CODE

10. Address Change NAME ADDRESS CITY STATE ZIP CODE

11. Name Change FROM: TO:

12. Withdrawn Partner(s) NAME:

**Foreign Limited Liability Limited Partnership**13.  CHECK THIS BOX IF THE FOREIGN LIMITED PARTNERSHIP IS A FOREIGN LIMITED LIABILITY LIMITED PARTNERSHIP.

**Execution** (This document must be signed by at least one general partner of the foreign limited partnership. If additional signature space is necessary, the signatures may be made on an attachment to this document.)

14. I DECLARE I AM THE PERSON WHO EXECUTED THIS INSTRUMENT, WHICH EXECUTION IS MY ACT AND DEED.

DATE

SIGNATURE OF GENERAL PARTNER

TYPE OR PRINT NAME OF GENERAL PARTNER



## Instructions for Completing the Amendment to Application for Registration (Form LP-6)

**Where to File:** For easier completion, this form is available on the Secretary of State's website at [www.sos.ca.gov/business/be/forms.htm](http://www.sos.ca.gov/business/be/forms.htm) and can be viewed, filled in and printed from your computer. The completed form along with the applicable fees can be mailed to Secretary of State, Document Filing Support Unit, P.O. Box 944225, Sacramento, CA 94244-2250 or delivered in person (drop off) to the Sacramento office, 1500 11th Street, 3rd Floor, Sacramento, CA 95814. If you are not completing this form online, please type or legibly print in black or blue ink. This form is filed only in the Sacramento office.

**Legal Authority:** Statutory filing requirements are found in California Corporations Code section 15909.06. All statutory references are to the California Corporations Code, unless otherwise stated. **Note:** Signing Form LP-6 constitutes an affirmation under penalty of perjury that the facts stated in the document are true. (Section 15902.08(b).)

**Fees:** The fee for filing Form LP-6 is \$30.00. A \$15.00 special handling fee is applicable for processing documents delivered in person (drop off) to the Sacramento office. The special handling fee is in addition to the filing fee, should be included in a separate check, and will be retained whether the document is filed or rejected. The preclearance and/or expedited filing of a document *within a guaranteed time frame* can be requested for an additional fee in lieu of the special handling fee. Please refer to the Secretary of State's website at [www.sos.ca.gov/business/be/service-options.htm](http://www.sos.ca.gov/business/be/service-options.htm) for detailed information regarding preclearance and expedited filing services. The special handling fee or preclearance and expedited filings services are not applicable to documents submitted by mail. Check(s) should be made payable to the Secretary of State.

**Copies:** The Secretary of State will certify up to two copies of the filed document without charge, provided that the complete copies with any required attachments are submitted to the Secretary of State with the document to be filed. Any additional copies submitted will be certified with payment of \$8.00 per copy.

### Complete the Amendment to Application for Registration (Form LP-6) as follows:

**Item 1.** Enter the file number issued to the foreign limited partnership by the California Secretary of State.

**Item 2.** Enter the name of the foreign limited partnership exactly as it is of record with the California Secretary of State. **Note:** If the foreign limited partnership is registered in California under an alternate name, enter the alternate name of the foreign limited partnership.

**Items 3 - 13.** Complete **ONLY** the items to be amended or added by this filing. Attach additional pages, if necessary. Any other matters to be included may be made on an attachment to Form LP-6, provided that the information is not inconsistent with law. Any attachments are incorporated by reference and made part of Form LP-6.

**Item 3.** Enter the name of the foreign limited partnership as amended in the foreign jurisdiction.

**Item 4.** Enter an alternate name meeting the requirements of Section 15901.08 if:

- The amended name of the foreign limited partnership in Item 3 does not comply with the requirements of Section 15901.08 (i.e., the name must end with the phrase "Limited Partnership" or the abbreviation "LP" or "L.P." and may not contain the words "bank," "insurance," "trust," "trustee," "incorporated," "inc.," "corporation," or "corp." **Note:** If the foreign limited partnership is a foreign limited liability limited partnership, the name must contain the phrase "limited liability limited partnership," or the abbreviation "LLLLP" or "L.L.L.P." and may not contain the abbreviation "LP" or "L.P."); or
- Amending a previously designated alternate name.

**Note:** If the actual name of the foreign limited partnership complies with the requirements of Section 15901.08, leave Item 4 blank and proceed to Item 5.

**Item 5.** Enter the address, including the zip code, of the principal office. Do not abbreviate the name of the city. (Section 15901.02.)

**Item 6.** Enter the address, including the zip code, required to be maintained by the foreign limited partnership under the laws of the foreign jurisdiction, if any. Do not abbreviate the name of the city.



**Items 7 & 8.** If designating an individual as the agent for service of process, complete Items 7 and 8. If designating a corporation as the agent for service of process, complete only Item 7 and proceed to Item 9 (do not complete Item 8). If a corporation is designated as agent, that corporation must have previously filed with the California Secretary of State a certificate pursuant to Corporations Code section 1505. The agent should agree to accept service of process on behalf of the limited partnership prior to designation. **Note: A limited partnership cannot act as its own agent** and no domestic or foreign corporation may file pursuant to Section 1505 unless the corporation is currently authorized to engage in business in California and is in good standing on the records of the California Secretary of State.

**Item 9.** Enter the name and address of each new general partner. Please do not abbreviate the name of the city. If there is more than one new general partner, attach additional pages. **Note:** If a general partner is a trust, both the name of the trust (including the date of the trust, if applicable) and the trustee should be listed. Example: Mary Todd, trustee of the Lincoln Family Trust U/T/A 5-1-94.

**Item 10.** Enter the name and address of each general partner whose address has changed. Please do not abbreviate the name of the city. If more than one general partner has changed their address, attach additional pages.

**Item 11.** Enter the previous and current name of each general partner whose name has changed. If more than one general partner has changed their name, attach additional pages.

**Item 12.** Enter the name of each general partner who has withdrawn from the foreign limited partnership. If more than two general partners have withdrawn, attach additional pages.

**Item 13.** Check the box if the foreign limited partnership is a foreign limited liability limited partnership.

**Item 14.** Form LP-6 must be signed by at least one general partner of the foreign limited partnership.

- If Form LP-6 is signed by any person other than the general partner(s), the signature must be followed by the words "signature pursuant to Section \_\_\_\_\_" identifying the appropriate statutory authority. (Section 15902.05.)
- If Form LP-6 is signed by an attorney-in-fact, the signature should be followed by the words "Attorney-in-fact for (name of the partner)." (Section 15902.04.)
- If an association is designated as a general partner, the person who signs for the association should state the **exact** name of the association, his/her name and position/title.
- If a trust is designated as a general partner, Form LP-6 should be signed by a trustee as follows:  
\_\_\_\_\_ trustee for \_\_\_\_\_ trust (including the date of the trust, if applicable).  
Example: Mary Todd, trustee of the Lincoln Family Trust (U/T/A 5-1-94).
- If additional signature space is necessary, the signatures may be made on an attachment to Form LP-6.

Any attachments to Form LP-6 are incorporated by reference and made part of Form LP-6. All attachments should be 8 ½" x 11", one-sided and legible.

*Comment:* This form is available on the Secretary of State's website, <http://www.sos.ca.gov/business/lp/forms/lp-6.pdf>, and may be completed online and downloaded. For information on the Secretary of State's preclearance and expedited filing services, see Comment to the form in §6.38.

**Source:** Business Law/Selecting and Forming Business Entities/6 Limited Partnerships/§6.42 VIII. ANNOTATED AGREEMENT FOR LIMITED PARTNERSHIP

**§6.42 VIII. ANNOTATED AGREEMENT FOR LIMITED PARTNERSHIP**

This form of limited partnership agreement is appropriate, with suitable modifications, for California business ventures. It has been drafted to accommodate the ownership, development, and operation of real estate. However, these clauses are not intended to cover every situation. They illustrate the type of provision that a practitioner should consider when drafting a form for the client's specific venture. Provisions must be modified to accommodate the partners' specific business and economic arrangements.

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**Source:** Business Law/Selecting and Forming Business Entities/6 Limited Partnerships/§6.43 A. Form: Title of Agreement

**§6.43 A. Form: Title of Agreement**

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §6.43 and ends in §6.151

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6.43-1 Title of agreement

**AGREEMENT OF LIMITED PARTNERSHIP OF**

— *[NAME OF PARTNERSHIP]* —

*Comment:* The name of a limited partnership must contain the words "limited partnership" or must end with either the abbreviation "L.P." or "LP". Corp C §15901.08(b). For further discussion of name requirements and restrictions, see §6.19 and chap 3.

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**§6.44 B. Form: Date and Parties**

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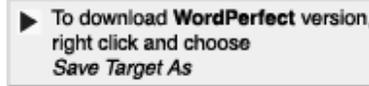
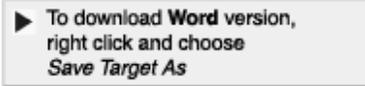
6.44-1 Date and parties

**This Agreement of Limited Partnership of**     *[name of partnership]*     **is entered into on**     *[date of agreement]*    , **by and among (1)**     *[name]*     **and**     *[name]*    , **as general partners, and (2)**     *[name]*    ,     *[name]*    , **and**     *[name]*    , **as limited partners.**

*Comment:* A limited partnership must have at least two partners, one of which is a general partner and one of which is a limited partner. Corp C §15901.02(q). In addition, a limited partnership will not constitute a partnership for tax purposes unless it has at least two partners. See Treas Reg §301.7701-3(a). In limited partnerships with numerous limited partners, limited partners may be identified by reference to the signature page, rather than listing them in the preamble.

**§6.45 C. Form: Definitions**

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §6.43 and ends in §6.151



6.45-1 Definitions

**ARTICLE I**

**DEFINITIONS**

**When used in this Agreement, the following terms have the meanings set forth below:**

*Comment:* Defined terms are capitalized in this agreement. This article clarifies terminology and allows for easy reference for definitions. Corporations Code §15901.02 sets forth numerous other definitions that the practitioner may want to incorporate into the agreement or coordinate with the defined terms set forth below.

**§6.46 1. Form: Affiliate**

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §6.43 and ends in §6.151

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6.46-1 Affiliate

**A. Affiliate.** "Affiliate" of a Partner means any person or entity, directly or indirectly, through one or more intermediaries, controlling, controlled by, or under common control with, that Partner, as applicable. The term "control" for these purposes means with respect to:

1. A corporation or a limited liability company, the right to exercise, directly or indirectly, more than 50 percent of the voting rights attributable to the corporation or the limited liability company, and

2. Any partnership, trust, or other entity, the possession, directly or indirectly, of the power to direct the management or policies of the partnership, trust, or other entity.

**Source:** Business Law/Selecting and Forming Business Entities/6 Limited Partnerships/§6.47 2. Form: Agreement

**§6.47 2. Form: Agreement**

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §6.43 and ends in §6.151

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6.47-1 Agreement

**B. Agreement.** "Agreement" means this Agreement of Limited Partnership of \_\_ *[name of partnership]* \_\_, as amended from time to time.

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**§6.48 3. Form: Bankruptcy**

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §6.43 and ends in §6.151

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6.48-1 Bankruptcy

**C. Bankruptcy.** "Bankruptcy" means the institution of any proceedings under federal or state laws for relief of debtors, including:

- 1. The filing of a voluntary or involuntary petition under the federal bankruptcy law;**
- 2. A general assignment for the benefit of creditors;**
- 3. The filing of a petition or answer seeking any reorganization, arrangement, composition, readjustment, liquidation, dissolution, or similar relief under any statute, law, or regulation;**
- 4. The filing of an answer or other pleading admitting or failing to contest the material allegations of a petition filed in any proceeding of this nature;**
- 5. The seeking, consenting to, or acquiescence in, the appointment of a trustee, receiver, or liquidator of all or any substantial portion of assets;**
- 6. The commencement of any proceeding seeking any reorganization, arrangement, composition, readjustment, liquidation, dissolution, or similar relief under any statute, law, or regulation, and the failure, in the case of any of these events, to obtain the dismissal of the proceeding within 60 days of the event; or**
- 7. The appointment, without consent or acquiescence, of a trustee, receiver, or liquidator of all or any substantial portion of assets, and the failure, in the case of any of these events, to obtain the dismissal of the proceeding or removal of the trustee, receiver, or liquidator within 60 days of the event.**

*Comment:* This provision is consistent with Corp C §15906.03(f)(1), which establishes bankruptcy as an event causing a general partner to be dissociated from a limited partnership as a general partner. The partnership agreement may redefine the extent to which bankruptcy will trigger this result.

**Source:** Business Law/Selecting and Forming Business Entities/6 Limited Partnerships/§6.49 4. Form: Cash Available for Distribution

#### §6.49 4. Form: Cash Available for Distribution

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §6.43 and ends in §6.151

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6.49-1 Cash available for distribution

**D. Cash Available for Distribution.** "Cash Available for Distribution" means the amount of cash that \_\_ [e.g., all General Partners/a Majority of General Partners]\_\_ deem available for distribution, taking into account all Partnership obligations then due and payable, any compensation payable to a Partner or an Affiliate, \_\_ [and those amounts that \_\_ [e.g., all General Partners/a Majority of General Partners]\_\_ deem reasonably appropriate to place into reserves to satisfy customary business claims, make repairs, or expand the partnership business]\_\_ .

*Comment:* This provision prescribes parameters for determining the amount of partnership funds available for distribution to the partners. The partners should carefully consider whether the general partners will have the right to establish and maintain reserves. This right can be significant because broad reserve rights enhance the general partners' control over the amount of distributions, and unfettered reserve rights give the general partners the unilateral right to withhold distributions.

This provision contemplates distributions of cash rather than property.

A partner has no right to demand or receive any distribution in any form other than cash. However, a limited partnership may ordinarily distribute an asset in kind to the extent that each partner receives a percentage of the asset equal to that partner's share of distributions. Corp C §15905.06. A distribution must be shared among the partners on the basis of the value, as stated in the required records when the limited partnership decides to make the distribution, of the contributions the limited partnership has received from each partner. Corp C §15905.03.

The partners will often treat proceeds derived from operations differently from those derived from other sources (e.g., sales of property). To accommodate differing treatment, the practitioner will need to carefully define the sources of proceeds, modify the distribution provisions set forth in form 6.80-1, and make corresponding adjustments to the profits and loss allocation provisions in form 6.85-1.

**Source:** Business Law/Selecting and Forming Business Entities/6 Limited Partnerships/§6.50 5. Form: Certificate of Limited Partnership

**§6.50 5. Form: Certificate of Limited Partnership**

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §6.43 and ends in §6.151

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6.50-1 Certificate of limited partnership

**E. Certificate of Limited Partnership.** "Certificate of Limited Partnership" means the certificate described in Corporations Code §15902.01 that the General Partners file with the Secretary of State of California on behalf of the Partnership.

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**Source:** Business Law/Selecting and Forming Business Entities/6 Limited Partnerships/§6.51 6. Form: Corporations Code

**§6.51 6. Form: Corporations Code**

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §6.43 and ends in §6.151

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6.51-1 Corporations Code

**F. *Corporations Code*. "Corporations Code" means the California Corporations Code.**

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**Source:** Business Law/Selecting and Forming Business Entities/6 Limited Partnerships/§6.52 7. Form: Re-RULPA

**§6.52 7. Form: Re-RULPA**

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §6.43 and ends in §6.151

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6.52-1 Re-RULPA

**G. Re-RULPA means the Uniform Limited Partnership Act of 2008, as set forth in Corporations Code §§15900-15912.07.**

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**§6.53 8. Form: General Partners**

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6.53-1 General partners

**H. General Partners.** "General Partners" means \_\_ *[name of partner]* \_\_, \_\_ *[name of partner]* \_\_, and any other party admitted as a general partner of the Partnership under the Agreement. "General Partner" means any one of the General Partners, unless the context requires otherwise.

**Source:** Business Law/Selecting and Forming Business Entities/6 Limited Partnerships/§6.54 9. Form: IRC

**§6.54 9. Form: IRC**

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §6.43 and ends in §6.151

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6.54-1 IRC

**I. IRC. "IRC" means the Internal Revenue Code of 1986, as amended from time to time, and any successor provisions.**

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**Source:** Business Law/Selecting and Forming Business Entities/6 Limited Partnerships/§6.55 10. Form: Limited Partners

**§6.55 10. Form: Limited Partners**

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §6.43 and ends in §6.151

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6.55-1 Limited partners

**J. Limited Partners.** "Limited Partners" means \_\_ *[name of partner]* \_\_, \_\_ *[name of partner]* \_\_, \_\_ *[name of partner]* \_\_, and any other party admitted as a limited partner of the Partnership under the Agreement. "Limited Partner" means any one of the Limited Partners, unless the context requires otherwise.

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**Source:** Business Law/Selecting and Forming Business Entities/6 Limited Partnerships/§6.56 11. Form: Majority in Interest of General Partners

**§6.56 11. Form: Majority in Interest of General Partners**

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §6.43 and ends in §6.151

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6.56-1 Majority in interest of general partners

**K. Majority in Interest of General Partners.** "Majority in Interest of General Partners" means \_\_ *[e.g., a majority in number of General Partners/those General Partners who hold a majority of the Percentage Interests held by all General Partners]* \_\_.

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**Source:** Business Law/Selecting and Forming Business Entities/6 Limited Partnerships/§6.57 12. Form: Majority in Interest of Limited Partners

**§6.57 12. Form: Majority in Interest of Limited Partners**

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §6.43 and ends in §6.151

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6.57-1 Majority in interest of limited partners

**L. Majority in Interest of Limited Partners.** "Majority in Interest of Limited Partners" means \_\_ [e.g., a majority in number of Limited Partners/those Limited Partners who hold a majority of the Percentage Interests held by all Limited Partners]\_\_.

*Comment:* Absent agreement to the contrary, a "majority in interest of the limited partners" is defined as more than 50 percent of the limited partnership interests. Corp C §15901.02(t).

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**Source:** Business Law/Selecting and Forming Business Entities/6 Limited Partnerships/§6.58 13. Form: Majority in Interest of Partners

**§6.58 13. Form: Majority in Interest of Partners**

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6.58-1 Majority in interest of partners

**M. Majority in Interest of Partners.** "Majority in Interest of Partners" means \_\_ [e.g., a majority in number of Partners/those Partners who hold a majority of the Percentage Interests held by all Partners]\_\_.

*Comment:* Absent agreement to the contrary, a "majority in interest of all partners" is defined as more than 50 percent of the interests of all partners. Corp C §15901.02(s).

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**Source:** Business Law/Selecting and Forming Business Entities/6 Limited Partnerships/§6.59 14. Form: Nonrecourse Liability

**§6.59 14. Form: Nonrecourse Liability**

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6.59-1 Nonrecourse liability

**N. *Nonrecourse Liability*.** "Nonrecourse Liability" has the meaning set forth in Treasury Regulations §1.752-1(a)(2).

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**Source:** Business Law/Selecting and Forming Business Entities/6 Limited Partnerships/§6.60 15. Form: Partner Nonrecourse Debt

**§6.60 15. Form: Partner Nonrecourse Debt**

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6.60-1 Partner nonrecourse debt

**O. Partner Nonrecourse Debt.** "Partner Nonrecourse Debt" has the meaning set forth in Treasury Regulations §1.704-2(b)(4).

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**Source:** Business Law/Selecting and Forming Business Entities/6 Limited Partnerships/§6.61 16. Form: Partners

**§6.61 16. Form: Partners**

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6.61-1 Partners

**P. *Partners*.** "Partners" means the General Partners and the Limited Partners. "Partner" means any one of the Partners, unless the context requires otherwise.

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**§6.62 17. Form: Partnership**

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6.62-1 Partnership

**Q. Partnership.** "Partnership" means \_\_ *[name of limited partnership]* \_\_, a California limited partnership.

**Source:** Business Law/Selecting and Forming Business Entities/6 Limited Partnerships/§6.63 18. Form: Partnership Minimum Gain

**§6.63 18. Form: Partnership Minimum Gain**

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6.63-1 Partnership minimum gain

**R. *Partnership Minimum Gain*.** "Partnership Minimum Gain" has the meaning set forth in Treasury Regulations §1.704-2(d).

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**Source:** Business Law/Selecting and Forming Business Entities/6 Limited Partnerships/§6.64 19. Form: Percentage Interests

**§6.64 19. Form: Percentage Interests**

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6.64-1 Percentage interests

**S. *Percentage Interests.* A Partner's "Percentage Interest" means the percentage set forth below opposite that Partner's name: \_ \_ [specify names of partners and percentages] \_ \_.**

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**Source:** Business Law/Selecting and Forming Business Entities/6 Limited Partnerships/§6.65 20. Form: Treasury Regulation

**§6.65 20. Form: Treasury Regulation**

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6.65-1 Treasury regulation

**T. *Treasury Regulation.* "Treasury Regulation" means the income tax regulations promulgated under the IRC for the purpose of interpreting and applying the provisions of the IRC, as amended and succeeded from time to time.**

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**Source:** Business Law/Selecting and Forming Business Entities/6 Limited Partnerships/ D. Organization/§6.66 1. Form: Formation

## **D. Organization**

### **§6.66 1. Form: Formation**

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6.66-2 Formation

## **ARTICLE II**

### **ORGANIZATION**

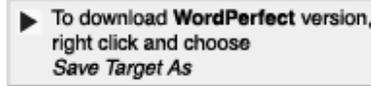
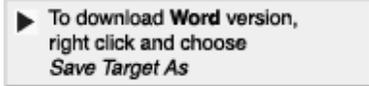
**A. Formation.** The Partners \_\_ *[have formed/agree to form]* \_\_ a limited partnership under the laws of the State of California, governed by Internal Revenue Code §§701-761 for federal income tax purposes and Re-RULPA for state law purposes.

*Comment:* For a provision defining Re-RULPA for purposes of the limited partnership agreement, see §6.52.

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§6.67 2. Form: Name

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6.67-1 Name

**B. Name.** The Partnership's name    *[is/shall be]*    "    *[name]*   ," and the Partnership's business will be conducted under that name. When required, the General Partner must sign and cause to be filed and published an appropriate fictitious business name statement under the California Fictitious Business Name Act (Business & Professions Code §§17900-17930) within 40 days after the partnership begins doing business, within 40 days after any subsequent change in its membership, and before the expiration of any previously filed statement.

*Comment:* The name of a limited partnership must contain the words "limited partnership" or must end with either the abbreviation "L.P." or "LP". Corp C §15901.08(b). A limited partnership's name is subject to additional statutory rules and restrictions. The practitioner should also ascertain any fictitious business names under which the limited partnership intends to conduct its business. For further discussion of name requirements and restrictions, see §6.19 and chap 3.

**Source:** Business Law/Selecting and Forming Business Entities/6 Limited Partnerships/§6.68 3. Form: Designated Office

**§6.68 3. Form: Designated Office**

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6.68-1 Designated office

**C. Designated Office.** The Partnership's designated office is located at \_\_ \_\_[street address of limited partnership]\_\_.

*Comment:* A limited partnership must designate and continuously maintain an office in California, which need not be a place of activity in California. Corp C §§15901.02(e), 15901.14(a)(1). The partnership must maintain its required records at this office. Corp C §15901.11.

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**Source:** Business Law/Selecting and Forming Business Entities/6 Limited Partnerships/ E. Certificate of Limited Partnership/§6.69 1. Form: Filing Certificate of Limited Partnership

## **E. Certificate of Limited Partnership**

### **§6.69 1. Form: Filing Certificate of Limited Partnership**

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6.69-1 Filing certificate of limited partnership

**D. Filing Certificate.** The General Partners \_\_*[have executed/will execute]*\_\_ a **Certificate of Limited Partnership** in the form required by California Corporations Code §15902.01 and \_\_*[have filed/will file]*\_\_ the **Certificate of Limited Partnership** with the Secretary of State of California. The General Partners may record the certified copy of the Certificate of Limited Partnership in each county in which any partnership real property is located.

*Comment:* To form a limited partnership, the practitioner must file a Certificate of Limited Partnership (Secretary of State Form LP-1) with the Secretary of State. Corp C §§15902.01(a), 15902.06(a). See §§6.20-6.27 and form in §6.37.

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**Source:** Business Law/Selecting and Forming Business Entities/6 Limited Partnerships/§6.70 2. Form: Amending Certificate of Limited Partnership

## §6.70 2. Form: Amending Certificate of Limited Partnership

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6.70-1 Amending certificate of limited partnership

**E. Amending Certificate.** The General Partners must amend the Certificate of Limited Partnership if and to the extent required by Re-RULPA (Corporations Code §§15900-15912.07). All amendments must be in the form required by Corporations Code §15902.02.

*Comment:* The general partners must amend the Certificate of Limited Partnership (Secretary of State Form LP-1) to reflect (Corp C §15902.02):

- The admission of a new general partner;
- The dissociation of a person as a general partner; or
- The appointment of a person to wind up the limited partnership's activities.

In addition, a general partner who knows that any information in a filed Certificate of Limited Partnership was false when the certificate was filed or has become false due to changed circumstances must promptly cause the certificate to be amended or file an amendment or a certificate of correction (Corp C §15902.07) with the Secretary of State. Corp C §15902.02(c).

A Certificate of Limited Partnership may also be amended at any time. Corp C §15902.02(d).

A Certificate of Limited Partnership is amended by filing an Amendment to Certificate of Limited Partnership (Form LP-2). Corp C §15902.02(a). See form in §6.39. The amendment must be filed promptly after the occurrence of the event requiring the amendment. Corp C §15902.02(b).

The Secretary of State accepts facsimile signatures on documents that are delivered by mail or by hand. The party on whose behalf such a document is submitted must maintain the originally signed document for at least 5 years from the date of filing. Corp C §17.1(c)-(d).

§6.71 F. Form: Term

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6.71-1 Term

**F. Term. The Partnership will commence on the date on which the General Partners file a Certificate of Limited Partnership for the Partnership and continue until terminated in accordance with this Agreement.**

*Comment:* A limited partnership is formed when its Certificate of Limited Partnership (Secretary of State Form LP-1) is filed with the Secretary of State. Corp C §15902.01(c). See §§6.20-6.27.

A limited partnership has a perpetual duration. Corp C §15901.04(c). This default provision may be changed in the partnership agreement. Corp C §15901.10(b).

**Source:** Business Law/Selecting and Forming Business Entities/6 Limited Partnerships/§6.72 G. Form: Business of Partnership

**§6.72 G. Form: Business of Partnership**

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6.72-1 Business of partnership

**G. Business of Partnership.** The Partnership's business is to \_\_ *[description of business of limited partnership]* \_\_. The Partnership is empowered to do all acts and things in furtherance of and incidental to this business.

*Comment:* The practitioner should identify all anticipated activities of the limited partnership and any limitations on the scope of such activities.

A limited partnership may be organized for any lawful purpose, whether or not for profit, except the banking business, the business of issuing policies of insurance and assuming insurance risks, or the trust company business. Corp C §15901.04(b).

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§6.73 H. Form: Financing

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6.73-1 Financing

**H. Financing.** To conduct its business, the Partnership will require a loan from \_\_[name of lender]\_\_ in the approximate amount of \$ \_\_[amount]\_\_. The General Partners must negotiate the terms and conditions of the financing. The final terms and conditions of the financing are subject to the prior consent of \_\_[e.g., all Partners/all General Partners/a Majority of General Partners/all General Partners and a Majority of Limited Partners/a Majority of Partners]\_\_. The General Partners may materially modify the financing only with the prior consent of \_\_[e.g., all Partners/all General Partners/a Majority of General Partners/all General Partners and a Majority of Limited Partners/a Majority of Partners]\_\_. If the Partnership fails to obtain its financing by \_\_[date]\_\_, \_\_[specify consequences, e.g., the Partnership shall be dissolved, liquidated, and terminated in accordance with this Agreement]\_\_.

*Comment:* This provision may be omitted, depending on whether the partnership intends to borrow money to finance the partnership's business. The practitioner should identify the source of all anticipated financing for the limited partnership's activities (e.g., construction loans, partner loans, capital contributions). In addition, the practitioner should consider whether (1) the limited partners have the right to approve the terms of any financing, and (2) the limited partners' consent will be required for any material changes to such terms. If so, the practitioner must address the consequences of the limited partners' failure to approve or consent (e.g., dissolution).

**Source:** Business Law/Selecting and Forming Business Entities/6 Limited Partnerships/§6.74 I. Form: Partner Guarantees Repayment

## §6.74 I. Form: Partner Guarantees Repayment

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6.74-1 Partner guarantees repayment

*[Add one of the following alternatives]*

*[Alternative 1: Partner guarantees repayment]*

**I. Partner Guarantees Repayment.** The \_\_ *[e.g., General Partners/Limited Partners]* \_\_ will guarantee the Partnership's repayment of \_\_ *[specify financing of limited partnership]* \_\_.

*[Alternative 2: No partner guarantees repayment]*

**I. No Partner Guarantees Repayment.** No Partner will be required to guarantee all or any part of any Partnership obligation.

*Comment:* The practitioner should determine whether one or more partners will be required to guarantee the repayment of any partnership financing. A limited partner's guaranty of a limited partnership's debt will not by itself undermine his or her protection from personal liability. Corp C §15903.03(b)(3).

## J. Capital Contributions

### §6.75 1. Form: Initial Capital Contributions

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6.75-1 Initial capital contributions

## ARTICLE III

### CAPITAL CONTRIBUTIONS

[Add one of the following alternatives]

[Alternative 1: Cash]

**A. Initial Capital Contributions.** On formation of the Partnership, \_\_ [name of partner] \_\_ must contribute to the Partnership cash in the amount of \_\_ [amount of cash] \_\_, for which \_\_ [name of partner] \_\_ will receive a corresponding credit to \_\_ [his/her] \_\_ capital account.

[Alternative 2: Contractual rights]

**A. Initial Capital Contributions.** On formation of the Partnership, \_\_ [name of partner] \_\_ must contribute to the Partnership all of \_\_ [his/her] \_\_ right to acquire the real property described on the attached Exhibit \_\_ [specify number or letter] \_\_ under the Purchase Agreement, dated \_\_ [date of agreement] \_\_, by and between \_\_ [name of partner] \_\_ and \_\_ [name of seller] \_\_. The Partners agree that such right has a net fair market value of \_\_ [net fair market value of purchase agreement] \_\_. \_\_ [Name of partner] \_\_ will receive a credit to \_\_ [his/her] \_\_ capital account equal to that amount.

[Alternative 3: Costs]

**A. Initial Capital Contributions.** \_\_ [Name of partner] \_\_ has incurred preformation costs in the amount of \$ \_\_ [amount] \_\_. On formation, \_\_ [name of partner] \_\_ will be deemed to have contributed cash to the Partnership in that amount and will receive a corresponding credit to \_\_ [his/her] \_\_ capital account.

[Alternative 4: Promissory note]

**A. Initial Capital Contributions.** On formation of the Partnership, \_\_ [name of partner] \_\_ will contribute to the Partnership that certain promissory note dated \_\_ [date] \_\_, in the principal amount of \_\_ [principal amount of promissory note] \_\_, executed by \_\_ [name of payor] \_\_ in favor of \_\_ [name of payee] \_\_.

[Alternative 5: Real property]

**A. Initial Capital Contributions.** On formation of the Partnership, \_\_ [name of partner] \_\_ will contribute to the Partnership \_\_ [his/her] \_\_ entire ownership interest in the real property described on attached Exhibit \_\_ [specify number or letter] \_\_. The Partners agree that the property has a net fair market value of \_\_ [net fair market value of property] \_\_. \_\_ [Name of partner] \_\_ will receive a credit to \_\_ [his/her] \_\_ capital account equal to that amount.

[Alternative 6: Services]

**A. Initial Capital Contributions.** On formation of the Partnership, \_\_ [name of partner] \_\_ will contribute services consisting of formation, organization, and operation of the Partnership. The Partners agree that these services have a fair market value of \_\_ [fair market value of services] \_\_. \_\_ [Name of partner] \_\_ will receive a credit to \_\_ [his/her] \_\_ capital account equal to that amount.

*Comment:* Although a partner is not required to contribute capital to a limited partnership to acquire an ownership interest in the limited partnership (Corp C §15905.02), the alternatives in this form accommodate the initial capital contributions of cash, contractual rights, costs, promissory notes, real property, and services. Practitioners must consider the tax ramifications associated with contributing these items to a limited partnership. A partner will receive a capital account credit for tax purposes equal to (1) the amount of money that the partner contributes to the partnership

and (2) the net fair market value of all property that the partner contributes to the capital of the partnership. Treas Reg §1.704-1(b)(2)(iv)(b). The contribution of capital to a partnership ordinarily constitutes a nontaxable event, except to the extent provided otherwise under IRC §§707 and 752 and the Treasury Regulations promulgated under IRC §§707 and 752. See IRC §721.

If contractual rights are being contributed, the practitioner should review the contracts to ascertain whether any third party consents are required for the contribution or the contribution triggers a due-on-sale clause.

A partner who contributes a nonnegotiable promissory note to a partnership will receive a capital account credit for tax purposes only when and to the extent that the partnership disposes of the promissory note in a taxable transaction or the partner makes a principal payment on the promissory note. Treas Reg §1.704-1(b)(2)(iv)(d)(2). Conversely, a partner's contribution of a promissory note that is readily tradable on an established securities market is treated like any other property contribution. Accordingly, it is currently reflected at its net fair market value in the partner's capital account. Treas Reg §1.704-1(b)(2)(iv)(d)(2). A partner's contribution of a promissory note to a partnership should not constitute a disposition of the promissory note under IRC §453(B); Treas Reg §1.453-9(c)(2).

If real property is being contributed, the practitioner should determine whether any development work, drawings, plans, studies, construction contracts, loans, permits, and other information should also be contributed. The practitioner should enumerate (1) liabilities to which the property is subject at the time of its contribution, and (2) liabilities that the limited partnership is assuming in connection with the contribution of real property. Contribution of property subject to debt or the partnership's assumption of debt can have significant tax consequences. See IRC §§707, 752. See also §6.96; *Advising California Partnerships*, chap 3 (3d ed Cal CEB 1999); 1 McKee, Nelson & Whitmire, *Federal Taxation of Partnerships and Partners*, chap 4 (4th ed 2007).

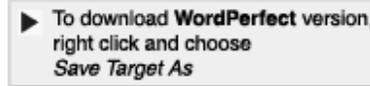
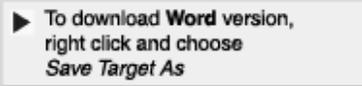
A partner's contribution of services to a partnership in exchange for a capital interest and corresponding capital account credit will trigger a taxable event to that partner. Treas Reg §1.721-1(b)(1). However, the rendition of services to a partnership in exchange for a profit interest should not be a taxable event for either the partner or the partnership. See Rev Proc 93-27, 1993-2 Cum Bull 343, clarified by Rev Proc 2001-43, 2001-2 Cum Bull 191 (guidance on what constitutes a profit interest). The receipt of a partnership interest in exchange for services performed could also be subject to IRC §83.

A proposed elective "safe harbor" for a partnership's transfer of interests is set forth in Prop Treas Reg §1.83-3(l). The proposed regulations, and related IRS proposals, would render Rev Proc 93-27 and Rev Proc 2001-42 obsolete. However, until the proposals become final, taxpayers may continue to rely on current law, including Rev Proc 93-27 and Rev Proc 2001-43, but not the proposed safe harbor. See Notice 2005-43, 2005-24 Int Rev Bull 1221.

## 2. Additional Capital Contributions

### §6.76 a. Form: General Partners' Additional Capital Contributions

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6.76-1 Additional capital contributions

[Add one of the following alternatives]

[Alternative 1: Additional contributions require consent of all general partners]

**B. General Partners' Additional Capital Contributions.** The General Partners must contribute additional capital to the Partnership in the amounts and at the times as all General Partners deem necessary to conduct the Partnership's business. Each General Partner will receive a credit to his or her capital account in the amount of any additional capital contribution.

[Alternative 2: Additional contributions mandatory]

**B. General Partners' Obligation to Contribute Additional Capital.** The General Partners must contribute additional capital to the Partnership in the amounts and at the times as \_\_ [e.g., a Majority of General Partners] \_\_ deem necessary to conduct the Partnership's business. Each General Partner will contribute that portion of the total additional capital required in the same proportion as the Percentage Interest that each General Partner bears of the aggregate Percentage Interests of all General Partners. On their determination that additional capital is required, the General Partners must give written notice to each General Partner. Each General Partner has \_\_ [number] \_\_ days from the date of notice to contribute his or her required additional capital. Each General Partner will receive a credit to his or her capital account in the amount of any additional capital contributed.

[Continue]

**C. Failure to Contribute.** If a General Partner does not contribute additional capital when required, that General Partner will be in default under this Agreement. On default, the \_\_ [e.g., nondefaulting General Partner/nondefaulting Partners] \_\_ must send the defaulting General Partner written notice of default, giving him or her \_\_ [number] \_\_ days from the date of notice to contribute his or her required additional capital. If the defaulting General Partner does not contribute his or her required additional capital within \_\_ [number] \_\_ days, \_\_ [e.g., the nondefaulting General Partner/those nondefaulting Partners who hold a Majority of the Percentage Interests held by all nondefaulting Partners] \_\_ may elect one or more of the following remedies:

[If applicable, add one or more of the following options]

[Option 1: General partners may advance funds]

1. \_\_ [E.g., The nondefaulting General Partner/One or more nondefaulting Partners] \_\_ may advance funds to the Partnership to cover those amounts that the defaulting General Partner fails to contribute. Amounts that a nondefaulting Partner advances will constitute a loan due and owing from the defaulting General Partner to the nondefaulting Partner and bear interest at the rate of \_\_ [number] \_\_ percent per annum, payable \_\_ [e.g., monthly/quarterly/annually] \_\_. This loan, together with interest, must be repaid from distributions otherwise payable to the defaulting General Partner under this Agreement. The distributions will be applied first to interest and thereafter to principal.

[Option 2: Partners' percentage interests adjusted]

[2.] The Partners' Percentage Interests must be adjusted as follows: Each Partner's Percentage Interest will be a fraction, the numerator representing the aggregate amount of that Partner's capital contributions, and the denominator representing the sum of all Partners' aggregate capital contributions.

[Option 3: Defaulting general partner's interest converted to limited partnership interest]

[3.] The defaulting General Partner's entire interest as a general partner will be converted to that of a Limited Partner under \_\_ [specify number or letter] \_\_.

[Option 4: Defaulting general partner loses right to vote]

**[4.] The defaulting General Partner forfeits the right to vote on Partnership matters and otherwise participate in the Partnership's business until the defaulting General Partner cures his or her default.**

[Option 5: Partnership dissolves]

**[5.] The Partnership will dissolve, be wound up, liquidated, and terminated in accordance with this Agreement.**

*Comment:* The agreement should state whether or not additional capital contributions by general partners are mandatory. If additional capital contributions are mandatory, the partnership agreement should address the consequences of a partner's failure to satisfy the obligation to contribute additional capital. Corporations Code §15905.02 allows a partnership agreement to establish remedies for the failure to make a required capital contribution.

A provision in a partnership agreement that provides for specific consequences to a partner for a breach of the partnership agreement is enforceable in accordance with its terms, unless the partner seeking to invalidate the provision establishes that the provision was unreasonable under the circumstances at the time the partnership agreement was made. Corp C §15905.02(d). The specific consequences may include loss of voting, approval, or other rights; loss of the ability, by a general partner, to actively participate in the management and operations of the partnership; liquidated damages; or a reduction of the defaulting partner's economic rights. The reduction of the defaulting partner's economic rights may include one or more of the following provisions:

- Diluting, reducing, or eliminating the defaulting partner's proportionate interest in the limited partnership;
- Subordinating the defaulting partner's partnership interest to that of nondefaulting partners;
- Permitting a forced sale of the partnership interest;
- Permitting the lending or contribution of capital by other partners of the amount necessary to meet the defaulting partner's commitment;
- Providing for the adjustment of interest rates or other rates of return, preferred, priority, or otherwise, with respect to contributions by or capital accounts of the other partners; or
- Providing for a fixing of the value of the defaulting partner's partnership interest by appraisal or by formula and redemption or sale of the defaulting partner's partnership interest at a percentage of that value. Corp C §15905.02(d).

However, these provisions do not affect the rights of third party creditors of the partnership to seek equitable remedies or any rights existing under the Uniform Fraudulent Transfer Act (CC §§3439-3439.12). Corp C §15905.02(d)(7)).

A partner is not excused from his or her obligation to contribute capital or to perform services because of death, disability, or other inability to perform personally. Corp C §15905.02(a). If a partner does not make a promised nonmonetary contribution, the partner must, at the partnership's option, contribute money equal to the value of the portion, as stated in the required information, of the stated contribution that has not been made. Corp C §15905.02(b). The obligation of a partner to make a contribution may be compromised only by consent of all partners. Without notice of any compromise, a creditor of a limited partnership that extends credit or otherwise acts in reliance on a partner's obligation to contribute may enforce the original obligation. Corp C §15905.02(c).

**Source:** Business Law/Selecting and Forming Business Entities/6 Limited Partnerships/§6.77 b. Form: Limited Partners—No Obligation to Contribute Additional Capital

**§6.77 b. Form: Limited Partners—No Obligation to Contribute Additional Capital**

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §6.43 and ends in §6.151

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6.77-1 Limited partners—No obligation to contribute additional capital

**D. Limited Partners—No Obligation to Contribute Additional Capital. The Limited Partners are not and may not be obligated to contribute additional capital to the Partnership.**

*Comment:* Not obligating a limited partner to contribute additional capital is consistent with the principle that a limited partner should not be personally liable for the debts or liabilities of a limited partnership. A partner's contractual obligation to contribute money, property, or services to the partnership is enforceable by the partnership and, in limited circumstances, by third party creditors when reliance on the obligation can be shown. See Corp C §15905.02. The practitioner has the option of requiring limited partners in appropriate circumstances to make further capital contributions. See Corp C §15905.02.

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**§6.78 3. Form: Capital Accounts**

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6.78-1 Capital accounts

**E. Capital Accounts. The Partnership will establish and maintain an individual capital account for each Partner, determined and maintained in accordance with Treasury Regulations §1.704-1(b)(2)(iv).**

*Comment:* Allocations of income, gain, loss, deduction, and credit for tax purposes must be made in accordance with the partners' respective interests in the partnership. IRC §704. Allocations that have substantial economic effect are deemed to be in accordance with the partners' respective interests for these purposes. Allocations will have economic effect if the partnership agreement incorporates the "safe harbor" provisions set forth in Treas Reg §1.704-1(b)(2). Under these provisions, capital accounts must be maintained in accordance with Treas Reg §1.704-1(b)(2)(iv), liquidating distributions must be made in accordance with positive capital account balances, and each partner must be obligated to restore any deficit balance in his or her capital account on liquidation of his or her partnership interest. In lieu of a deficit restoration requirement, the partnership agreement can include "qualified income offset" and corresponding "loss limitation" provisions drafted to comply with Treas Reg §1.704-1(b)(2)(ii)(d). To ensure that allocations will be respected for tax purposes, the partnership agreement should contain a provision that requires capital accounts to be maintained in accordance with Treas Reg §1.704-1(b)(2)(iv) as well as provisions that satisfy the remaining safe harbor requirements. See §§6.86-6.92, 6.129-6.130. For further information and sources discussing IRC §704 allocations, see Comment to form 6.90-1.

**Source:** Business Law/Selecting and Forming Business Entities/6 Limited Partnerships/§6.79 4. Form: No Interest

**§6.79 4. Form: No Interest**

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6.79-1 No interest

**F. *No Interest.* No Partner is entitled to receive interest on the unreturned balance of his or her capital contributions.**

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**Source:** Business Law/Selecting and Forming Business Entities/6 Limited Partnerships/§6.80 5. Form: No Withdrawal of Capital

**§6.80 5. Form: No Withdrawal of Capital**

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6.80-1 No withdrawal of capital

**G. No Withdrawal of Capital.** Except as expressly provided otherwise in this Agreement, no Partner has the right, without the prior consent of \_\_ [e.g., all Partners/all General Partners/a Majority of General Partners/a Majority of Partners] \_\_, to withdraw all or any part of his or her capital contributions from the Partnership.

*Comment:* The parties must determine whether the partners will be entitled to demand the return of their respective capital contributions. If so, the partnership agreement should address the terms for the return of capital and the source of money for the return (e.g., construction loan proceeds).

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**Source:** Business Law/Selecting and Forming Business Entities/6 Limited Partnerships/ K. Distributions/§6.81 1. Form: Manner of Distribution

## **K. Distributions**

### **§6.81 1. Form: Manner of Distribution**

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6.81-1 Manner of distribution

## **ARTICLE IV**

### **DISTRIBUTIONS**

**A. Manner of Distribution.** The Partnership will distribute Cash Available for Distribution in the following order of priority:

- 1. First, to the Partners, pro rata, in proportion to their unreturned capital contributions; and**
- 2. Second, to the Partners, pro rata, in proportion to their Percentage Interests.**

*Comment:* A distribution must be shared among the partners on the basis of the value, as stated in the required records when the limited partnership decides to make the distribution, of the contributions that the limited partnership has received from each partner. Corp C §15905.03.

The order of priority reflects a common economic arrangement among partners. Corp C §15905.03.

Clearly, the practitioner should modify this order of priority for distributions as necessary to accommodate the partners' specific economic understanding.

**Source:** Business Law/Selecting and Forming Business Entities/6 Limited Partnerships/§6.82 2. Form: Time of Distribution

**§6.82 2. Form: Time of Distribution**

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6.82-1 Time of distribution

**B. Time of Distribution.** The Partnership will distribute Cash Available for Distribution when \_\_ [e.g., all General Partners/a Majority of General Partners]\_\_ **determine(s)**, \_\_ [e.g., but at least monthly/quarterly/annually]\_\_ .

*Comment:* If representing the general partners, the practitioner should ordinarily attempt to grant them broad discretion in determining the timing of distributions. Conversely, if representing a limited partner, the practitioner should generally require the general partners to make distributions at specified times (e.g., at least monthly, quarterly, annually). At the time a partner becomes entitled to receive a distribution, he or she has the status of, and is entitled to all remedies available to, a creditor of the limited partnership with respect to the distribution. Corp C §15905.07.

**§6.83 3. Form: Recontribution**

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6.83-1 Recontribution

**C. Recontribution. The Partners understand and acknowledge that they are obligated to recontribute Partnership distributions to the extent required by Corporations Code §15905.09.**

*Comment:* A partner or transferee that receives a distribution knowing that it was made when immediately after the distribution the limited partnership could not pay its debts in the ordinary course of business or that liabilities plus costs associated with dissolution, winding up, or terminating would exceed assets (see Corp C §15905.08) is personally liable for the shortfall. Corp C §15905.09(b).

**§6.84 4. Form: Withholding**

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6.84-1 Withholding

**D. Withholding. The Partnership must withhold and pay all withholding taxes to the Internal Revenue Service and the California Franchise Tax Board in accordance with the provisions set forth in the Internal Revenue Code and the California Revenue and Taxation Code.**

*Comment:* In general, a limited partnership must withhold taxes on a foreign partner's distributive share of the limited partnership's effectively connected taxable income and of the limited partnership's rents, dividends, and interest. IRC §§1441, 1445(e), 1446(a). For details regarding the rules governing federal withholding obligations of partnerships that have foreign partners, see 1 McKee, Nelson & Whitmire, *Federal Taxation of Partnerships and Partners* ¶9.03[4] (4th ed 2007); *Forming and Operating California Limited Liability Companies* (2d ed Cal CEB 2007).

California conforms to the federal provisions and requires a partnership to withhold taxes on income allocable to foreign partners, to the extent that amounts withheld under IRC §1446 represent income from California sources. Rev & T C §18666. For more information regarding the rules governing California withholding obligations of partnerships that have foreign partners, see *Limited Liab*, chap 5.

**Source:** Business Law/Selecting and Forming Business Entities/6 Limited Partnerships/ L. Profits and Losses/§6.85 1.  
Form: Determination of Profits and Losses

## **L. Profits and Losses**

### **§6.85 1. Form: Determination of Profits and Losses**

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6.85-1 Determination of profits and losses

## **ARTICLE V**

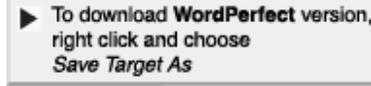
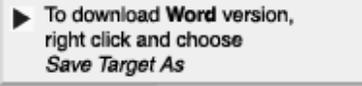
### **PROFITS AND LOSSES**

**A. *Determination of Profits and Losses.* Partnership profits and losses must be determined in accordance with Internal Revenue Code §§703-704 and the Regulations under those statutes.**

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**§6.86 2. Form: Allocation of Profits and Losses**

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6.86-1 Allocation of profits and losses

**B. Allocation of Profits and Losses.**

**1. Profits. Partnership profits must be allocated to the Partners in the following order of priority:**

(a) First, to the Partners in the amount of any losses previously allocated to them under subparagraphs (2)(b) and (2)(c) (to the extent such losses have not been offset by prior profit allocations under this subparagraph (1)(a)); and

(b) Second, to the Partners, pro rata, in accordance with their Percentage Interests.

**2. Losses. Partnership losses must be allocated to the Partners in the following order of priority:**

(a) First, to the Partners in the amount of any profits previously allocated to them under subparagraph (1)(b) (to the extent such profits have not been offset by prior loss allocations under this subparagraph (2)(a));

(b) Second, to the Partners, pro rata, in accordance with their Percentage Interests; and

(c) Notwithstanding subparagraphs (2)(a)-(b), loss allocations to a Limited Partner may only be made to the extent that loss allocations will not create a deficit capital account balance for a Limited Partner in excess of an amount, if any, equal to the Limited Partner's share of Partnership Minimum Gain that would be realized on a foreclosure of the Partnership's property. Any loss not allocated to a Limited Partner because of the foregoing provision must be allocated to the Partners (if and to the extent that such other Partners are not limited with respect to loss allocations under this subparagraph (2)(c)). Any loss reallocated under this subparagraph (2)(c) must be taken into account in computing subsequent allocations of income and losses under this section, so that the net amount of any item so allocated and the income and losses allocated to each Partner under this section, to the extent possible, is equal to the net amount that would have been allocated to each such Partner under this section if no reallocation of losses had occurred under this subparagraph (2)(c).

*Comment:* Corporations Code §15905.035 provides for the allocation of partnership profits and losses in accordance with the partnership agreement. To the extent that the partnership agreement is silent, profits and losses will be allocated among the partners in the same manner as the partners share distributions. Corp C §15905.035. For tax purposes, allocations of income, gain, loss, deduction, and credit must be made in accordance with the partners' interests in the partnership or have "substantial economic effect." See Comment to form 6.78-1. This agreement provides for allocations that have "substantial economic effect" to enhance the likelihood that the allocations will be respected for tax purposes.

The profit allocations set forth in subparagraph (1) correspond with the distribution provisions set forth in form 6.80-1. Accordingly, these profit allocations must be modified to accommodate any changes to the order in priority of distributions set forth in form 6.81-1.

The loss limitation provision set forth in subparagraph (2)(c), when used with the "qualified income offset" provision set forth in form 6.91-1, operates as a substitute for the deficit restoration requirement set forth in form 6.130-1 and is intended to comply with the alternative test for economic effect set forth in Treas Reg §1.704-1(b)(2). See Comment to form 6.78-1.

**Source:** Business Law/Selecting and Forming Business Entities/6 Limited Partnerships/ 3. Special Allocations of Profits and Losses/§6.87 a. Form: Minimum Gain Chargeback

### 3. Special Allocations of Profits and Losses

#### §6.87 a. Form: Minimum Gain Chargeback

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6.87-1 Minimum gain chargeback

**C. *Minimum Gain Chargeback.*** If there is a net decrease in Partnership Minimum Gain during any Partnership fiscal year, each Partner will be specially allocated items of Partnership income and gain for that fiscal year (and, if necessary, in subsequent fiscal years) in an amount equal to the portion of that Partner's share of the net decrease in Partnership Minimum Gain that is allocable to the disposition of Partnership property subject to a Nonrecourse Liability, which share of that net decrease will be determined in accordance with Treasury Regulations §1.704-2(g)(2). Allocations under this section must be made in proportion to the respective amounts required to be allocated to each Partner under this section. The items to be so allocated must be determined in accordance with Treasury Regulations §1.704-2(f). This section is intended to comply and is to be interpreted consistently with the minimum gain chargeback requirement of Treasury Regulations §1.704-2(f).

**Source:** Business Law/Selecting and Forming Business Entities/6 Limited Partnerships/§6.88 b. Form: Chargeback of Partnership Minimum Gain Attributable to Partner Nonrecourse Debt

**§6.88 b. Form: Chargeback of Partnership Minimum Gain Attributable to Partner Nonrecourse Debt**

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6.88-1 Chargeback of partnership minimum gain attributable to partner nonrecourse debt

**D. Chargeback of Partnership Minimum Gain Attributable to Partner Nonrecourse Debt.** If there is a net decrease in Partnership Minimum Gain attributable to Partner Nonrecourse Debt during any Partnership fiscal year, each Partner who has a share of the Partnership Minimum Gain attributable to that Partner Nonrecourse Debt (which share will be determined in accordance with Treasury Regulations §1.704-2(i)(5)) must be specially allocated items of Partnership income and gain for that fiscal year (and, if necessary, in subsequent fiscal years) in an amount equal to that portion of the Partner's share of the net decrease in Partnership Minimum Gain attributable to the Partner Nonrecourse Debt that is allocable to the disposition of Partnership property subject to Partner Nonrecourse Debt (which share of the net decrease must be determined in accordance with Treasury Regulations §1.704-2(i)(5)). Allocations under this section must be made in proportion to the respective amounts required to be allocated to each Partner under this section. The items to be allocated must be determined in accordance with Treasury Regulations §1.704-2(i)(4). This section is intended to comply and is to be interpreted consistently with the minimum gain chargeback requirement of Treasury Regulations §1.704-2(i)(4).

**Source:** Business Law/Selecting and Forming Business Entities/6 Limited Partnerships/§6.89 c. Form: Nonrecourse Deductions

**§6.89 c. Form: Nonrecourse Deductions**

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6.89-1 Nonrecourse deductions

**E. *Nonrecourse Deductions.* Any nonrecourse deductions, as defined in Treasury Regulations §1.704-1(b)(1), for any fiscal year or other period must be specially allocated to the Partners, pro rata, in proportion to their respective Percentage Interests.**

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**§6.90 d. Form: Partner Nonrecourse Deductions**

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6.90-1 Partner nonrecourse deductions

**F. Partner Nonrecourse Deductions.** Those items of Partnership loss, deduction, or Internal Revenue Code §705(a)(2)(B) expenditures that are attributable to Partner Nonrecourse Debt for any fiscal year or other period must be specially allocated to the Partner who bears the economic risk of loss with respect to the Partner Nonrecourse Debt to which those items are attributable, in accordance with Treasury Regulations §1.704-2(i).

*Comment:* Losses, deductions, and IRC §705(a)(2)(B) expenditures attributable to nonrecourse liabilities must be allocated among the partners in accordance with their respective interests in the partnership. Treas Reg §1.704-2(b)(1). Allocations of these items will be deemed in accordance with the partners' interests if (Treas Reg §1.704-2(e)):

- The partnership agreement incorporates the "safe harbor" provisions contained in Treas Reg §1.704-1(b)(2) (see Comment to form 6.75-1);
- Allocations of nonrecourse deductions are reasonably consistent with allocations that have substantial economic effect of other significant partnership items attributable to the property securing the nonrecourse liabilities;
- The partnership agreement contains a "minimum gain chargeback" provision drafted to comply with Treas Reg §1.704-2(f); and
- All other material allocations and capital account adjustments are valid under Treas Reg §1.704-1(b).

The provisions in forms 6.87-1 through 6.91-1 are intended to comply with these requirements. See Treas Reg §1.704-2(f).

**Source:** Business Law/Selecting and Forming Business Entities/6 Limited Partnerships/§6.91 e. Form: Qualified Income Offset

**§6.91 e. Form: Qualified Income Offset**

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6.91-1 Qualified income offset

**G. Qualified Income Offset.** If a Limited Partner unexpectedly receives any adjustments, allocations, or distributions described in Treasury Regulations §1.704-1(b)(2)(ii)(d)(4), (5), or (6), or any other event creates a deficit balance in that Limited Partner's capital account in excess of his or her share of Partnership Minimum Gain, items of Partnership income and gain must be specially allocated to that Limited Partner in an amount and manner sufficient to eliminate the excess deficit balance as quickly as possible. Any special allocations of items of income and gain under this section must be taken into account in computing subsequent allocations of income and gain under this section so that the net amount of any item so allocated and the income, gain, and losses allocated to each Partner under this section to the extent possible, will be equal to the net amount that would have been allocated to each such Partner under the provisions of this section if those unexpected adjustments, allocations, or distributions had not occurred.

*Comment:* When used in conjunction with the loss limitation provision set forth in subparagraph section (2)(c) of form 6.86-1, this provision operates as a substitute for the deficit restoration requirement set forth in form 6.130-1 and is intended to comply with the alternative test for economic effect set forth in Treas Reg §1.704-1(b)(2). See Comment to form 6.78-1.

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**Source:** Business Law/Selecting and Forming Business Entities/6 Limited Partnerships/§6.92 4. Form: IRC §704(c) Allocations

## §6.92 4. Form: IRC §704(c) Allocations

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6.92-1 IRC §704(c) allocations

**H. IRC §704(c) Allocations.** In accordance with Internal Revenue Code §704(c) and Treasury Regulations under that section, income, gain, loss, and deduction with respect to any property contributed to the capital of the Partnership are to be allocated, solely for tax purposes, among the Partners taking into account any variation between the adjusted basis of the property to the Partnership for federal income tax purposes and its fair market value on the date of contribution. Allocations under this section are solely for purposes of federal, state, and local taxes. They will not be taken into account in computing a Partner's capital account or share of profits, losses, or other items of distributions under any provision of this Agreement.

*Comment:* Assets that a partner contributes to the capital of a partnership and that have built-in gain or loss at the time of contribution are subject to IRC §704(c). The provisions of IRC §704(c) are mandatory and cannot be altered by the partnership agreement.

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**Source:** Business Law/Selecting and Forming Business Entities/6 Limited Partnerships/ M. Rights and Powers of General Partners/§6.93 1. Form: Participation by All General Partners

## **M. Rights and Powers of General Partners**

### **§6.93 1. Form: Participation by All General Partners**

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6.93-1 Participation by all general partners

## **ARTICLE VI**

### **RIGHTS AND POWERS OF GENERAL PARTNERS**

**A. Participation by All General Partners.** Except as otherwise provided in this Agreement, each General Partner will participate in the management and operation of the Partnership's business, and all Partnership matters will be determined by \_\_ [e.g., all General Partners/a Majority of General Partners]\_\_.

*Comment:* A general partner of a limited partnership ordinarily possesses all rights and powers and is subject to all the restrictions of a partner in a general partnership. See Corp C §15904.06(a). See §6.9.

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**§6.94 2. Form: Rights and Powers**

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6.94-1 Rights and powers

**B. Rights and Powers. Except as expressly provided otherwise in this Agreement, the General Partners have exclusive control over the Partnership's business. Among other rights, the General Partners have the right to do the following on the Partnership's behalf without the Limited Partners' consent:**

*[If applicable, add one or more of the following options]*

*[Option 1: Execute agreements]*

**1. Execute agreements, contracts, and other documents and instruments in connection with the Partnership's business;**

*[Option 2: Employ workers]*

**[2.] Employ or discharge, at the Partnership's expense, agents, employees, independent contractors, attorneys, and/or accountants to render services to the Partnership;**

*[Option 3: Project management]*

**[3.] Perform daily project management duties as required by the Agreement;**

*[Option 4: Purchase property]*

**[4.] Cause the Partnership to purchase property on the terms and conditions that the General Partners determine to be in the Partnership's best interests;**

*[Option 5: Sell or transfer property]*

**[5.] Sell, lease, exchange, or otherwise transfer all or any part of the Partnership's property on the terms and conditions that the General Partners determine to be in the Partnership's best interests;**

*[Option 6: Borrow money]*

**[6.] Borrow money on behalf of the Partnership;**

*[Option 7: Encumber property]*

**[7.] Pledge, hypothecate, or otherwise encumber all or any part of the Partnership's property;**

*[Option 8: Refinance]*

**[8.] Repay, refinance, increase, modify, or extend any Partnership obligation;**

*[Option 9: Inspect and copy records]*

**[9.] Inspect and copy partnership records as provided in Corporations Code §15904.07 \_\_[and]\_\_**

*[Option 10: Assume rights and responsibilities]*

**[10.] Assume all rights and exercise all responsibilities that \_\_[Re-RULPA]\_\_ imposes on a general partner of a limited partnership.**

*Comment:* Each general partner of a limited partnership ordinarily has equal rights in the management and conduct of the partnership's activities. Except as expressly provided in Re-RULPA, any matter relating to the activities of the limited partnership may be exclusively decided by the general partner or, if there is more than one general partner, by a majority of the general partners. Corp C §15904.06. Each general partner is an agent of the limited partnership for the purposes of its activities. An act of a general partner, including the signing of a record in the partnership's name, for

apparently carrying on in the ordinary course the limited partnership's activities binds the limited partnership unless the general partner did not have authority to act for the limited partnership and the person with which the general partner was dealing knew, had received notification, or had notice under Corp C §15901.03(d) that the general partner lacked authority. Corp C §15904.02(a). Therefore, the partnership agreement should define any restrictions on the general partners' right to manage the limited partnership's business and affairs and the extent of the general partners' obligations in this regard.

This form is intended to enumerate common general partner rights. The practitioner is responsible for modifying this form as necessary to reflect accurately the partners' economic deal. If representing a general partner, the practitioner should attempt to broaden the rights set forth in this provision. If representing a limited partner, the practitioner should attempt to limit the general partners' authority under this provision.

### 3. Compensation

#### §6.95 a. Form: Amount of Compensation

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §6.43 and ends in §6.151

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6.95-1 Amount of compensation

[Add one of the following alternatives]

[Alternative 1: No compensation]

**C. No Compensation. No General Partner or an Affiliate of a General Partner is entitled to receive compensation for services rendered to the Partnership.**

[Alternative 2: Consent required]

**C. Consent Required. A General Partner or an Affiliate of a General Partner is entitled to receive compensation for services rendered to the Partnership, provided \_\_ [e.g., all General Partners/a Majority of General Partners/all General Partners and a Majority of Limited Partners/a Majority of Partners] \_\_ approve the compensation.**

[Alternative 3: Management fee]

**C. Management Fee. The Partnership will pay \_\_ [name of general partner or affiliate] \_\_ a fee for services rendered in connection with the management of the Partnership's business. The fee equals \$ \_\_ [amount] \_\_ per \_\_ [e.g., month/quarter/year] \_\_. That part of the fee payable for any \_\_ [e.g., month/quarter/year] \_\_ must be paid \_\_ [e.g., in full/in equal installments] \_\_ on or before \_\_ [time for payment] \_\_.**

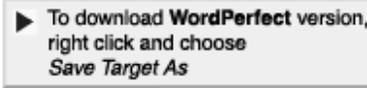
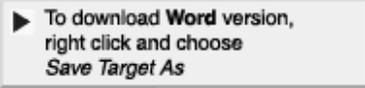
*Comment:* The right of a general partner or an affiliate to receive compensation for services rendered to the limited partnership should be set forth in the partnership agreement. In particular, the partners should agree to: the amount of compensation, the time compensation becomes due and payable, the source of payment, and the nature and extent of subsequent adjustments to the amount or terms of compensation.

A general partner is not entitled to remuneration for services performed for the partnership unless the partnership agreement provides to the contrary. See Corp C §15904.06(f). Therefore, the right of a general partner to receive compensation for services rendered to the limited partnership must be set forth in the partnership agreement. In particular, the partners should agree to the amount of compensation, the time compensation becomes due and payable, the source of payment, and the nature and extent of subsequent adjustments to the amount or terms of compensation.

When representing a limited partner, the practitioner should ordinarily attempt to limit compensation payable to the general partners and their affiliates. Because compensation is typically taken into account in determining the amount available for distribution to the partners, it dilutes the amount available for distribution to the limited partners.

**§6.96 b. Form: Tax Treatment**

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §6.43 and ends in §6.151



6.96-1 Tax treatment

**D. Tax Treatment. Any compensation that the Partnership pays to a General Partner will be treated as a payment made under IRC §707(a) or (c).**

*Comment:* Internal Revenue Code §707(a) governs the tax treatment of payments to partners acting in a nonpartner capacity. Transactions between a partnership and a partner acting in a nonpartner capacity are taxed as though the transaction had occurred between unrelated parties. IRC §707(a)(1). For example:

- Payments that a partnership makes on a partner loan are interest;
- Payments that a partnership makes for the use of a partner's property are rent;
- Payments that a partnership makes to a partner in exchange for such partner's property are sales proceeds; and
- Payments that a partnership makes to a partner for services rendered in a nonpartner capacity are compensation.

In determining whether a partner is acting in a non-partner capacity, the substance, rather than the form, of the transaction controls. Treas Reg §1.707-1(a). For example, for tax purposes, a transfer by the partnership of money or property to a member will be treated as a loan payment rather than a distribution only if the partner made a bona fide loan to the partnership. Rev Rul 73-301, 1973-2 Cum Bull 215; Treas Reg §1.731-1(c)(2). Similarly, a mortgage payment on property that reduces the debt of a partner will be treated as a distribution rather than a payment of rent unless the payment represents fair rental value for the property. *Curtis R. Bitker*, TC Memo 2003-209.

Internal Revenue Code §707(c) governs the tax treatment of payments to partners acting in a partner capacity if the payment is determined without regard to partnership income, as is a guaranteed payment. A guaranteed payment is a payment that a partnership makes to a partner for services rendered in his or her capacity as a partner, or for the use of that partner's capital contributions, provided that the amount of the payment is fixed and determined without regard to partnership income. IRC §707(c); Treas Reg §1.707-1(c).

Any other payment, including a payment to a partner for services or capital supplied in his or her capacity as a partner, is simply a distributive share of partnership income, taxable under IRC §§702-704.

**Source:** Business Law/Selecting and Forming Business Entities/6 Limited Partnerships/§6.97 4. Form: Reimbursement of Expenses

**§6.97 4. Form: Reimbursement of Expenses**

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6.97-1 Reimbursement of expenses

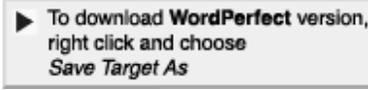
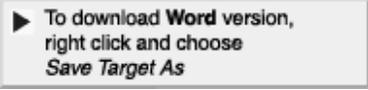
**E. *Reimbursement of Expenses.* A General Partner is entitled to reimbursement from the Partnership for those costs that a General Partner reasonably incurs in the proper conduct of the Partnership's business.**

*Comment:* A limited partnership must reimburse a general partner for payments made and indemnify a general partner for liabilities incurred by the general partner in the ordinary course of the activities of the partnership or for the preservation of its activities or property. Corp C §15904.06(c). Further, a limited partnership must reimburse a general partner for any advances to the limited partnership beyond the amount of capital the general partner agreed to contribute. Corp C §15904.06(d). Payments or advances by a general partner that give rise to an obligation of the limited partnership constitute a loan to the limited partnership that accrues interest from the date of the payment or advance. Corp C §15904.06(e).

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**§6.98 5. Form: Indemnification**

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6.98-1 Indemnification

**F. Indemnification.** The Partnership will bear the cost of all expenditures and liabilities that the General Partner(s) incur(s) in the proper conduct of the Partnership's business. To the extent of its assets, the Partnership will indemnify, defend, and hold harmless each General Partner from and against any and all losses, expenses, damages, and liabilities arising out of, or in connection with, the operation of Partnership business, except as to those matters arising by reason of a General Partner's fraud, gross negligence, \_\_ \_\_[or willful misconduct/willful misconduct, or violation of this Agreement]\_\_ \_\_.

*Comment:* A provision providing for the indemnification of general partners is a common provision in a partnership agreement. It clarifies that the general partners are personally liable for the limited partnership's debts and obligations only if and to the extent that the limited partnership's assets are insufficient to satisfy those debts and obligations. Depending on whether the practitioner represents the general partner or the limited partners, he or she may wish to include the general partner's "violation of the agreement" as an action that will not be indemnified by the partnership.

**§6.99 6. Form: Devotion of Time**

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6.99-1 Devotion of time

**G. Devotion of Time. Each General Partner will devote to the Partnership the amount of time necessary and appropriate to carry out his or her obligations under this Agreement.**

*Comment:* The partners need to consider whether the general partners will be obligated to devote all their business time to the limited partnership. A provision to the effect that the general partners are not obligated to work full-time with respect to the limited partnership's affairs is common in partnership agreements and avoids an implied obligation to the contrary.

**§6.100 7. Form: Other Business Activities**

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6.100-1 Other business activities

*[Add one of the following alternatives]*

*[Alternative 1: Activities not restricted]*

**H. *Other Business Opportunities.*** Each General Partner may engage in any business activity for his or her own profit or advantage without the other Partners' consent, regardless of whether the business activity is in competition with the Partnership's business. Neither the Partnership nor any other Partner is entitled to any fees, income, or profits that a General Partner derives from his or her business activity.

*[Alternative 2: Activities restricted]*

**H. *Other Business Opportunities.*** Each General Partner may engage in any business activity for his or her own profit or advantage without the other Partners' consent, provided the other business activity is not in competition with Partnership business. The Partnership is entitled to all fees, income, and profits that a General Partner derives from any business activity that is in competition with the Partnership's business.

*Comment:* The partners should consider whether the general partners will have the ability to engage in business activities that compete with the limited partnership's business. Because the general partners owe fiduciary duties to the limited partners, the practitioner may wish to clarify in the agreement what constitutes a competitive activity and what constitutes engaging in a competitive activity.

**Source:** Business Law/Selecting and Forming Business Entities/6 Limited Partnerships/ N. Rights and Powers of Limited Partners/§6.101 1. Form: Generally No Right to Participate

## **N. Rights and Powers of Limited Partners**

### **§6.101 1. Form: Generally No Right to Participate**

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6.101-1 Generally no right to participate

## **ARTICLE VII**

### **RIGHTS AND POWERS OF LIMITED PARTNERS**

**A. *Generally No Right to Participate.* Except as expressly provided otherwise in this Agreement, the Limited Partners do not have the right to participate in the conduct of the Partnership's business or the power to bind the Partnership.**

*Comment:* A limited partner is not liable for any obligation of a limited partnership unless named as a general partner in the certificate or, in addition to exercising the rights and powers of a limited partner, the limited partner participates in the control of the business. If a limited partner participates in the control of the business without being named as a general partner, that partner may be held liable as a general partner only to persons who transact business with the limited partnership with actual knowledge of that partner's participation in control and with a reasonable belief, based on the limited partner's conduct, that the partner is a general partner at the time of the transaction. Corp C §15903.03(a).

More specific activities that do not constitute participation in management and control when performed by limited partners are identified in Corp C §15903.03(b). See Corp C §15903.03(c) (list is nonexclusive). These default provisions may be changed by agreement. See Corp C §15901.10(b).

**Source:** Business Law/Selecting and Forming Business Entities/6 Limited Partnerships/§6.102 2. Form: Consent Required for Specified Actions by General Partners

## §6.102 2. Form: Consent Required for Specified Actions by General Partners

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6.102-1 Consent required for specified actions by general partners

**B. Consent Required for Specified Actions by General Partners. The General Partners may not take any of the following actions without the prior written consent of \_\_ [e.g., all Limited Partners/a Majority of Limited Partners]\_\_:**

*[If applicable, add one or more of the following options]*

*[Option 1: Amend the partnership agreement]*

**1. Amend the Partnership Agreement.**

*[Option 2: Sell or transfer partnership property]*

**[2.] Sell, exchange, lease, mortgage, pledge, or otherwise transfer, or grant a security interest in all or substantially all of the Partnership's property, with or without the goodwill, other than in the ordinary course of Partnership business.**

*[Option 3: Dissolve the partnership]*

**[3.] Dissolve the Partnership.**

*[Option 4: Merge the partnership]*

**[4.] Merge the Partnership.**

*[Option 5: Convert the partnership]*

**[5.] Convert the Partnership.**

*[Option 6: Incur partnership debt]*

**[6.] Incur Partnership indebtedness, other than in the ordinary course of Partnership business.**

*[Option 7: Conflict of interest]*

**[7.] Engage in a transaction in which a General Partner has an actual or potential conflict of interest with the Partnership or the Limited Partners.**

*[Option 8: Add or remove general partner]*

**[8.] Add or remove a general partner.**

*Comment:* The partnership agreement should define the acts that require the limited partners' consent. Under Re-RULPA, the consent of each partner is necessary to amend the partnership agreement and to sell, lease, exchange, or otherwise dispose of all or substantially all of the partnership's property other than in the usual and regular course of the partnership's activities. Corp C §15904.06(b). Re-RULPA specifically provides that a limited partner does not have the right or the power as a limited partner to act for or bind the limited partnership. Corp C §15903.02. This rule may be varied by agreement. See Corp C §15901.10(b).

Re-RULPA also eliminates the statutory right of limited partners to remove a general partner that existed under the former California Revised Limited Partnership Act (CRLPA) (Corp C §§15611-15723) (see Corp C §15636(f)(2)). Re-RULPA contains no counterpart to former Corp C §15636(f)(2). Thus limited partners no longer have the statutory right to remove a general partner.

The practitioner should modify this form as necessary to accommodate the partners' specific economic deal. If representing a general partner, the practitioner generally should attempt to limit the limited partners' voting rights. If representing a limited partner, the practitioner generally should attempt to broaden the limited partners' rights. However,

the practitioner should be careful not to grant the limited partners too much authority. Doing so could undermine their status as limited partners and render them personally liable for debts and obligations of the limited partnership. See §6.11.

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**Source:** Business Law/Selecting and Forming Business Entities/6 Limited Partnerships/§6.103 3. Form: Liability of Limited Partners

### §6.103 3. Form: Liability of Limited Partners

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6.103-1 Liability of limited partners

**C. Liability of Limited Partners. A Limited Partner is not personally liable for the Partnership's debts, obligations, or losses, except to the extent of that Limited Partner's capital contributions or as provided by law.**

*Comment:* A limited partner is not liable for any limited partnership obligations, unless he or she is named as a general partner in the Certificate of Limited Partnership (Secretary of State Form LP-1) or participates in the control of the limited partnership's business. If a limited partner participates in the control of the business without being named as a general partner, that partner may be held liable as a general partner only to persons who transact business with the limited partnership with actual knowledge of that partner's participation in control and with a reasonable belief, based upon the limited partner's conduct, that the partner is a general partner at the time of the transaction. Corp C §15903.03(a). However, a limited partner may be liable for tortious conduct in which that partner participates. Corp C §15903.03(a). On the parameters of a limited partner's protection from personal liability, see §6.12.

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**Source:** Business Law/Selecting and Forming Business Entities/6 Limited Partnerships/ 4. Transactions With Limited Partners/§6.104 a. Form: Consent Required for Transactions With Partnership

#### 4. Transactions With Limited Partners

##### §6.104 a. Form: Consent Required for Transactions With Partnership

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6.104-1 Consent required for transactions with partnership

**D. Consent Required for Transactions with Partnership. The Partnership may enter into an agreement with a Limited Partner or an Affiliate of a Limited Partner for the performance of services, provided the agreement is approved in writing by \_\_ [e.g., all General Partners/a Majority of General Partners/a Majority of Partners]\_\_.**

*Comment:* Being an independent contractor for, being an agent or employee of, or transacting business with a limited partnership does not impair a limited partner's protection from personal liability. Corp C §15903.03(b)(1)(A). This clause provides considerable planning opportunities for limited partners who desire to participate in the limited partnership's business and preserve their protection from personal liability for the partnership's debts and obligations. On the parameters of a limited partner's protection from personal liability, see §6.12.

**§6.105 b. Form: Tax Treatment**

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6.105-1 Tax treatment

**E. Tax Treatment.** Any compensation that the Partnership pays to a Limited Partner or his or her Affiliate under Section 6.4 will be treated as a payment made under IRC §707(a) or (c).

*Comment:* On payments made under IRC §§707(a) and 707(c), see §6.96.

**Source:** Business Law/Selecting and Forming Business Entities/6 Limited Partnerships/ O. Administration/§6.106 1.  
Form: Books and Records

## O. Administration

### §6.106 1. Form: Books and Records

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6.106-1 Books and records

## ARTICLE VIII

### ADMINISTRATION

**A. Books and Records.** The General Partners must keep, at the Partnership's expense, accurate records of all Partnership business transactions, and all records and documents required to be maintained under Corporations Code §15901.11, including those listed in subparagraphs (1)-(6) below. The General Partners must maintain these books and records at the Partnership's designated office, and make them available at ordinary business hours for inspection, copying, and auditing by each Partner (or his or her agent or attorney):

1. A current list showing the full name and last known street and mailing address of each Partner, separately identifying the general partners, in alphabetical order, and the limited partners, in alphabetical order;
2. A copy of the original Agreement, together with the originals of any amendments to the Agreement;
3. A copy of the Certificate of Limited Partnership and all Amendments or Restatements to the Certificate, together with signed copies of any powers of attorney under which any certificate, amendment, or restatement has been signed;
4. A copy of any filed Certificate or conversion or merger;
5. Copies of the Partnership's federal, state, and local income tax or information returns and/or reports for the 6 most recent taxable years;
6. Financial statements of the Partnership for the 6 most recent fiscal years;
7. The Partnership's books and records for the current and past 3 fiscal years;
8. A record stating the amount of cash and a description and statement of the agreed value of the other benefits contributed and agreed to be contributed by each partner.

*Comment:* A limited partnership must maintain the books and records enumerated in this form at its designated office. Corp C §15901.11. For further discussion, see §6.15.

The partnership agreement may impose reasonable restrictions on the availability and use of information obtained under Corp C §15901.11 and may define appropriate remedies, including liquidated damages, for a breach of any reasonable restriction on use. Corp C §15901.10(b)(4).

**§6.107 2. Form: Reports and Copies**

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6.107-1 Reports and copies

**B. Reports and Copies.** At the request of a Limited Partner, the Partnership must allow the Limited Partner, at the Limited Partner's expense, to inspect and copy the following within 10 days of such a request during regular business hours at the Partnership's designated office:

1. A current list showing the full name and last known street and mailing address of each Partner, separately identifying the general partners, in alphabetical order, and the limited partners, in alphabetical order;
2. A copy of the original Agreement, together with the originals of any amendments to the Agreement;
3. A copy of the Certificate of Limited Partnership, and all Amendments or Restatements to the Certificate, together with signed copies of any powers of attorney under which any certificate, amendment, or restatement has been signed;
4. A copy of any filed Certificate or conversion or merger;
5. Copies of the Partnership's federal, state, and local income tax or information returns and/or reports for the 6 most recent taxable years;
6. Financial statements of the Partnership for the 6 most recent fiscal years;
7. The Partnership's books and records for the current and past 3 fiscal years;
8. A record stating the amount of cash, and a description and statement of the agreed value of the other benefits, contributed and agreed to be contributed by each partner.

**Other information.** At the request of a Limited Partner for any information regarding the state of the activities and financial condition of the Partnership and other information, the Partnership must within 10 days inform the Limited Partner:

1. What information the Partnership will provide in response to the demand;
2. When and where the Partnership will provide the information; and
3. If the Partnership declines to provide any demanded information, the Partnership's reasons for declining.

*Comment:* The requirements set forth in this form are mandated by Re-RULPA. Corp C §15903.04. A limited partner's rights under Corp C §15903.04 cannot be waived, but reasonable restrictions on the availability and use of such information may be imposed, and appropriate remedies may be defined. Corp C §15901.10(b)(4). See §6.16.

If representing a limited partner, the practitioner may want to require the production of additional reports indicative of the limited partnership's activities or profitability. If the general partners will be required to produce additional reports, the partnership agreement should specify the types of additional reports, when and how often the general partners must produce the additional reports, and the party that bears the cost of the additional reports.

**Source:** Business Law/Selecting and Forming Business Entities/6 Limited Partnerships/ 3. Tax Matters Partner/§6.108  
a. Form: Tax Returns

### 3. Tax Matters Partner

#### §6.108 a. Form: Tax Returns

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6.108-1 Tax returns

**C. Tax Returns.** The General Partners must prepare and file, or cause to be prepared and filed, at the Partnership's expense, all federal, state, and local tax or information returns on behalf of the Partnership in a timely manner. The General Partners will deliver to each Partner within 90 days after the end of each tax year (1) a complete copy of the Partnership's federal, state, and local income tax or information returns for the year or (2) information necessary to complete the federal, state, and local income tax or information returns.

*Comment:* The limited partnership must make copies of tax returns for the most recent 6 taxable years available for inspection, copying, and auditing by each limited partner or his or her agent or attorney. On 10 days' demand, made in a record received by the limited partnership, a limited partner may inspect and copy any information required to be maintained by the partnership during regular business hours in the partnership's designated office. See Corp C §§15901.11, 15903.04(a). On the inspection rights of partners concerning documents maintained in accordance with Corp C §15901.11, see §6.17.

**Source:** Business Law/Selecting and Forming Business Entities/6 Limited Partnerships/§6.109 b. Form: Tax Matters Partner

**§6.109 b. Form: Tax Matters Partner**

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6.109-1 Tax matters partner

**D. Tax Matters Partner.** \_\_[Name of general partner]\_\_ will act as the Partnership's "tax matters partner," as that term is defined in Internal Revenue Code §6231(a)(7).

*Comment:* The Internal Revenue Service audits partnerships at the entity level. If the partnership has more than ten partners, or a partner who is a nonresident alien or an entity other than a natural person, it is subject to comprehensive unified audit proceedings. IRC §6231. Internal Revenue Code §6231 requires a "tax matters partner" to act as the primary representative of the partnership and facilitate dealings with the Internal Revenue Service in unified audit proceedings.

**§6.110 c. Form: Taxable Year**

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6.110-1 Taxable year

**E. Taxable Year. The taxable year of the Partnership is \_\_[e.g., the calendar year]\_\_.**

*Comment:* A partnership is limited in its ability to use a taxable year that differs from the taxable year of its partners. In general, a partnership must adopt the same taxable year as those of its partners who own, in the aggregate, more than 50 percent of partnership profits and capital. IRC §706(b)(1)(B)(i), (4)(A)(i). If those partners do not have the same taxable year, the partnership must adopt the same taxable year as all of its principal partners. IRC §706(b)(1)(B)(ii). A principal partner for these purposes is one who owns 5 percent or more of partnership profits or capital. IRC §706(b)(3). If the principal partners do not have the same taxable year or if there are no principal partners, the limited partnership must adopt a calendar year. IRC §706(b)(1)(B)(iii).

**Source:** Business Law/Selecting and Forming Business Entities/6 Limited Partnerships/§6.111 4. Form: Accounting Method

**§6.111 4. Form: Accounting Method**

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6.111-1 Accounting method

**F. Accounting Method.** The Partnership's books will be kept on the \_\_ [e.g., cash/accrual] \_\_ method of accounting.

*Comment:* In general, a partnership is entitled to select its method of accounting, which may be different from its partners' method of accounting. IRC §446(c). A partnership's ability to use the cash method of accounting is limited in two primary respects. First, a partnership that constitutes a tax shelter within the purview of IRC §461(i)(3) cannot use the cash method of accounting. IRC §448(a)(3), (d)(3). Second, under certain circumstances, a partnership which has a C corporation as a partner cannot use the cash method of accounting. IRC §448(a)(2).

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**§6.112 5. Form: Bank Accounts**

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6.112-1 Bank accounts

**G. Bank Accounts.** The General Partners must maintain a bank account for the Partnership in which all Partnership funds will be deposited. Withdrawals of Partnership funds from the bank account may only be made by checks and require the signature of \_\_ *[name of signatory]* \_\_.

**Source:** Business Law/Selecting and Forming Business Entities/6 Limited Partnerships/§6.113 6. Form: Partnership Meetings

## §6.113 6. Form: Partnership Meetings

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §6.43 and ends in §6.151

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6.113-1 Partnership meetings

**H. Partnership Meetings.** A Partner may call for a meeting of the Partners or the Limited Partners or for a vote of the Limited Partners without a meeting on any matter on which the Limited Partners are entitled to vote, in accordance with the following provisions:

**1. A General Partner may call for a meeting or for a vote after giving written notice to all Partners not less than 10 days or more than 60 days before the meeting or vote. The notice must set forth the hour, date, and location of the meeting or vote and the general nature of the business proposed to be transacted at the meeting or by vote, and no other business may be transacted.**

**2. Limited Partners who hold more than 10 percent of the Percentage Interests held by all Limited Partners may request, in writing, that the General Partners call a meeting or a vote. The request must set forth the hour, time, and place of the meeting or vote and the general nature of the business proposed to be transacted at the meeting or by vote. Promptly on receipt of such a request, the General Partners must give written notice to all Partners that a meeting or vote will be held at the time specified in the request but not less than 10 days or more than 60 days after the General Partners' receipt of the request. The notice must also specify the general nature of the business proposed to be transacted at the meeting or by vote, and no other business may be transacted. If the General Partners do not give this notice to all Partners within 20 days after the Limited Partners request the meeting or vote, the requesting Limited Partners may give notice in the manner set forth in this subsection.**

*Comment:* This provision is consistent with Corp C §15903.03(b)(10).

§6.114 7. Form: Insurance

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6.114-1 Insurance

**I. Insurance.** The General Partners    *[will/may]*    obtain, insurance that the General Partners deem reasonably necessary for the proper protection of the Partnership and the Partners.    *[E.g., The Partnership/The General Partners]*    will bear the cost of that insurance.

*Comment:* The partnership agreement should specify any obligation of the general partners to (1) insure the limited partnership or the partners under its blanket insurance policy, if any, or (2) obtain, carry, and maintain in force any type of insurance with respect to the limited partnership's activities. In addition, the partnership agreement should indicate whether the partnership or the general partners must bear the cost of insurance.

## P. Transfers of Partnership Interests

### §6.115 1. Form: General Prohibition

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6.115-1 General prohibition

## ARTICLE IX

### TRANSFERS OF PARTNERSHIP INTERESTS

**A. General Prohibition.** Except as expressly provided otherwise in this Agreement, no Partner may sell, assign, pledge, hypothecate, or otherwise transfer or encumber his or her interest in the Partnership without the prior written consent of \_\_ [e.g., all Partners/all General Partners/a Majority of General Partners/a Majority of Partners]\_\_.

*Comment:* The partnership agreement should specify all restrictions on a partner's ability to transfer or encumber his or her interest in the limited partnership to clarify the partners' rights and make it difficult for undesirable third parties (e.g., the partners' creditors) to interfere in the limited partnership's business.

The limitations on the transferability of limited partnership interests under Re-RULPA are consistent with former law. Pursuant to Corp C §15907.02, a transfer, in whole or in part, of a partner's transferable interest is permissible without causing a dissociation, dissolution, or winding up of the partnership's activities. However, it does not entitle the transferee to participate in the management or conduct of the partnership's business or, absent dissolution and winding up of the partnership, give the transferee the right to access to partnership records or information concerning the partnership's transactions, except under Corp C §§15907.02(a)(3), (c) and 15907.04 (transferee functioning as a representative of a deceased partner acting for purposes of settling the estate). The partnership need not give effect to a transferee's rights until the limited partnership has notice of the transfer. Upon transfer, the transferor retains the rights of a partner other than the interest in distributions transferred and retains all duties and obligations of a partner. See Corp C §15907.02(d). A transferee that becomes a partner with respect to a transferable interest is liable for several of the transferor's obligations. Corp C §15907.02(g); see Corp C §§15905.02, 15905.09. However, the transferee is not obligated for liabilities unknown to the transferee at the time the transferee became a partner. Corp C §15907.02(g). A transferee of a partnership interest, including a transferee of a general partner, may become a limited partner if and to the extent that (1) the partnership agreement provides or (2) all general partners and a majority in interest of the limited partners consent. Corp C §15907.02(h).

**Source:** Business Law/Selecting and Forming Business Entities/6 Limited Partnerships/§6.116 2. Form: Conditions of Transfer

## §6.116 2. Form: Conditions of Transfer

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6.116-1 Conditions of transfer

**B. Conditions of Transfer.** Any transferee who acquires an interest in the Partnership in accordance with this Agreement must satisfy the following three conditions:

1. The transferee must execute a written agreement agreeing to be bound by this Agreement; and
2. Any spouse of the transferee must execute either a community property spousal consent in the form attached as Exhibit \_\_[specify number or letter]\_\_ or a separate property waiver and acknowledgment in the form attached as Exhibit \_\_[specify number or letter]\_\_; and
3. The transferor and the transferee must file a notice with evidence of transfer and any other information that the General Partner may reasonably require, including the name, address, and telephone numbers of the transferee.

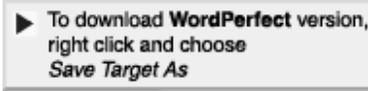
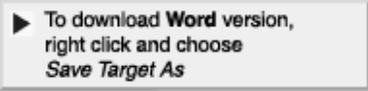
**On the satisfaction of these conditions, the transferee acquires all rights and obligations with respect to title, management, capital, allocations, and distributions that the transferor Partner held in the Partnership.**

*Comment:* For a separate property waiver and acknowledgment form, see §6.151. For a community property spousal consent form, see §11.232.

A transferee partner of a transferable interest is liable for the obligations of the transferring partner with regard to obligations under Corp C §15905.02 (obligations to make contributions) and Corp C §15905.09 (receipt of improper distributions) but is not liable for liabilities unknown to the transferee at the time the transferee became a partner. See Corp C §15907.02(g).

§6.117 3. Form: Permitted Transfers

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6.117-1 Permitted transfers

**C. Permitted Transfers.** Notwithstanding any other provision in this Agreement, a Partner may, without the other Partners' consent, transfer his or her interest in the Partnership to the following:

*[If applicable, add one or more of the following options]*

*[Option 1: Another partner]*

**1. Another Partner;**

*[Option 2: A trust]*

**[2.] A trust established for the primary benefit of the Partner, his or her spouse, his or her lineal descendants, and/or Another Partner** \_\_ *[as long as the transferring Partner is a settlor and trustee of this trust]* \_\_ ;  
\_\_ *[or]* \_\_

*[Option 3: A related entity]*

**[3.] Any entity, the legal and beneficial ownership interests of which are held only by the Partner, his or her spouse, his or her lineal descendants, and/or Another Partner** \_\_ *[as long as the transferring Partner controls the management and operation of that entity]* \_\_ .

*Comment:* The transfers permitted under subparagraphs (2) and (3) are designed to give the partners flexibility in structuring their respective estate plans. However, before incorporating these provisions into a partnership agreement, the practitioner should consider and address the ramifications of the transferee partner's subsequent death or incapacity and the transferee partner's subsequent loss of control over a trust or entity (e.g., whether the trust or entity should continue to act as a partner of the partnership).

**§6.118 4. Form: Right of First Refusal**

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6.118-1 Right of first refusal

**D. Right of First Refusal.** If a Partner receives a bona fide offer to purchase all or any part of his or her interest in the Partnership, and the selling Partner is willing to accept such offer, the following applies:

1. The selling Partner first must offer his or her Partnership Interest to the other Partners for the same price, terms, and conditions set forth in the bona fide offer;

2. The selling Partner will deliver to the other Partners a true and complete copy of the bona fide offer, and the selling Partner's written statement that he or she intends to accept the offer;

3. From the date the selling Partner delivers a copy of the bona fide offer to them, the other Partners have \_\_[number]\_\_ days to accept the selling Partner's proposal by giving written notice of acceptance to the selling Partner;

4. Each other Partner has the right to purchase that portion of the selling Partner's Partnership Interest that is in the same proportion as the Percentage Interest of that other Partner to the aggregate Percentage Interests of all other Partners who want to purchase the selling Partner's Partnership Interest;

5. If the other Partners reject the selling Partner's proposal, or fail to give notice of their acceptance, within \_\_[number]\_\_ days, the selling Partner may sell his or her Partnership Interest for the purchase price and on substantially the same terms and conditions set forth in the bona fide offer, provided that the sale is consummated within \_\_[number]\_\_ days from the expiration of the above-referenced \_\_[number]\_\_-day period; and

6. If the sale is not consummated within \_\_[number]\_\_ days, the selling Partner may not transfer all or any part of his or her interest in the Partnership without first making an offer to the other Partners in accordance with this section.

*Comment:* The partners should consider whether to use this provision in their agreement to condition a partner's transfer of an interest in the limited partnership on the other partners' rights of first refusal.

**Source:** Business Law/Selecting and Forming Business Entities/6 Limited Partnerships/§6.119 5. Form: Transferor's Rights in Partnership

**§6.119 5. Form: Transferor's Rights in Partnership**

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6.119-1 Transferor's rights in partnership

**E. *Transferor's Rights in Partnership.* If a transferee acquires any part of a Partner's interest in the Partnership in violation of this Agreement, the transferee will have no rights under this Agreement, other than the right to receive as much of the transferor Partner's share of Partnership profits, losses, and distributions to which the transferor Partner otherwise would be entitled under this Agreement.**

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**Source:** Business Law/Selecting and Forming Business Entities/6 Limited Partnerships/§6.120 Q. Form: Admission of Additional Partners

**§6.120 Q. Form: Admission of Additional Partners**

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6.120-1 Admission of additional partners

**ARTICLE X**

**ADMISSION OF ADDITIONAL PARTNERS**

**A person or entity may be admitted as an additional partner of the Partnership only with the prior written consent of \_\_ [e.g., all Partners/a Majority of Partners] \_\_.**

*Comment:* A person may become a general partner with the consent of all partners, but the consent need not be in writing. Rather, a person becomes a general partner (Corp C §15904.01(d)):

- As provided in the partnership agreement;
- After the dissociation of a limited partnership's last general partner pursuant to Corp C §15908.01(c)(2);
- As the result of a conversion or merger under Article 11 (Corp C §§15911.01-15911.19); or
- With the consent of all the partners.

Special rules apply if the last general partner has ceased to be a general partner and an additional general partner must be admitted to continue the limited partnership.

A person becomes a limited partner (Corp C §15903.01):

- As provided in the partnership agreement;
- As the result of a conversion or merger (see Corp C §§15911.01-15911.19); or
- With the consent of all the partners.

In general, the practitioner should consider including a provision in the partnership agreement that requires the consent of all partners to admit an additional partner other than an assignee or transferee, because such admission typically dilutes the ownership interests of all existing partners.

**Source:** Business Law/Selecting and Forming Business Entities/6 Limited Partnerships/ R. Default of General Partner/  
§6.121 1. Form: Events of Default of General Partner

## **R. Default of General Partner**

### **§6.121 1. Form: Events of Default of General Partner**

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6.121-1 Events of default of general partner

## **ARTICLE XI**

### **DEFAULT OF GENERAL PARTNER**

**A. Events of Default of General Partner. A General Partner will be in default under this Agreement on the occurrence of any of the following events:**

*[If applicable, add one or more of the following options]*

*[Option 1: Willful misconduct]*

**1. The General Partner commits willful misconduct, fraud, or gross negligence in his or her conduct of the Partnership's business;**

*[Option 2: Breach]*

**[2.] The General Partner breaches any material term of this Agreement;**

*[Option 3: Bankruptcy]*

**[3.] The General Partner is in Bankruptcy;**

*[Option 4: Withdrawal]*

**[4.] The General Partner withdraws, or attempts to withdraw, from the Partnership; \_\_ *[or]* \_\_**

*[Option 5: Transfer or encumbrance of interest]*

**[5.] The General Partner transfers or encumbers his or her interest in the Partnership in violation of this Agreement.**

*Comment:* A general partner may be disassociated for any event agreed to in the partnership agreement. Corp C §15906.03(b). This is not exhaustive. See Corp C §15906.03.

The partners should consider whether the limited partners will have the right to remove a general partner on the occurrence of specified events, e.g., breach of agreement, fraud, bankruptcy, misconduct. In the event of removal, the partnership agreement should specify whether the removed general partner's interest in the LP is terminated or simply converted to an interest as a limited partner.

Providing for default in the event of bankruptcy may not be enforceable under federal bankruptcy law. 11 USC §365(c); *In re Cardinal Indus., Inc.* (Bankr SD Ohio 1990) 116 BR 964. See Smith, Issues in Partnership and Partner Bankruptcy Cases and Reorganization of Partnership Debtors, Partnerships, LLCs, and LLPs: Uniform Acts, Taxation, Drafting, Security and Bankruptcy 691, 701 (12th ed 1996).

**Source:** Business Law/Selecting and Forming Business Entities/6 Limited Partnerships/§6.122 2. Form: Notice of Default and Time to Cure

**§6.122 2. Form: Notice of Default and Time to Cure**

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6.122-1 Notice of default and time to cure

**B. Notice of Default and Time to Cure.** If a General Partner is in default under this Agreement, \_\_ [e.g., the nondefaulting General Partner/the nondefaulting General Partner and a Majority of Limited Partners] \_\_ may send the defaulting General Partner written notice of the default, giving him or her an additional \_\_ [number] \_\_ days from the date of default to cure the default.

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### §6.123 3. Form: Election of Remedies After Default of General Partner

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6.123-1 Election of remedies after default of general partner

**C. Election of Remedies After Default of General Partner.** If the defaulting General Partner does not cure the default within the \_\_ [number] \_\_ -day period, the \_\_ [e.g., the nondefaulting General Partner/the nondefaulting General Partner and a Majority of Limited Partners] \_\_ may elect any of the following remedies:

[If applicable, add one or more of the following options]

[Option 1: Removal and conversion to limited partner]

1. \_\_ [E.g., The nondefaulting General Partner/The nondefaulting General Partner and those Limited Partners who hold a Majority of the Percentage Interests held by all Limited Partners] \_\_ may elect to remove the defaulting General Partner as a general partner of the Partnership by giving written notice of removal to the General Partner. On the removal of the defaulting General Partner under this article, the removed General Partner's entire interest as a General Partner will be converted to that of a Limited Partner. From and after conversion, the removed General Partner will have only those rights and obligations of a Limited Partner of the Partnership. The removal of a defaulting General Partner under this article does not dissolve the Partnership, provided that at least one general partner of the Partnership remains to carry on the Partnership's business.

[Option 2: Liquidation of partnership interest]

[2.] \_\_ [E.g., The nondefaulting General Partner/The nondefaulting General Partner and a Majority of Limited Partners] \_\_ may elect to cause the Partnership to liquidate the defaulting General Partner's entire Partnership Interest by giving written notice to the General Partner. Liquidation of the General Partner's interest will be in accordance with the following provisions:

(a) The Partnership will liquidate the General Partner's entire ownership interest in the Partnership for an amount equal to the then-outstanding balance of the General Partner's capital account, as determined after adjusting the General Partner's capital account by his or her allocable share of all Partnership income and losses up to the date of the event of default, including any income or loss that the Partnership would have recognized if it were to sell its assets for their then fair market value. Fair market value for these purposes will be determined in accordance with section \_\_ [specify number or letter; see §6.75] \_\_; and

(b) Amounts payable in liquidation of the defaulting General Partner's Partnership Interest will be paid by \_\_ [specify terms of payment, e.g., cash/promissory note] \_\_.

[Option 3: Purchase of partnership interest]

[3.] \_\_ [E.g., The nondefaulting General Partner/the nondefaulting General Partner and a Majority of Limited Partners] \_\_ may purchase the defaulting General Partner's entire Partnership Interest under the following provisions:

(a) Each nondefaulting Partner has the right, but not the obligation, to purchase that portion of the defaulting General Partner's interest that is in the same proportion as his or her Percentage Interest is to the aggregate Percentage Interests of all nondefaulting Partners who desire to purchase the defaulting General Partner's Partnership Interest. A nondefaulting Partner may exercise this right by giving written notice to the defaulting General Partner;

(b) The purchase price for the defaulting General Partner's Partnership Interest is equal to the fair market value of his or her Partnership Interest, determined in accordance with section \_\_ [specify number or letter; see §6.75] \_\_;

(c) Each purchasing Partner's share of the purchase price must be in the same proportion as his or her Percentage Interest is to the aggregate Percentage Interests of all purchasing Partners; and

(d) Amounts payable in liquidation of the defaulting General Partner's Partnership Interest will be paid by

\_\_ [specify terms of payment, e.g., cash/promissory note] \_\_.

[Option 4: Dissolution of partnership]

**[4.] \_\_ [E.g., The nondefaulting General Partner/The nondefaulting General Partner and a Majority of Limited Partners] \_\_ may elect to dissolve the Partnership. If dissolved, the Partnership will be wound up, liquidated, and terminated in accordance with this Agreement.**

*Comment:* As discussed in §6.78, the "safe harbor" provisions of Treas Reg §1.704-1(b)(2) require that distributions in liquidation of a partner's interest be made in accordance with that partner's positive capital account balance. See Treas Reg §1.704-1(b)(2)(ii)(b)(2). To comply with the safe harbor provisions, Option 2 requires the limited partnership to liquidate the defaulting general partner's interest for an amount equal to the defaulting general partner's positive capital account balance.

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#### §6.124 4. Form: Determination of Fair Market Value

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6.124-1 Determination of fair market value

**D. Determination of Fair Market Value.** Whenever the fair market value of a defaulting General Partner's Partnership Interest or the Partnership's assets is required under this article, the purchasing party and the selling party must determine fair market value. If the purchasing party and the selling party cannot agree on the fair market value within \_\_[number]\_\_ days after the date the purchasing party elects to purchase the defaulting General Partner's Partnership Interest, independent appraisers will determine fair market value in the following manner:

1. The purchasing party will select one appraiser and send written notice of his or her selection to the selling party within \_\_[number]\_\_ days after the \_\_[number]\_\_-day period described above. The selling party may either agree to the appraiser that the purchasing party has selected, or select a second appraiser by giving written notice of his or her selection to the purchasing party within \_\_[number]\_\_ days after the end of the \_\_[number]\_\_-day period. The selling party's failure to give written notice within the \_\_[number]\_\_-day period constitutes his or her agreement to the appraiser that the purchasing party has selected. Each appraiser selected in accordance with this subsection must be a member of a recognized professional organization for appraisers and have at least \_\_[number]\_\_ years' experience in appraising assets similar to the Partnership's assets.

2. The appraiser(s) selected in accordance with subparagraph (1) must determine the fair market value of the defaulting General Partner's ownership interest in the Partnership, or of the Partnership's assets, as the case may be, within \_\_[number]\_\_ days after the last appraiser is selected.

3. If the purchasing party's appraiser is the only appraiser, then the fair market value set forth in his or her appraiser's appraisal constitutes the fair market value of the defaulting General Partner's Partnership Interest or of the Partnership's assets, as the case may be.

4. If two appraisers are selected under subparagraph (1) and the fair market values set forth in their respective appraisals are within 10 percent of each other, then the fair market value of the defaulting General Partner's Partnership Interest or of the Partnership's assets, as the case may be, is the average of the two appraisals.

5. If two appraisers are selected under subparagraph (1) and the fair market values set forth in their respective appraisals are not within 10 percent of each other, then the two appraisers must appoint a third appraiser. The third appraiser must be a member of a recognized professional organization for appraisers and have at least \_\_[number]\_\_ years' experience in appraising assets similar to the Partnership's assets. The third appraiser must determine the fair market value of the defaulting General Partner's Partnership Interest or the Partnership's assets, as the case may be, within \_\_[number]\_\_ days after appointment. If one appraisal is the average of the other two appraisals, it establishes the fair market value of the defaulting General Partner's Partnership Interest or of the Partnership's assets, as the case may be. However, if one of the appraisals is not the average of the other two appraisals, the two appraisals that are nearest in amount will be retained and the third appraisal will be discarded. The fair market value of the defaulting General Partner's Partnership Interest or of the Partnership's assets, as the case may be, is equal to the average of the two retained appraisals.

6. The parties each bear the cost of their respective appraisers. The purchasing party and the selling party must each bear one-half of the cost of any third appraiser.

7. The appraisal process terminates when a party accepts the other party's value or the parties negotiate a mutually agreeable value.

*Comment:* For alternative valuation provisions, see §6.78.

**Source:** Business Law/Selecting and Forming Business Entities/6 Limited Partnerships/ S. Dissolution, Winding Up, Liquidation, and Termination/§6.125 1. Form: Events of Dissolution

## S. Dissolution, Winding Up, Liquidation, and Termination

### §6.125 1. Form: Events of Dissolution

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6.125-1 Events of dissolution

## ARTICLE XII

### DISSOLUTION, WINDING UP, LIQUIDATION, AND TERMINATION

**A. Events of Dissolution.** The Partnership will dissolve on occurrence of any of the following events:

1. \_\_ [Date certain] \_\_;

2. **The cessation of the last General Partner to be a general partner of the Partnership under** \_\_ [Corporations Code §15906.03] \_\_ unless those Limited Partners who hold a Majority of the Percentage Interests held by all Limited Partners agree in writing to continue the Partnership's business and, within 90 days after the last remaining General Partner has ceased to be a general partner, admit one or more other general partners;

3. **Any event that makes it unlawful for the Partners to carry on the Partnership's business;**

4. **The entry of a decree of judicial dissolution;**

*[If applicable, add one or more of the following options]*

*[Option 1: Consent]*

5. **The written consent of** \_\_ [e.g., all General Partners/a Majority of General Partners/all General Partners and a Majority of Limited Partners/a Majority of Partners] \_\_ **to dissolve the Partnership;**

*[Option 2: Failure to obtain financing]*

**[6.] The Partnership's failure to obtain financing within** \_\_ [number] \_\_ **days after the formation of the Partnership;**

*[Option 3: Sale of property]*

**[7.]** \_\_ [Number] \_\_ **days after the sale or other disposition of substantially all of the Partnership's property;**  
\_\_ [or] \_\_

*[Option 4: Election to dissolve]*

**[8.] The election to dissolve the Partnership under** \_\_ [specify number or letter; see §§6.76, 6.123] \_\_.

*Comment:* Corporations Code §15908.01(a) provides that a limited partnership is dissolved at the time or on the occurrence of events specified in the partnership agreement. Accordingly, the partners should agree on the events that will trigger dissolution. The parties should consider whether the partnership should dissolve on

- A sale of all or substantially all the limited partnership's property;
- The limited partnership's failure to obtain any financing required by the partnership agreement; or
- The general partner's withdrawal or other failure to act as general partner of the limited partnership.

The practitioner should be reminded that the *dissolution* of a limited partnership does not constitute the *termination* of the limited partnership. A dissolution is simply a change in the relationship of the partners and triggers the winding-up and liquidation phases. The partnership is terminated when the winding-up and liquidation phases are completed. See Corp C §15908.03(a). The practitioner should be cautious in providing additional grounds for termination. For more

information regarding the dissolution of limited partnerships, see *Advising California Partnerships*, chap 17 (3d ed Cal CEB 1999).

With respect to subparagraph (2), the limited partners have no right to modify the consent required to continue the limited partnership. Corp C §15908.01(c)(2).

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**Source:** Business Law/Selecting and Forming Business Entities/6 Limited Partnerships/ 2. Winding Up/§6.126 a. Form: Winding Up After Dissolution

## 2. Winding Up

### §6.126 a. Form: Winding Up After Dissolution

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §6.43 and ends in §6.151

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6.126-1 Winding up after dissolution

**B. *Winding Up After Dissolution.* On the Partnership's dissolution, the Partnership's business must be wound up within a reasonable period of time, its assets liquidated, a final accounting made, and the Partnership's books closed.**

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**Source:** Business Law/Selecting and Forming Business Entities/6 Limited Partnerships/§6.127 b. Form: Party Authorized to Wind Up

**§6.127 b. Form: Party Authorized to Wind Up**

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6.127-1 Party authorized to wind up

**C. Party Authorized to Wind Up.** Those General Partners who have not wrongfully dissolved the Partnership, or if there are none, the Limited Partners, will wind up the Partnership's affairs. However, if the Partnership has dissolved by reason of a decree of judicial dissolution under Corporations Code §15908.02, the winding up must be conducted in accordance with the decree.

*Comment:* This provision is consistent with Corp C §15908.02(d).

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**§6.128 c. Form: Filings**

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6.128-1 Filings

**D. Filings.** The party authorized to wind up the Partnership's affairs must sign and cause to be executed (1) a certificate of dissolution in the form required by Corporations Code §15908.03(c), and (2) a certificate of cancellation in the form required by Corporations Code §15902.03. The authorized party must file these documents with the Secretary of State of California on or before the last day of the taxable year in which the Partnership ceases to do business.

*Comment:* A limited partnership that no longer conducts business in California will remain liable for the annual minimum franchise tax of \$800 until it files with the Secretary of State a Certificate of Cancellation (Secretary of State Form LP-4/7). Rev & T C §17935. Accordingly, if a limited partnership has ceased to do business in California, or intends to cease to do business in California by the end of its present taxable year, the practitioner should file both certificates with the Secretary of State by the end of that taxable year.

**Source:** Business Law/Selecting and Forming Business Entities/6 Limited Partnerships/§6.129 3. Form: Distribution of Liquidation Proceeds

**§6.129 3. Form: Distribution of Liquidation Proceeds**

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6.129-1 Distribution of liquidation proceeds

**E. Distribution of Liquidation Proceeds.** Those proceeds that the Partnership derives from the liquidation of its assets must be applied and distributed in the following order of priority:

**1. First, to the payment of expenses of liquidation and Partnership debts owed to creditors including Partners;**

**2. Second, to the Partners in accordance with their positive capital accounts balances, after taking into account profit and loss allocations for the Partnership taxable year during which liquidation occurs. Liquidating distributions must be made by the end of the Partnership taxable year in which the Partnership is liquidated, or, if later, within 90 days after the date of liquidation.**

*Comment:* The priority of liquidating distributions is governed by Corp C §15908.09. The "safe harbor" provisions of Treas Reg §1.704-1(b)(2) require that distributions in liquidation be made in accordance with positive capital account balances (see §6.78). See Treas Reg §1.704-1(b)(2)(ii)(b)(2).

**§6.130 4. Form: Deficit Restoration Requirement**

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6.130-1 Deficit restoration requirement

**F. Deficit Restoration Requirement.** If, on winding up, a deficit balance exists in any General Partner's capital account, as determined after taking into account all capital account adjustments for the Partnership taxable year during which liquidation occurs, that General Partner must contribute cash to the capital of the Partnership in an amount sufficient to eliminate the deficit balance by the end of the Partnership taxable year during which liquidation occurs, or, if later, within 90 days after the date of liquidation.

*Comment:* On liquidation, the "safe harbor" provisions of Treas Reg §1.704-1(b)(2) require each partner to restore any deficit balance in his or her capital account (see §6.78). See Treas Reg §1.704-1(b)(2)(ii)(b)(3). In lieu of a deficit restoration requirement, the partnership agreement may include "qualified income offset" and corresponding "loss limitation" provisions in compliance with Treas Reg §1.704-1(b)(2)(ii)(d). Because an unlimited deficit restoration requirement is inconsistent with the unlimited liability protection afforded to limited partners, the practitioner typically should include (1) a deficit restoration requirement only for general partners and (2) the "qualified income offset" and corresponding "loss limitation" provisions for limited partners. See §§6.88, 6.91.

**Source:** Business Law/Selecting and Forming Business Entities/6 Limited Partnerships/§6.131 T. Miscellaneous Provisions

**§6.131 T. Miscellaneous Provisions**

The clauses in §§6.132-6.149 represent miscellaneous provisions that are often included in limited partnership agreements. The prudent practitioner will carefully consider how each clause may materially alter the partners' respective rights and obligations. The following miscellaneous provisions are not intended to be an exhaustive list but to illustrate the type of provisions that the practitioner should consider adding to the limited partnership agreement.

For an analysis of miscellaneous contract provisions, see *Drafting Business Contracts: Principles, Techniques & Forms*, chap 17 (Cal CEB 1994).

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**§6.132 1. Form: Amendment**

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6.132-1 Amendment

**ARTICLE XIII**

**MISCELLANEOUS PROVISIONS**

**A. Amendment.** This Agreement may be amended only with the written consent of those Partners whose consent is required under this Agreement to accomplish the action reflected in the amendment.

*Comment:* Absent an agreement to the contrary and subject to the statute of frauds, oral amendments to a partnership agreement may be valid. CC §1698(c). Providing that any amendment to the partnership agreement must be in writing helps eliminate discrepancies concerning the existence or nature of amendments.

§6.133 2. Form: Arbitration

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6.133-1 Arbitration

**B. Arbitration.** Any controversy, dispute, or claim among the Partners concerning the construction, performance, breach, or application of this Agreement must be resolved by binding arbitration. The controversy must be submitted to arbitration in \_\_ [location] \_\_, California, on the request of any Partner. Arbitrations must comply with and are governed under the provisions of the \_\_ [e.g., California Arbitration Act/commercial arbitration rules of the American Arbitration Association, JAMS, etc.] \_\_. Any award or decision of the arbitrator is binding on all parties and is enforceable in any court of competent jurisdiction. Notwithstanding any contrary provision, the parties agree to \_\_ [number of arbitrators] \_\_ who will be selected by the chosen arbitration institution.

[If applicable, add one or more of the following options]

[Option 1: Discovery Permitted]

**1. The parties agree to submit to \_\_ [specify discovery permitted, e.g., a number of depositions as to each side, or limited discovery] \_\_, which will be governed by the California Code of Civil Procedure, subject to the right of the arbitrator to reasonably limit discovery.**

[Option 2: Injunctive Relief]

**[2.] The arbitrator \_\_ [may/may not] \_\_ award injunctive relief of any kind and a party may appeal to the court for that limited purpose.**

[Option 3: Written Decision]

**[3.] The arbitrator must prepare in writing, and provide to the parties, an award including factual findings and the reasons on which the decision is based.**

*Comment:* This clause is consistent with Corp C §15901.17(b), providing that a partner may consent in a written partnership agreement to be (1) nonexclusively subject to arbitration in a specific jurisdiction or (2) exclusively subject to arbitration in the State of California. Further, Corp C §15910.01 allows any partner procedural access to the courts (and arbitration) for all issues relating to the partnership.

This relatively short form arbitration clause contemplates the practitioner's selection of one of the many arbitration regimes. Before selecting one, the practitioner should review the rules for different methods of arbitration. For further information on arbitration, see Structuring an Alternative Dispute Resolution Agreement (Cal CEB Action Guide Spring 1996). The prevailing party's fees provisions should be consistent with the arbitration provision.

**Source:** Business Law/Selecting and Forming Business Entities/6 Limited Partnerships/§6.134 3. Form: Successors and Assigns

**§6.134 3. Form: Successors and Assigns**

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6.134-1 Successors and assigns

**C. Successors and Assigns. Subject to the restrictions contained in this Agreement, this Agreement is binding on and inures to the benefit of the Partners and their respective heirs, successors, assigns, legal representatives, and beneficiaries.**

*Comment:* This clause is intended to clarify that successors to an interest in the LP are bound by the partnership agreement. It is not intended to sanction restricted transfers.

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**Source:** Business Law/Selecting and Forming Business Entities/6 Limited Partnerships/§6.135 4. Form: Titles and Headings

**§6.135 4. Form: Titles and Headings**

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6.135-1 Titles and headings

**D. *Titles and Headings.*** The article, section, and paragraph titles and headings contained in this Agreement are inserted as matter of convenience and for ease of reference only and are to be disregarded for all other purposes, including the construction or enforcement of this Agreement or any of its provisions.

*Comment:* This clause enhances the likelihood that a particular section will not be interpreted more narrowly than the intent of the language based on the titles or captions in the agreement. Courts have used captions and headings to interpret the parties' intent when a provision is ambiguous or misleading. See *Wise v Westchester Fire Ins. Co.* (10th Cir 1972) 463 F2d 386; *Orchard v Agricultural Ins. Co.* (D Or 1964) 228 F Supp 564, *aff'd* (9th Cir 1965) 340 F2d 948. From a purely practical standpoint, the practitioner should use titles and headings only in a manner that aids in interpreting and organizing the partnership agreement.

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§6.136 5. Form: Counterparts and Facsimiles

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6.136-1 Counterparts and facsimiles

**E. Counterparts and Facsimiles.** The Partners may execute this Agreement simultaneously, in any number of counterparts, or on facsimile copies, each of which will be deemed an original, but all of which together constitute one and the same instrument.

*Comment:* This clause makes it possible to execute the partnership agreement without a meeting of all the partners. California law recognizes that properly executed counterpart copies effectively constitute one instrument. See *Ivey v Kern County Land Co.* (1896) 115 C 196, 46 P 926; *Kennedy v Gloster* (1892) 98 C 143, 32 P 941.

The practitioner should be aware that when a partner is a corporation, it may be prudent to ensure that the corporate partner signs the agreement consistent with Corp C §313, which provides: "[S]ubject to the provisions of subdivision (a) of §208, any note, mortgage, evidence of indebtedness, contract, share certificate, initial transaction statement or written statement, conveyance, or other instrument in writing, and any assignment or endorsement thereof, executed or entered into between any corporation and any other person, when signed by the chairman of the board, the president or any vice president and the secretary, any assistant secretary, the chief financial officer or any assistant treasurer of such corporation, is not invalidated as to the corporation by any lack of authority of the signing officers in the absence of actual knowledge on the part of the other person that the signing officers had no authority to execute the same." When, applicable, the statute provides a conclusive, rather than a merely rebuttable, evidentiary presumption of authority on the part of the specified corporate officers to execute the document in question on behalf of the corporation. The statute also limits the burden of proof, insofar as the third party's knowledge is concerned, to a showing that he or she did not have actual knowledge of any lack of authority on the part of the signing officers. *Snukal v Flightways Mfg., Inc.* (2000) 23 C4th 754, 783, 98 CR2d 1.

**Source:** Business Law/Selecting and Forming Business Entities/6 Limited Partnerships/§6.137 6. Form: Counting of Days

**§6.137 6. Form: Counting of Days**

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6.137-1 Counting of days

**F. *Counting of Days.* If a party is required to complete the performance of an obligation under this Agreement by a date certain and that date is a Saturday, Sunday, or federal bank holiday, then the required date of completion of performance will be the next day that is not a Saturday, Sunday, or federal bank holiday.**

*Comment:* This clause establishes a protocol for calculating time periods. Absent such a clause in the partnership agreement, statutory methods for calculating time periods may apply. See, e.g., CC §§7, 10-11; CCP §§12-12a, 13; Govt C §6706. If the statutory methods for calculating time periods are acceptable, this clause may be superfluous.

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**Source:** Business Law/Selecting and Forming Business Entities/6 Limited Partnerships/§6.138 7. Form: Cumulative Remedies

**§6.138 7. Form: Cumulative Remedies**

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6.138-1 Cumulative remedies

**G. Cumulative Remedies. The Partner's remedies under the Agreement are cumulative and do not exclude any other remedies to which the Partner may be lawfully entitled.**

*Comment:* Absent an agreement to the contrary, remedies are generally cumulative. This clause clarifies that the exercise of certain rights and remedies under the partnership agreement does not preclude other action.

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**Source:** Business Law/Selecting and Forming Business Entities/6 Limited Partnerships/§6.139 8. Form: Entire Agreement

**§6.139 8. Form: Entire Agreement**

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6.139-1 Entire agreement

**H. Entire Agreement.** This Agreement, including any Exhibits and Schedules attached to it, contains the Partners' entire agreement and supersedes any prior oral or written agreements among them with respect to the subject matter of the Agreement. There are no representations, agreements, arrangements, or understandings (oral or written) among the Partners relating to the subject matter of this Agreement that are not fully expressed in this Agreement.

*Comment:* This clause is intended to trigger the application of the parol evidence rule (*i.e.*, that the partnership agreement constitutes a final expression of the terms set forth in it and cannot be contradicted by prior or contemporaneous agreements). See CCP §1856(a); CC §1625. The parol evidence rule is, however, subject to numerous exceptions.

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**Source:** Business Law/Selecting and Forming Business Entities/6 Limited Partnerships/§6.140 9. Form: Exhibits

**§6.140 9. Form: Exhibits**

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6.140-1 Exhibits

**I. Exhibits. All exhibits referenced in this Agreement are incorporated into the Agreement by this reference.**

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**Source:** Business Law/Selecting and Forming Business Entities/6 Limited Partnerships/§6.141 10. Form: Further Documents

**§6.141 10. Form: Further Documents**

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6.141-1 Further documents

**J. Further Documents.** Each party agrees to execute, with acknowledgment and affidavit if required, all documents that may be required under this Agreement.

*Comment:* This clause is intended to obligate a partner to do all further acts necessary to effectuate the intent of the partnership agreement, including those that the partners may not have identified at the time they enter into the partnership agreement.

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**§6.142 11. Form: Governing Law**

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6.142-1 Governing law

**K. Governing Law.** The provisions of, and the transactions contemplated by, this Agreement, and the Partners' respective rights and obligations under this Agreement, are to be governed by and construed in accordance with the laws of the State of California.

*Comment:* In general, California courts will respect a choice-of-law provision if the transaction bears a natural and substantial relationship to the state chosen and the application of the laws of another state would not violate a fundamental public policy of California. See *Nedlloyd Lines B.V. v Superior Court* (1992) 3 C4th 459, 11 CR2d 330; *Application Group, Inc. v Hunter Group, Inc.* (1998) 61 CA4th 881, 897, 72 CR2d 73. In the absence of a choice-of-law clause, the courts may examine a number of factors to determine the applicable law. See 1 Witkin, Summary of California Law, *Contracts* §§74-80 (10th ed 2005).

**§6.143 12. Form: Jurisdiction**

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6.143-1 Jurisdiction

**L. Jurisdiction.** The parties agree that all actions or proceedings arising out of or in connection with this Agreement must be arbitrated or litigated exclusively in the California and federal courts located in the County of \_\_ *[name of county]* \_\_, California. The parties each consent to the jurisdiction of these courts. The parties intend the choice of venue to be mandatory and not permissive in nature, precluding the possibility of litigation among the parties with respect to any matter arising out of or in connection with this Agreement in any jurisdiction other than that designated in this section.

*Comment:* A partner may consent, in a written partnership agreement, to be subject to the nonexclusive jurisdiction of the courts of a specified jurisdiction, or the exclusive jurisdictions of the courts of the State of California. Corp C §15901.17(a). On the enforceability of consent-to-jurisdictions clauses, see *Nedlloyd Lines B.V. v Superior Court* (1992) 3 C4th 459, 11 CR2d 330; *Burger King Corp. v Rudzewicz* (1985) 471 US 462, 85 L Ed 2d 528, 105 S Ct 2174; *Yu v Signet Bank/Virginia* (1999) 69 CA4th 1377, 82 CR2d 304.

§6.144 13. Form: Notice

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6.144-1 Notice

**M. Notice.** A notice required or permitted under this Agreement must be given in writing and will be deemed effectively given on personal delivery, 24 hours after deposit with Federal Express or a comparable express courier, addressed to a party at the address set forth below his or her signature, or 48 hours after deposit in the United States mail by \_\_[regular mail/ certified mail/registered mail]\_\_, postage prepaid, addressed to a Partner at the address set forth below his or her signature. A Partner may designate another address for notice purposes by giving written notice to the General Partners.

*Comment:* If the partnership agreement does not specify what is meant by "notice," statutory provisions will govern concerning the time notice is given and may produce an unintended result. Corp C §15901.02(ah). Accordingly, the partnership agreement should contain a detailed notice clause.

Often, the partners will fail to refer to their partnership agreement to verify the notice requirements. They may give notice in a manner that is inconsistent with the notice requirements and unwittingly create a question of whether effective notice was given. Therefore, it is advisable to provide in the notice clause the method most likely to be used by the partners.

**Source:** Business Law/Selecting and Forming Business Entities/6 Limited Partnerships/§6.145 14. Form: Prevailing Party's Fees

**§6.145 14. Form: Prevailing Party's Fees**

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6.145-1 Prevailing party's fees

**N. Prevailing Party's Fees.** In any dispute among the Partners resulting in arbitration or litigation, the party substantially prevailing will be entitled to recover from the other party reasonable attorney fees, costs, and expenses; court costs; and other costs of action. For purposes of this Agreement, the terms "attorney fees" or "attorney fees and costs" mean the fees and expenses of counsel to the parties and may include, without limitation, printing, photostatting, duplicating, and other expenses; air freight charges; and fees billed for law clerks, paralegals, librarians, and others not admitted to the bar but performing services under the supervision of an attorney. The terms "attorney fees" or "attorney fees and costs" also include, without limitation, all fees and expenses for appeals, arbitrations, and bankruptcy proceedings.

*Comment:* In general, attorney fees cannot be recovered unless they are provided for by statute or contract. See *Superior Strut & Hanger Co. v Port of Oakland* (1977) 72 CA3d 987, 140 CR 515; CC §1717; CCP §1021. For detailed discussion regarding the recovery of attorney fees and other costs, see California Attorney Fee Awards (3d ed Cal CEB 2010). Counsel should review carefully with the client(s) whether or not to include an attorney fees clause. Depending on a variety of circumstances, the clause may or may not be in the best interests of the client(s).

**Source:** Business Law/Selecting and Forming Business Entities/6 Limited Partnerships/§6.146 15. Form: Number and Gender

**§6.146 15. Form: Number and Gender**

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6.146-1 Number and gender

**O. Number and Gender.** Whenever used in this Agreement, the singular includes the plural and the plural includes the singular, and the neuter gender includes the male and female, as well as a partnership, trust, firm, company, or corporation, all as the context and meaning of this Agreement may require.

*Comment:* This clause, which is consistent with California law, ensures that no claim can be based on the use of the wrong gender or number in referring to the parties. See *McClintick v Frame* (1929) 98 CA 338, 276 P 1033. See also CC §14; CCP §17.

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§6.147 16. Form: Severability

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6.147-1 Severability

**P. Severability.** If a court of competent jurisdiction finds any provision in this Agreement to be invalid, that invalidity does not affect the remainder of the Agreement. The provision deemed invalid will be severed from the Agreement and the remainder of the Agreement will remain enforceable in accordance with its terms and of full force and effect.

*Comment:* This clause reaffirms the principle of severability, supported by statutory law and case law. As a practical matter, the force of this provision depends on whether the unenforceable provision constitutes a material part of the partnership agreement. See CC §§1598-1599, 1608; *Keene v Harling* (1964) 61 C2d 318, 38 CR 513.

For an alternative severability clause that requires a court to first try a narrower construction if that would avoid the invalidity, illegality, or unenforceability issue, see §5.113.

**Source:** Business Law/Selecting and Forming Business Entities/6 Limited Partnerships/§6.148 17. Form: Time of Essence

**§6.148 17. Form: Time of Essence**

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6.148-1 Time of essence

**Q. *Time of Essence.* Time is of the essence as to every provision of this Agreement that specifies a time for performance.**

*Comment:* Even when a contract provides a fixed date for performance, courts have held that a reasonable extension of time must be given to allow for factors beyond the parties' control. However, the inclusion of a "time of the essence" provision may encourage the partners to timely fulfill their respective obligations under the partnership agreement and increase the enforceability of specific dates. See CC §1657. See *Stratton v Tejani* (1982) 139 CA3d 204, 187 CR 231; California Real Property Sales Transactions §4.139 (4th ed Cal CEB 2007).

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**Source:** Business Law/Selecting and Forming Business Entities/6 Limited Partnerships/§6.149 18. Form: Waiver

**§6.149 18. Form: Waiver**

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▶ To download **Word** version,  
right click and choose  
*Save Target As*

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*Save Target As*

6.149-1 Waiver

**R. Waiver. A party's waiver of any breach of any provision contained in this Agreement does not constitute a continuing waiver or a waiver of any subsequent breach of that provision or any other provision of this Agreement.**

*Comment:* This clause attempts to prevent partners from modifying their agreement by a course of conduct.

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**§6.150 19. Form: Execution**

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §6.43 and ends in §6.151

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6.150-1 Execution

**IN WITNESS WHEREOF, the Partners have signed the Agreement to be effective on the date first stated above.**

**Date:** \_ \_ \_ \_ \_                      \_\_ [Signature]\_\_  
  \_\_ [Typed name]\_\_  
  \_\_ [Address]\_\_

**Date:** \_ \_ \_ \_ \_                      \_\_ [Signature]\_\_  
  \_\_ [Typed name]\_\_  
  \_\_ [Address]\_\_

**Date:** \_ \_ \_ \_ \_                      \_\_ [Signature]\_\_  
  \_\_ [Typed name]\_\_  
  \_\_ [Address]\_\_

**Date:** \_ \_ \_ \_ \_                      \_\_ [Signature]\_\_  
  \_\_ [Typed name]\_\_  
  \_\_ [Address]\_\_

A separate signature line should be provided for each partner. The practitioner should ensure that all general partners and limited partners sign the partnership agreement. See Corp C §15902.01. For the advantages of a written partnership agreement, see §6.29. Only general partners execute certificates of limited partnership, except as provided in Corp C §15902.02.



# 7

## Limited Liability Partnerships

Alan M. Insul

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## **§7.1 I. SCOPE OF CHAPTER**

This chapter discusses the general nature of limited liability partnerships (LLPs) organized under California law, California general partnerships that elect to convert to the LLP form, and foreign LLPs. See §§7.2-7.7. Considerable emphasis has been placed on the mechanics and requirements of filing and maintaining registration as an LLP. See §§7.11-7.21.

The chapter discusses statutory schemes governing LLPs (see §7.8) and tax and security law considerations (see §§7.9-7.10), but it is beyond the scope of the chapter to provide a detailed analysis of the tax considerations associated with partnerships in general or as may be peculiar to LLPs. In addition, the chapter does not discuss the treatment of a California LLP and its partners seeking to do business in other jurisdictions. Limited treatment is given to advising a foreign LLP or its partners desiring to do business in California when the LLP is not engaged in the LLP activities permitted in California. See §7.7. These choice of law issues are made all the more complex due to the lack of uniformity among states as to scope of liability protection and permissible activities for LLPs. For a good discussion of an issue likely to become increasingly important, see Rutledge, *To Boldly Go Where You Have Not Been Told You May Go: LLCs, LLPs, and LLLPs in Interstate Transactions*, 58 Baylor L Rev 205 (2006).

**NOTE:** The Uniform Partnership Act of 1994 (RUPA) (Corp C §§16100-16962) defines two types of LLPs, registered and foreign LLPs. See Corp C §16951. Because all foreign LLPs must in fact register, the definition of a domestic LLP organized under the California RUPA as a "registered LLP" may lead to some confusion. Corporations Code §16953 provides for the registration of California organized LLPs, and Corp C §16959 for the registration of foreign LLPs. Further, the use of the term "registered" by the State Bar to refer to a law firm LLP filing and obtaining approval to practice law in California may serve as an additional source of contextual confusion when analyzing the applicable statutes and regulations. State Bar LLP R 2.1.

## **II. DISTINGUISHING CHARACTERISTICS OF LLPs**

### **§7.2 A. Definition of LLP**

The LLP is a relatively recent creation that has been adopted in one form or another in all jurisdictions. Although some confusion may exist due to the inclusion of the words "limited liability" in its name, the LLP is clearly a general partnership with the corporate feature of providing a partner with a liability shield for certain forms of debts and obligations. A practitioner intending to draft an LLP agreement or advise an LLP organized under California law should review chap 5 together with the aspects of this specialized form of general partnership addressed in this chapter.

In general, an LLP is designed to provide the benefits of limited liability while permitting partners to actively participate in the management of the LLP. The vast majority of jurisdictions permit LLPs to carry on a broad range of business activities, not just the practice of specified professions. See 6 Del Code §15-1001 (Delaware); 805 ILCS 206/1001 (Illinois). See *PDM Steel Serv. Ctrs., Inc. v Mullen & Filippi* (Aug. 8, 2008, F054031; not certified for publication) 2008 Cal App Unpub Lexis 6429 (citing Selecting and Forming Business Entities §7.2 (2d ed Cal CEB 2007)).

**Source:** Business Law/Selecting and Forming Business Entities/7 Limited Liability Partnerships/§7.3 B. Limited to Certain Professions

### **§7.3 B. Limited to Certain Professions**

In California, the LLP vehicle is only available to general partnerships engaged in the practice of law, public accountancy, or architecture, and LLPs providing services or facilities "related" to those provided by such professional firms. See Corp C §16101(6), (8), (14), (19). To qualify as a registered LLP, all partners of the law, accounting, or architectural firm must be licensed to practice their respective profession. See Corp C §16101(7), (14). See also *PDM Steel Serv. Ctrs., Inc. v Mullen & Filippi* (Aug. 8, 2008, F054031; not certified for publication) 2008 Cal App Unpub Lexis 6429 (citing Selecting and Forming Business Entities §7.3 (2d ed Cal CEB 2007)). Further, an LLP may provide services for which a professional license is required only through licensed persons. Corp C §16951.

The "related" partnership provision was intended primarily to accommodate the consulting businesses of accounting firms, which are often organized as separate partnerships in which not all the partners are certified public accountants. A threshold requirement for any LLP to qualify as related to one providing professional LLP services is that a requisite commonality of ownership interests exists among the partners of each potentially related LLP. For the specific criteria used to determine whether a partnership is "related" for these purposes, see Corp C §16101(8)(B) (LLPs related to domestic registered LLPs) and Corp C §16101(6)(B) (LLPs related to foreign LLPs).

**NOTE:** Although the Corporations Code authorizes law firm LLPs to have related entities, as yet the State Bar has not promulgated any rules permitting related entities. Corp C §16101(6)(A), (8)(A).

California is among the few jurisdictions that limit the availability of this form to the practice of public accountancy, architecture, the practice of law, and certain limited activities of LLP affiliates. For example, Oregon limits LLPs to domestic and foreign LLPS (and affiliates) engaged in a number of specified professions ranging from the practice of law to medicine and chiropractic. See ORS §§67.005(12), 67.500(1)(a).

**Source:** Business Law/Selecting and Forming Business Entities/7 Limited Liability Partnerships/§7.4 C. General Partnership With Limited Liability Shield

## **§7.4 C. General Partnership With Limited Liability Shield**

The LLP is a logical outgrowth of the recent trend to develop newer business entities that afford individuals greater flexibility in decision-making, insulating operating owners from liability, and tax treatment as a non-taxable association. The unique nature of the LLP is that it is first and foremost a general partnership with all the flexibility afforded partners under that form of business entity to structure their internal relationship. At the same time, this species of general partnership offers the desirable corporate feature of the limited liability shield. See §7.5.

Except as expressly provided in RUPA, Article 10 (Corp C §§16951-16962), it is clear that the other provisions applicable to general partnerships are intended to apply to LLPs. See Corp C §§16101(9), 16202. Each general partner ordinarily has vicarious personal liability for all debts and obligations of the partnership. Corp C §16306(a). However, by registering as an LLP, the general partners of a California LLP can eliminate their vicarious liability for the partnership's obligations (Corp C §16306(c)), with only limited exceptions. See *PCO, Inc. v Christensen, Miller, Fink, Jacobs, Glaser, Weil & Shapiro, LLP* (2007) 150 CA4th 384, 389 n3, 58 CR3d 516. See also §§7.5-7.6.

**NOTE:** Like all general partnerships, the LLP requires the essential element of two or more persons. Corp C §§16101(9), 16202. The RUPA defines "person" extremely broadly, accommodating all manner of individual and business entities. Corp C §16101(13). Thus, it would appear that so long as an entity acting as a partner of a professional LLP is itself properly licensed in California (Corp C §16101(7)) or otherwise licensed in another jurisdiction to provide professional LLP services (Corp C §16101(14)), the LLP partners may include other professional LLPs, corporations, or partnerships. For further discussion of professional corporations, see chap 10.

## **§7.5 1. Scope of Liability Shield**

The LLP legislation in California (Corp C §§16951-16962) establishes a broad liability shield that is designed to cover debts and obligations arising both in tort and in contract. Subject to specified exceptions, Corp C §16306(c) provides that

a partner in a registered limited liability partnership is not liable or accountable, directly or indirectly, including by way of indemnification, contribution, assessment, or otherwise, for debts, obligations, or liabilities of or chargeable to the partnership or another partner in the partnership, whether arising in tort, contract, or otherwise, that are incurred, created, or assumed by the partnership while the partnership is a registered limited liability partnership, *by reason of being a partner or acting in the conduct of the business or activities of the partnership*. [Emphasis added.]

See also *PCO, Inc. v Christensen, Miller, Fink, Jacobs, Glaser, Weil & Shapiro, LLP* (2007) 150 CA4th 384, 389 n3, 58 CR3d 516.

Therefore, a partner in a California LLP is ordinarily protected not only against vicarious personal liability for the negligence or other tortious conduct of his or her partners, but also against personal liability for any of the partnership's contractual obligations (e.g., leases, loans, purchase orders). *PCO, Inc. v Christensen, Miller, Fink, Jacobs, Glaser, Weil & Shapiro, LLP, supra*.

**CAUTION:** Some care should be exercised with respect to the potential liability of a partner arising out of a claim of negligent supervision. Although no California case has addressed this question, particular attention should be given to Corp C §16306(e), which states that nothing in Corp C §16306(c) will be construed to affect the liability of a partner of a registered LLP to third parties for that partner's tortious conduct. This subsection seems to indicate that negligently supervising partners remain personally liable to the extent their conduct proximately causes injury. Even if the LLP is treated as an entity for purposes of determining with whom an injured third party was in contractual privity, the claims against a partner for negligent supervision may be validly asserted even when a contractual relationship only exists between the LLP and the injured third party. See *Holley v Crank* (9th Cir 2004) 400 F3d 667 (determining that a designated corporate real estate broker may be liable to a third party client for negligent supervision despite the lack of contractual privity).

**Source:** Business Law/Selecting and Forming Business Entities/7 Limited Liability Partnerships/§7.6 2. Exceptions to Liability Shield

## §7.6 2. Exceptions to Liability Shield

The liability shield of an LLP does not apply to protect a partner against personal liability in the following circumstances:

- Each partner remains liable for all debts, obligations, and liabilities incurred, created, or assumed by the partnership *before* it registered as an LLP. See Corp C §16306(c). In addition, to the extent registration and State Bar approval are required before an LLP may practice law, failure to obtain that State Bar approval may subject the partners to joint and several liability despite having an otherwise effective registration with the Secretary of State. See State Bar LLP R 2.1.
- The partners in an LLP may agree by majority vote, or a different vote required in the partnership agreement, to be liable individually for specified obligations. Corp C §16306(d).

**PRACTICE TIP:** If the partnership is silent on the subject, a majority in interest of the partners can vote to waive the liability shield for all partners as to a specified obligation. Because of this, the attorney should consider inserting a specific voting requirement (*e.g.*, two-thirds, three-fourths, unanimous) to waive limited liability under Corp C §16306(d) in an LLP's partnership agreement.

- A partner may act as a guarantor or surety for an LLP's debts, or provide collateral for its debts under a separate agreement between the creditor and that partner. Corp C §16306(h). See §7.20; see also *Apcar Investment Partners VI, Ltd. v Gaus* (2005) 161 SW3d 137, 141 (LLP must be in compliance with registration requirements when incurring obligation for partners to be protected from liability).
- A general partnership's registration as an LLP does not affect a partner's liability to third parties for that partner's own tortious conduct. Corp C §16306(e).

**NOTE:** This exception is much narrower than that contained in many other states' LLP statutes with respect to professional LLPs. Other jurisdictions hold a partner responsible for the negligence or other wrongful conduct of any person acting under the partner's supervision, direction, or control, regardless of whether the partner was negligent in his or her supervision or control of the person. In California, a partner is not liable for the tort of another agent of the LLP merely by reason of the partner's supervision or control over the agent. The supervision itself must be "tortious" before the partner is liable under §16306(e).

- The validity of a law firm's liability shield is conditioned on the firm's maintenance of an effective certificate of registration issued by the California State Bar (see Corp C §16306(f)), which has adopted Limited Liability Partnership Rules and Regulations, effective January 1, 1996. However, the LLP may not act as a law firm until it has been registered with the State Bar. See State Bar LLP R 2.1; see also §7.23.
- A partner in an LLP may be liable to return certain distributions if, after giving effect to the distributions, (1) the partnership would become insolvent or have a negative net worth (see Corp C §16957); or (2) federal and state fraudulent transfer laws of general application require such a return.

**NOTE:** A distribution is defined as the transfer of money or property from the LLP to a partner without consideration. Corp C §16957(c). According to the two-prong test set forth in Corp C §16957(a)(1)-(2), a distribution is improper if after it is made

(1) The LLP would be unable to pay its debts as they come due in the ordinary course of business.

(2) The total assets of the LLP would be less than the sum of its total liabilities plus the amount necessary, if the LLP were to dissolve at the time of the distribution, to satisfy any preferential rights of partners to the extent those preferential rights would be superior to the rights of those receiving the distribution.

**CAUTION:** This exposure is real enough to admonish clients not to operate in an insolvent LLP. In a recent case, the EPA brought an action against a New York LLP formed to own and operate real estate and its partners, seeking

to hold them personally liable for the LLP's violation of the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (CERCLA) (42 USC §§9601-9675). The court concluded that New York's version of the limited liability law shielded partners of the LLP from personal liability under CERCLA. However, the court nevertheless found the partners personally liable for the clean-up because the partnership failed to satisfy New York's version of LLP solvency tests. See *U.S. v 175 Inwood Assocs. LLP* (ED NY 2004) 330 F Supp 2d 213, 223.

**§7.7 D. Treatment of Foreign LLPs Not Engaged in Permitted Professions and Unregistered Foreign LLPs**

It is generally beyond the scope of this chapter to analyze California's treatment of foreign LLPs doing business in California when the foreign LLP is organized to engage in a business other than accounting, architecture, law, or related LLPs. Although Corp C §16959 seems to clearly preclude the Secretary of State from registering any foreign LLP unless it is engaged in one of the three professions or as a related LLP, it is not so clear how such a foreign non-qualifying LLP would be treated if it nevertheless transacts intrastate business without registration. See Corp C §§16958(a), 16959(i), (j).

**NOTE:** Practitioners should advise against a foreign LLP either failing to register or transacting intrastate business in California if the LLP does not otherwise qualify for registration with the Secretary of State. Further, practitioners should carefully consider the exposure of partners of a non-qualifying foreign LLP that has already "transacted intrastate business" (Corp C §16959(l)) in California when the non-qualifying foreign LLP is the subject matter of litigation in connection with its California activities.

If an LLP is a foreign partnership transacting intrastate business in California, the foreign jurisdiction's laws govern the organization and internal affairs of the partnership, as well as the liability and authority of its partners. Corp C §16958(a)(1). It is uncertain whether this statute will be construed as affording a foreign LLP the liability shield of its home jurisdiction if it is not registered as one of the enumerated professions or a related LLP. Because a foreign LLP that is not a law, accounting, or architectural partnership (or an affiliated partnership) does not qualify as a foreign LLP (Corp C §16101), California may not recognize the LLP form, in which case the partnership would be treated as a general partnership without the LLP liability shield. See Corp C §16951. However, in contrast to Corp C §16959, Corp C §16958(a) states:

The laws of the jurisdiction under which a foreign limited liability partnership is organized shall govern its organization and internal affairs and the liability and authority of its partners...and a foreign limited liability partnership may not be denied registration by reason of any difference between those laws and the laws of this state.

Finally, Corp C §16959(j), which provides that a partner is not liable for the foreign LLP's debts and obligations solely by reason of the LLP's transaction of business in California without registration, would seem to evince a legislative intent that even a willful failure to register, without more, is insufficient to subject the partners of the non-qualifying LLP to personal liability. Arguably, the penalty set forth in Corp C §16959(l), when viewed in light of §§16958 and 16959(j), establishes a legislative intent to limit the consequences of failing to register as a foreign LLP to the monetary sanction. Of course, clearly the state has the right to seek an order enjoining such unlawful business activity within its borders.

### **III. LAWS GOVERNING LLPs**

#### **§7.8 A. California Statutes and Regulations**

The legislation authorizing LLPs in California did not enact a separate statutory scheme for general partnerships that convert to LLPs. Instead, provisions specifically dealing with LLPs are included in the Uniform Partnership Act of 1994 (RUPA) (Corp C §§16100-16962). See also *PDM Steel Serv. Ctrs., Inc. v Mullen & Filippi* (Aug. 8, 2008, F054031; not certified for publication) 2008 Cal App Unpub Lexis 6429 (citing .Selecting and Forming Business Entities §7.8 (2d ed Cal CEB 2007)). The LLP provisions are found in Article 10. Corp C §§16951-16962. As a result, an LLP remains for all purposes a general partnership under California law and is governed by RUPA.

**NOTE:** If an LLP is a foreign partnership or one transacting intrastate business in California, the foreign jurisdiction's partnership or LLP law governs the organization and internal affairs of the partnership, as well as the liability and authority of its partners. Corp C §16958(a). It is uncertain whether this statute will be construed as affording a foreign LLP the liability shield of its home jurisdiction if it is not registered as one of the enumerated professions or related LLP. See §7.7.

An LLP is also subject to the registration and filing requirements of the State Bar, State Board of Accountancy, or Board of Architectural Examiners, as may be applicable. Corp C §§16101(8)(A), 16953(h). Business and Professions Code §6174, signed by the Governor on January 25, 2010, and effective as emergency legislation the same day, codifies the obligations of LLPs engaged in the practice of law, mandating compliance

with all administrative or filing requirements of the State Bar, including, but not limited to, the payment of fees, and all rules and regulations adopted by the board and approved by the Supreme Court. All fees shall be paid into the treasury of the State Bar and shall be used for its regulatory and disciplinary purposes.

The State Bar has adopted rules and regulations. See State Bar LLP R 1-12; see also §§7.23, 7.40.

The State Board of Accountancy has prescribed forms that LLPs must file. See Bus & P C §5072; 16 Cal Code Regs §§27-28; see also §§7.24, 7.41-7.43. Although the Board of Architectural Examiners has not prescribed forms, Bus & P C §5558 specifically authorizes architectural LLPs. See §§7.25, 7.44.

## **§7.9 B. Tax Laws**

With the adoption of federal and California "check-the-box" regulations (see Treas Reg §§301.7701-1—301.7701-3), an LLP may elect its classification status for income tax purposes. It is hard to envision a circumstance in which an LLP and its partners would not want to elect to be taxed as a partnership, rather than as an association taxable as a corporation. An LLP need do nothing to be taxed as a partnership, because an LLP that fails to file an election is automatically taxed as a partnership. See Treas Reg §301.7701-3(b)(1)(i).

As an entity taxable as a partnership, an LLP's income and losses flow through and are taxed to or deducted by the partners, retaining the character that they had in relation to the LLP. Thus, there is a single level of tax at the partner level, and losses are fully deductible by members (but not in excess of their bases in their partnership interests). See IRC §§701-702, 704(d). Distributions of cash or property by an LLP to its partners are ordinarily not taxable events to the partners or the LLP (*i.e.*, no gain or loss is recognized). See IRC §731. However, if the distribution exceeds the partner's adjusted basis in the partnership immediately before the distribution, gain is recognized to the extent of the excess. IRC §731(a)(1).

Both domestic and foreign LLPs must pay a minimum franchise tax of \$800 for the privilege of doing business in California. Rev & T C §§17948(a), (b), 23153(d)(1). The tax is due on the date on which the domestic or foreign LLP files its tax return with the Franchise Tax Board (without regard to extensions) on or before the 15th day of the fourth month following the close of its taxable year—not on the date on which the LLP files its registration with the Secretary of State. Rev & T C §§17948(c), 18633(a). This tax is due and payable until the LLP files a Notice of Change of Status (Secretary of State Form LLP-4). Rev & T C §17948(c). See form in §7.38.

**NOTE:** A registered LLP is not liable for the minimum franchise tax if the LLP did no business in California during the taxable year and the taxable year was 15 days or less. Rev & T C §17948.2.

## **§7.10 C. Securities Laws**

Because of the active participation of attorneys, accountants, and architects in their respective LLPs, partnership interests in an LLP are unlikely to be considered securities. Although some consideration might be given to the level of management and control among the partners of an LLP in determining whether or not the offer or sale of interests in the LLP constitutes a security, it is clear that it is not subject to qualification even if it is a security under Corp C §§25110 and 25120. Interests in registered limited liability partnerships and foreign limited liability partnerships are exempt from qualification requirements. 10 Cal Code Regs §260.105.6(a)(2).

Multi-jurisdictional professional LLPs and related LLPs must register or otherwise be exempt from registration under the Federal Securities Act of 1933 (15 USC §§77a-77aa) as well as exempt from qualification under the laws of each state in which they are engaged in business.

**CAUTION:** Even though an LLP is a general partnership, there is no automatic presumption that interests in an LLP are not securities. One state court considered whether the partner's interest should not constitute a security because of the theoretical management and control that LLP partners exercise over the LLP's affairs. The court concluded that, in the context of a non-professional LLP, the status as a general partner alone does not create a presumption that the issuance of a partner's interest is not a security. *Toothman v Freeborn & Peters* (Colo App 2002) 80 P3d 804 (structure of Colorado LLP did not lead to presumption that LLP membership interests were not securities). See also Welle, *When Are Limited Liability Partnership Interests Securities?* 27 Iowa J Corp L 63 (Fall 2001).

## **IV. FORMATION, REGISTRATION, AND CONVERSION**

### **§7.11 A. Formation Requirements**

A domestic general partnership may be organized to qualify as an LLP, or an existing general partnership may be converted to an LLP. In either situation, the attorney must comply with the requirements of forming a general partnership. See chap 5. Note that the LLP provisions of Corp C §§16951-16952 do not alter the default provisions of a general partnership permitting the partnership agreement to be oral or written. See Corp C §§16101(2)(B)(10), 16202. The additional steps necessary to qualify as a California LLP are summarized below. LLPs formed in another jurisdiction must comply with separate registration requirements that are similar to those applicable to the domestic registered LLPs.

**NOTE:** For a firm practicing in professional corporation form, LLP status can be achieved by merger of the corporation into a general partnership that elects to register as an LLP. Corp C §1113. However, the merger will not qualify for tax-free treatment because the tax-free reorganization provisions of the Internal Revenue Code apply only to reorganizations between corporations. For tax purposes, the merger of a professional corporation into a general partnership that elects to be treated as an LLP will be treated as either a transfer of assets directly to the LLP from the corporation, or a liquidation and subsequent contribution of the assets to the LLP, with taxation of all appreciation in the assets transferred to the LLP. See generally *Forming and Operating California Limited Liability Companies*, chap 11 (2d ed Cal CEB 2007).

**PRACTICE TIP:** A professional corporation may become a partner in an LLP. It would seem that it may do so with shareholders as partners. Thus, consideration should be given to the possibility of structuring a contribution to the LLP of those corporate assets that will not result in a recognition of gain or loss on contribution. See IRC §721(a). Care should be taken with this approach, however, as certain assets will not qualify for nonrecognition on contribution. For example, contributed receivables are a taxable event. IRC §751(c). It may be possible to structure the partnership agreement to provide for the withdrawal of the corporate partner based on predetermined conditions.

**Source:** Business Law/Selecting and Forming Business Entities/7 Limited Liability Partnerships/§7.12 1. Partnership Vote to Register as LLP

## **§7.12 1. Partnership Vote to Register as LLP**

If the partnership becoming an LLP is an existing domestic general partnership, it may elect to convert to LLP status by the vote of partners holding a majority interest in the current profits of the partnership, or by a different vote as specified in the partnership agreement. Corp C §16955(a). If the partnership is being organized to qualify as an LLP, the partnership agreement itself should provide for LLP qualification. On partnership agreement provisions, see §§7.17-7.21.

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**Source:** Business Law/Selecting and Forming Business Entities/7 Limited Liability Partnerships/§7.13 2. Effect of Registration

## **§7.13 2. Effect of Registration**

On the effective date of registration (or conversion), the following legal effects result (Corp C §16955(b)):

- All property (whether real or personal, tangible or intangible) of the converting partnership remains vested in the converted registered LLP;
- All debts, obligations, liabilities, and penalties of the converting partnership continue as such in the converted registered LLP;

**CAUTION:** This rule seemingly suggests that the joint and several liability for pre-existing obligations is eliminated by operation of law on conversion. However, such an expansive view is unlikely to be adopted by a court faced with objections from an unconsenting obligee.

- Any action, suit or proceeding (whether civil or criminal) then pending by or against the converting general partnership may be continued as if the conversion had not occurred;
- The same persons continue as partners in the converted and registered LLP unless otherwise agreed, or as otherwise provided by the provisions of the RUPA; and
- The general partnership that has been converted to an LLP and registered as such is considered to be the same person that existed before the conversion. Person is defined in Corp C §16101(B)(13) broadly.

**§7.14            3. Name**

The name of a domestic or registered LLP must contain the words "Registered Limited Liability Partnership" or "Limited Liability Partnership" or one of the abbreviations "L.L.P.," "LLP," "R.L.L.P." or "RLLP" as the last words or letters of its name. Corp C §16952. For detailed discussion of LLP name requirements, see §3.29. The name of a foreign LLP may contain as its last letters or words any abbreviations required or authorized under the laws of the jurisdiction of its formation. Corp C §16958(b). Once registered under Corp C §§16953 (domestic LLP registration) or 16959 (foreign LLP registration), an LLP has no obligation to comply with the fictitious name statement filings that might otherwise apply to it. Corp C §16961.

#### **4. Registration With Secretary of State**

##### **§7.15 a. Domestic or Registered LLPs**

Following the requisite vote of the partners of a general partnership, a general partnership completes its conversion to an LLP by filing a registration form (Registered Limited Liability partnership Registration (Secretary of State Form LLP-1); see §7.35) with the Secretary of State and paying a \$70 registration fee. Corp C §16953(a)-(b); Govt C §12189(a). Unless another later date is selected in the LLP-1, the general partnership becomes an LLP on the filing of the initial registration statement by the Secretary of State. Corp C §16953(e). As discussed in §7.11, the partnership must be organized as a general partnership formed under a partnership agreement governed by Corp C §§16951-16962 and, except for certain related entities (see §7.3), may include as partners only persons licensed to practice law, public accountancy, or architecture in California or another jurisdiction.

**PRACTICE TIP:** For a registered LLP providing professional limited liability partnership services (Corp C §16101(14)), the partners should be careful not to engage in the actual practice of the particular profession without first ensuring compliance with the regulatory requirements associated with each profession. For example, the partners of an LLP who intend to engage in the practice of law may not do so unless and until its registration has been approved by the Bar. State Bar LLP R 2.1. See §§7.22-7.25.

The use of the Secretary of State form for registering an LLP is mandatory. The registration form requires the following information (Corp C §16953(a); see form in §7.35):

- The name of LLP;
- The address of its principal office;
- The name and address of its agent for service of process in California;

**PRACTICE TIP:** Each registered LLP whose principal office is outside California, and each foreign LLP registered in California, must designate as its agent for service of process any natural person or domestic or foreign corporation in accordance with Corp C §1505. Corp C §16962(a). See also *PDM Steel Serv. Ctrs., Inc. v Mullen & Filippi* (Aug. 8, 2008, F054031; not certified for publication) 2008 Cal App Unpub Lexis 6429 (citing Selecting and Forming Business Entities §7.15 (2d ed Cal CEB 2007)).

- A brief statement describing the business in which the partnership engages;
- A statement that the partnership is registering as a registered LLP; and

**NOTE:** If any information in the currently effective registration becomes inaccurate, the registration may be amended as soon as reasonably practicable after the change. A registration or amended registration may also be amended to add information. Corp C §16954(a). See form in §7.36.

- Any other matters that the partnership wishes to include.

**NOTE:** Because the certificate of registration is a public document, caution should be exercised before including additional information in the certificate. Further, information contained in the certificate may only be changed by filing a certificate of amendment filed with the Secretary of State. Corp C §16954.

## **§7.16            b. Foreign LLPs**

Before transacting intrastate business in California, a foreign LLP providing professional LLP services (see Corp C §16101(14)) must first comply with all statutory and administrative registration or filing requirements of the state board, commission, or agency that prescribes the rules and regulations governing a particular profession in which the partnership proposes to be engaged, pursuant to the applicable provisions of the Business and Professions Code relating to the profession or applicable rules adopted by the governing board. Corp C §16959(a)(1). See §§7.22-7.25. For example, an LLP that intends to engage in the practice of law may not do so unless and until its registration has been approved by the Bar. State Bar LLP R 2.1.

**NOTE:** A foreign LLP that is not a law, accounting, or architectural partnership or an affiliated partnership does not qualify as a foreign LLP as defined in Corp C §16101. California may not recognize such an LLP, in which event it would be treated as a general partnership without the LLP liability shield. See Corp C §16951. For further discussion, see §7.7.

A foreign LLP transacting intrastate business in this state must register as a foreign LLP with the Secretary of State within 30 days after the LLP first transacts intrastate business. Corp C §16959(a)(1). The California legislation authorizing LLPs contains definitions of "transact intrastate business," with an extensive list of exceptions. Corp C §16959(l)-(o), (q). Unless a later date is provided in Form LLP-1, the foreign LLP becomes a registered foreign LLP upon the filing of the registration statement by the Secretary of State. Corp C §16959(e).

The registration application filed with the Secretary of State by a foreign LLP contains the same information as that provided by a domestic LLP. See §7.15. It must be signed by a person with authority to do so under the laws of the jurisdiction of formation. Corp C §16959(a)(1), (b). The fee for filing the registration is \$70. Govt C §12189(b).

A foreign LLP must attach one of the following to its registration (Corp C §16959(a)(2)):

- A certificate from an authorized public official of the foreign LLP's jurisdiction of organization, stating that the foreign LLP is in good standing in that jurisdiction; or
- If the foreign jurisdiction does not issue such a certificate, a statement by the foreign LLP that the laws of its jurisdiction do not permit issuance of those certificates.

**NOTE:** If any information in the currently effective registration becomes inaccurate, the registration may be amended as soon as reasonably practicable after the change. A registration or amended registration may also be amended to add information or to withdraw its registration as a foreign LLP. Corp C §16960(a). See forms in §§7.36, 7.38.

A foreign LLP may not maintain any action in California until it is properly registered. Corp C §16959(h). The Secretary of State is deemed to be the appointed agent for service of process for an unregistered foreign LLP. Corp C §16959(k). Further, transacting intrastate business in California without proper registration subjects the foreign unregistered LLP to a penalty of \$20 a day, up to a maximum of \$10,000. Corp C §16959(i). Intrastate business for this purpose means "repeatedly and successively providing professional limited liability partnership services in California, other than in interstate or foreign commerce." Corp C §16959(j). Specific exclusions from this definition are set forth in Corp C §16959(m)-(o). The Attorney General may seek to enjoin an unregistered foreign LLP from transacting intrastate business. Corp C §16959(p). However, these statutory provisions against a foreign LLP transacting intrastate business without registration are not intended to alter existing law with respect to professionals licensed in another jurisdiction providing services in California. Corp C §16959(q).

**Source:** Business Law/Selecting and Forming Business Entities/7 Limited Liability Partnerships/§7.17 B. Modification of Partnership Agreement Converting LLP

### **§7.17 B. Modification of Partnership Agreement Converting LLP**

To convert an existing general partnership to an LLP, the partners must make changes and additions to the general partnership agreement. To form a partnership intended to qualify as an LLP, the partners must make changes to the draft general partnership agreement. General partnership agreements are covered in chap 5. Modifications to effect a conversion to an LLP are discussed in §§7.17-7.21.

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**Source:** Business Law/Selecting and Forming Business Entities/7 Limited Liability Partnerships/§7.18 1. Registration as LLP; Waiver of Shield

### **§7.18 1. Registration as LLP; Waiver of Shield**

The partnership agreement should expressly state the agreement of the partners to register the partnership as an LLP, to change or to adopt an authorized name (*e.g.*, ending in LLP; see §7.14), and to adopt the benefit of the liability shield. Corp C §16953. The agreement should also set forth the partnership vote necessary to waive the liability shield in any specified circumstances. Corp C §16955. See form in §7.46.

If converting to an LLP, many firms will adopt resolutions authorizing conversion. See clauses in §7.45.

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**Source:** Business Law/Selecting and Forming Business Entities/7 Limited Liability Partnerships/§7.19 2. Personal Guaranties

## **§7.19            2. Personal Guaranties**

Each partner automatically guarantees any deficiency in the security provided by the LLP. Corp C §§16956(a)(1)(C), (a)(2)(C), (a)(3)(C). The partnership agreement may provide for a limited guaranty by partners of firm debts. Corp C §16306(d). See form in §7.47. However, the scope of this guaranty would seem to be strictly limited to the statutory circumstances enumerated.

**NOTE:** Caution should be exercised when guaranties are provided by one or more partners. While the LLP may provide a liability shield, nothing prevents a partner from waiving the liability shield by providing a creditor with a personal guaranty. In *Apcar Investment Partners VI, Ltd. v Gaus* (2005) 161 SW3d 137, a Texas court held that the personal guaranties of an LLP's partners exposed the partners to liability despite the liability shield protecting them in their partner capacity. For partners to be protected from liability, the LLP must be in compliance with registration requirements when incurring obligation. 161 SW3d at 141.

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### **§7.20 3. Indemnity and Contribution Provisions**

Many general partnership agreements provide that each partner will

- Be indemnified by the partnership against liabilities incurred in the course of the partnership's business, and
- Contribute his or her prorata portion of any such liability to the extent that the partnership is unable to pay the liability in full.

These provisions are based on the theory that each general partner is jointly liable for all partnership obligations, including the obligation to indemnify each other partner against liabilities incurred for and on behalf of the partnership. See Corp C §§16306, 16401(c).

Indemnity and contribution provisions may expose LLP partners to liabilities they would otherwise be protected against by the LLP's liability shield. For example, if one partner in an LLP commits a tort (*e.g.*, malpractice, sexual harassment), he or she and the partnership itself will be liable for that conduct despite the liability shield. (The purpose of the liability shield is to protect the other partners. See §§7.4-7.6, 7.48.) If the partnership is unable to pay the claim and the partnership agreement provides that the tortfeasor partner is entitled to indemnity or contribution from the other partners, the creditor or bankruptcy trustee of the tortfeasor partner could assert those rights on his or her behalf and the liability shield would be defeated. Because of this risk, LLPs should adopt provisions that track Corp C §16306(c) rather than adding a general indemnity provision in the partnership agreement. See form in §7.49.

**Source:** Business Law/Selecting and Forming Business Entities/7 Limited Liability Partnerships/§7.21 4. Loss Allocations and Capital Contributions

#### **§7.21 4. Loss Allocations and Capital Contributions**

Loss allocations under a partnership agreement may result in a partner having a deficit capital account balance. Some partnership agreements provide that a partner must restore a deficit account by capital contribution, usually on dissolution and liquidation of the partnership. The partnership should consider limiting or expressly negating a capital account deficit restoration obligation because it may provide partnership creditors with a method to circumvent the liability shield. See form in §7.51. For the same reason, any other provision in the partnership agreement that requires partners to make capital contributions or loans to the partnership should also be modified or deleted. However, careful consideration should be given to the limitations of non-recourse debt in the context of tax deductions for income tax purposes. See Oberst, *The Disappearing Limited Deficit Restoration Obligation*, 56 Tax Law 485 (Spring 2003).

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**Source:** Business Law/Selecting and Forming Business Entities/7 Limited Liability Partnerships/§7.22 V. SPECIFIC REQUIREMENTS FOR LEGAL, ACCOUNTING, AND ARCHITECTURAL LLPs

## **§7.22 V. SPECIFIC REQUIREMENTS FOR LEGAL, ACCOUNTING, AND ARCHITECTURAL LLPs**

California's statutory scheme contemplates that each LLP (except for a "related" LLP) that will provide professional limited liability services (see Corp C §16101(14)) must satisfy not only the limited liability partnership statutes (Corp C §§16951-16962), including registration with the Secretary of State, but that each LLP will also comply with the rules and regulations promulgated from time to time by each of the governing bodies for the three eligible professions, the State Bar of California, the State Board of Accountancy, and the State Board of Architects. Each board has broad regulatory authority over the manner in which the clients of the LLP will be afforded adequate assurance that the LLP has adequate security for errors and omissions claims as a trade off for permitting partners not involved in the act of professional negligence to shield themselves from liability. Unless further extended, the availability to architectural partnerships of the LLP form of doing business will sunset on January 1, 2012. It was already extended for a 5-year period effective January 1, 2007. Corp C §16101(19).

**NOTE:** The regulatory schemes required for each profession differ markedly. Compare the forms in §7.39 for LLP law firms with those in §§7.41-7.43 for accounting firms.

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**Source:** Business Law/Selecting and Forming Business Entities/7 Limited Liability Partnerships/§7.23 A. State Bar of California Rules and Regulations

## **§7.23 A. State Bar of California Rules and Regulations**

The State Bar of California has adopted detailed rules and regulations implementing the LLP legislation. See Corp C §§16951-16962. For the State Bar's registration packet, see §7.39. These materials are available on the State Bar's website, and copies may also be obtained from the State Bar Office of Certification in San Francisco. For the address and telephone number, as well as the State Bar website address, see the Directory.

**NOTE:** As of February, 2010, changes to the State Bar rules for LLPs were pending. If adopted as expected by the Board of Governors, the effective date will likely be July 1, 2010. While not intended as a significant substantive revision of the rules, the changes would reflect current practice and improve the Bar's operational efficiency with respect to its governance of LLPs. Among the more significant proposed changes are the following:

- Rule 3.172(B) would eliminate an effective date of registration that is earlier than the date of receipt of a complete application.
- Rule 3.176(B) would provide an opportunity to cure a suspension of a certificate for failure to file an annual renewal if submitted within a year. It also makes clear that after the 1-year period, the LLP is deemed involuntarily terminated.

The proposed changes can be viewed at the State Bar website at [http://calbar.ca.gov/calbar/pdfs/public-comment/2009/Prop-LLP-Rules\\_Ch3\\_Att3.pdf](http://calbar.ca.gov/calbar/pdfs/public-comment/2009/Prop-LLP-Rules_Ch3_Att3.pdf).

Existing rules require the execution and filing, on a form prescribed by the State Bar, of an Application for Issuance of Certificate of Registration as a Limited Liability Partnership. The application includes the following items (State Bar LLP R 4.1-4.6):

- Attachment 1, identifying all persons and entities practicing law on behalf of the LLP;
- Attachment 2, a list of the names of all nonpartners, including employees and all other persons or law corporations practicing in partnership, association, or "of counsel" with the LLP in a continuous relationship;
- Attachment 3, a declaration of compliance with Cal Rules of Prof Cond 1-400, governing the use of misleading names;
- An original, certified copy (including the cover with the red date stamp) of Form LLP-1, the Certificate of Registration, or foreign LLP Application for Registration, as filed with the Secretary of State; and
- A filing fee of \$50 per partner (not to exceed \$2500).

**NOTE:** The registration date is the date that the complete application is received in the State Bar's office. The LLP liability shield will not apply if the law firm LLP does not have a currently effective certificate of registration. Corp C §16306(f); see also State Bar LLP R 3.4, 5.1.

**PRACTICE TIP:** In addition to its registration with the State Bar, a law firm LLP must file an annual renewal. State Bar LLP R 10.0. If the LLP fails to timely file a completed annual renewal, the LLP is terminated. State Bar LLP R 8.1.1, 10.0. A law firm LLP must file a special report within 45 days of a change in the LLP's official State Bar address, its name, or the designated partner or partners authorized to act on behalf of the LLP. State Bar LLP R 11.0. The report must include an original certified copy of the Amendment to Registration (Secretary of State Form LLP-2) including the cover page with the red date stamp and a Declaration of Compliance with Rules of Prof Conduct 1-400.

**Source:** Business Law/Selecting and Forming Business Entities/7 Limited Liability Partnerships/§7.24 B. State Board of Accountancy Requirements

## **§7.24 B. State Board of Accountancy Requirements**

All domestic and foreign partnerships engaged in the practice of public accountancy in California are required to register with the State Board of Accountancy. Bus & P C §5072. Accountancy partnership registrations must be renewed every 2 years. Bus & P C §5070.5. Additionally, the State Board of Accountancy has prescribed forms for licensure of an LLP engaged in rendering public accountancy services. For the partnership application packet, see §§7.41-7.43.

Different forms and filing fees apply to a new LLP that applies for licensure (application fee of \$150 plus \$50 or \$100 license fee) or a previously licensed partnership that converts to LLP status. A converting partnership need file only a name-change application (\$150 filing fee).

The forms and other printed information concerning LLPs engaging in public accountancy are also available from the Board's offices in Sacramento. For the address and telephone number, see the Directory.

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**Source:** Business Law/Selecting and Forming Business Entities/7 Limited Liability Partnerships/§7.25 C. Architectural Firm Requirements

### **§7.25 C. Architectural Firm Requirements**

Domestic and foreign partnerships engaged in the practice of architecture may register as LLPs. Corp C §16101(6)(A). The availability of the LLP form to architectural firms has been extended until January 1, 2012. Corp C §16101(19).

Each member of the architectural firm LLP must be a California licensed architect. There are no forms and no additional fee for forming an architectural firm LLP other than filing the LLP forms available from the Secretary of State (see forms in §§7.35-7.38), paying the Secretary of State's filing fees, and notifying the California Architects Board of the name and address of the entity (see form in §7.44). Bus & P C §5558.

**CAUTION:** One difficulty architectural partnerships will confront in selecting the LLP form is that they often have members who are not licensed architects but hold another professional license, such as engineer. Such "multi-disciplinary" partnerships do not qualify for use of the LLP form in California. Corp C §16101(6)(A). A further legislative fix would be required to permit multi-disciplinary architectural firms to practice in LLP form, but such a proposal might embroil the architectural profession in a debate similar to the one that is occurring in the legal profession over whether to permit multi-disciplinary practice.

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## **D. Security for Claims**

### **§7.26 1. Amount of Security**

Arranging security for claims is the most substantive requirement that a domestic or foreign firm must meet when registering as a California LLP. Corp C §16956(a)(1)(A)-(D), (a)(2)(A)-(D), (a)(3)(A)-(D). See §§7.28-7.31.

The maximum required security for claims is \$5 million for accounting and architectural firm LLPs and \$7.5 million for law firm LLPs. Corp C §16956.

**NOTE:** On and after January 1, 2008, the maximum required security for architectural partnerships with five or fewer licensees is \$1 million. For partnerships with more than five licensees rendering professional services, an additional \$100,000 of liability coverage must be obtained for each additional licensee. However, the total aggregate limit of liability under the policy or policies of insurance is not required to exceed \$5 million. Corp C §16956(a)(3)(A)-(B).

Firms not subject to the maximum requirement (*i.e.*, smaller firms) that elect to meet the requirement through insurance may be required to maintain the maximum required level of insurance for all claims made against the firm in the aggregate, because more than one claim can be made against a firm in any one year. The firm may need to recalculate the amount of security each year if the number of licensed persons changes.

**NOTE:** In *Hecht, Solberg, Robinson, Goldberg & Bagley LLP v Superior Court (Panther)* (2006) 137 CA4th 579, 40 CR3d 446, the court was asked to interpret whether or not a nonparty law firm LLP's compliance with the filing requirements for provision of security (Corp C §16956) may be discoverable in light of Corp C §16956(d), which expressly prohibits the admission into evidence of the existence of the security requirement and the extent of the LLP's compliance. The unanimous court concluded that the law firm's filings under §16956 could lead to admissible evidence about the extent of assets available to satisfy any underlying judgment. Thus, a trial court may properly order the disclosure of these filings regarding security because they are relevant to the issues presented on collectibility as part of causation and damages (by potentially leading to admissible evidence about the extent of assets available to satisfy any underlying judgment). Admissible evidence on collectibility could also include information about assets or net worth. The court sidestepped perhaps the more significant question as to whether and to what extent an LLP under an entity theory has privacy rights independent of its partners.

**Source:** Business Law/Selecting and Forming Business Entities/7 Limited Liability Partnerships/§7.27 2. When Security Is Required

**§7.27            2. When Security Is Required**

Security is required only for claims based on acts, errors, or omissions arising out of the practice of law, public accountancy, or architecture. Corp C §16956(a)(1)-(3). Accordingly, no security is required of a domestic or foreign LLP that does not render "professional limited liability partnership services." Corp C §16101(14). Consulting affiliates of LLPs, as well as any other partnership, related to a domestic or foreign LLP within the meaning of Corp C §16101(6), need not provide security for claims if the affiliate LLP does not provide legal, accounting, or architectural services.

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**Source:** Business Law/Selecting and Forming Business Entities/7 Limited Liability Partnerships/§7.28 3. Meeting Security Requirement; Effect of Noncompliance

**§7.28            3. Meeting Security Requirement; Effect of Noncompliance**

An LLP must provide security for claims based on acts, errors, or omissions arising out of its professional practice under Corp C §16956(a)(1), (2), or (3). To the extent that it does not, each partner is a guarantor of the difference between the maximum amount of security required for the LLP and the security otherwise furnished under Corp C §16956(a)(1), (2), or (3) (provided that the aggregate amount paid by all partners under these guaranties does not exceed the difference). Corp C §16956(a)(1)(C), (a)(2)(C), (a)(3)(C). A partner's withdrawal does not affect liability for events occurring before withdrawal.

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**§7.29 a. Law Firms**

Business and Professions Code §6174.5, signed by the Governor and effective as emergency legislation on January 25, 2010, codified a requirement that at the time of filing an application for issuance of a certificate of registration as an LLP pursuant to the State Bar Rules, "an applicant for registration shall *also* file with the State Bar a separate form stating that the limited liability partnership has complied with the security requirements described in [Corp C §16956(a)(2)]." (Emphasis added.) A law firm LLP must provide the required security in one of three ways. To the extent that it does not, each partner is a guarantor of the difference between the maximum amount of security required for the LLP and the security otherwise furnished under Corp C §16956(a)(2) (provided that the aggregate amount paid by all partners under these guaranties does not exceed the difference). Corp C §16956(a)(2)(C). A partner's withdrawal does not affect liability for events occurring before withdrawal. Some combination of the following three alternatives may be used to satisfy the security requirement (Corp C §16956(a)(2), (b)):

(1) A policy or policies of insurance in an aggregate amount of not less than \$1 million for LLPs of five or fewer licensed persons. For LLPs with more than five licensees rendering professional services on behalf of the LLP, the aggregate amount is an additional \$100,000 for each additional licensee. However, the maximum amount of insurance need not exceed \$7.5 million for claims initially asserted in any one designated period. ("Designated period" refers to a policy year or any other period designated in the policy that is not greater than 12 months.) These limits are net of amounts paid in defending, settling, or discharging those claims; thus, the LLP need not acquire additional insurance coverage for the designated period if the limits are exhausted. The policy or policies may be in a form reasonably available in the commercial insurance market, and subject to those terms, conditions, exclusions, and endorsements that are typically contained in professional liability policies. The policy may be subject to a deductible or self-insured retention. Corp C §16956(a)(2)(A).

**NOTE:** On the dissolution and winding up of an LLP, the LLP must, with respect to any insurance policy then maintained, maintain or obtain an extended reporting period endorsement, or an equivalent provision, in the maximum total aggregate limit of liability required under the statute, for a minimum of 3 years if such an endorsement is reasonably available from the insurer. Corp C §16956(a)(2)(A).

(2) In trust or in a bank escrow, cash, bank certificates of deposit, United States Treasury obligations, bank letters of credit, or bonds of insurance or surety companies in an amount of not less than \$1 million for *all* claims against an LLP with five or fewer licensees, and an additional \$100,000 for each additional licensee. However, as with the use of insurance to provide security against claims, the maximum amount of this form of security is not required to exceed \$7,500,000. A law firm LLP electing this method of providing security for claims may do so even *after* a claim has been filed against the firm if, within 30 days after the claim is initially asserted against it through service of a summons, complaint, or comparable pleading in a judicial or administrative proceeding, the firm provides the required amount of security by designating and segregating funds in compliance with the collateral requirements. Corp C §16956(a)(2)(B).

**PRACTICE TIP:** If a law firm LLP elects to satisfy the security requirements by making a deposit into trust, the LLP should establish and use a trust other than its client trust funds to avoid any issues associated with the commingling of assets.

(3) A written confirmation that the LLP had a net worth of at least \$15 million as of its most recently completed fiscal year. Corp C §16956(a)(2)(D). If the law partnership elects this alternative, the application for registration (Registered Limited Liability Partnership Registration (Secretary of State Form LLP-1) (see §7.35) must state this election and be accompanied by an executed alternative security provision confirming a net worth of at least \$15 million. See Limited Liability Alternative Security Provision (Secretary of State Form LLP-3) in §7.37.

**NOTE 1:** An LLP relying on this method of security must confirm, as of the last day of its most recently completed fiscal year, that it had a net worth equal to or exceeding the requisite amount. The LLP must file an annual confirmation with the Secretary of State's office, signed by an authorized member of the registered limited liability partnership

or foreign limited liability partnership, accompanied by a transmittal form. Corp C §16956(c); see Corp C §16956(b) (transmittal form). To be current in a given year, the partnership form must be on file within 4 months of the completion of the fiscal year. On its filing, the confirmation constitutes full compliance with the financial security requirements as of the beginning of the fiscal year. A confirmation filed during any particular fiscal year continues to be effective for the first 4 months of the next succeeding fiscal year. Corp C §16956(c).

**NOTE 2:** Compare these financial security requirements with those of a professional corporation. See §10.7.

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**§7.30            b. Accountancy Firms**

An LLP that engages in public accountancy must provide security in the form of one or some combination of three alternatives (Corp C §16956(a)(1), (b):

(1) A policy or policies of insurance in an aggregate amount of at least \$1 million for LLPs with five or fewer licensees rendering professional services to the LLP. For LLPs with more than five licensees, an additional \$100,000 of insurance must be obtained for each additional licensee. However, the maximum amount of insurance need not exceed \$5 million for claims initially asserted in one designated period (see §7.29), less amounts paid in defending, settling, or discharging those claims. The policy or policies may be in a form reasonably available in the commercial insurance market, and subject to those terms, conditions, exclusions, and endorsements that are typically contained in professional liability policies. The policy may be subject to a deductible or self-insured retention. Corp C §16956(a)(1)(A).

**NOTE:** On the dissolution and winding up of an LLP, the LLP must, with respect to any insurance policy then maintained, maintain or obtain an extended reporting period endorsement, or an equivalent provision, in the maximum total aggregate limit of liability required under the statute, for a minimum of 3 years if such an endorsement is reasonably available from the insurer. Corp C §16956(a)(1)(A).

(2) In trust or in a bank escrow, cash, bank certificates of deposit, United States Treasury obligations, bank letters of credit, or bonds of insurance or surety companies in an amount for *all* claims of at least \$1 million for LLPs with five or fewer licensees. For LLPs with more than five licensees, an additional \$100,000 per additional licensee is required. However, as with the use of insurance to provide security against claims, the maximum amount of this form of security is not required to exceed \$5 million. A public accounting firm LLP electing this method of providing security for claims may do so even *after* a claim has been filed against the firm if, within 30 days after the claim is initially asserted against it through service of a summons, complaint, or comparable pleading in a judicial or administrative proceeding, the firm provides the requisite security by designating and segregating funds in compliance with the collateral requirements. Corp C §16956(a)(1)(B).

(3) A written confirmation that the LLP had a net worth of at least \$10 million as of its most recently completed fiscal year. Corp C §16956(a)(1)(D). If the accounting partnership elects this alternative, the LLP's application for registration (Registered Limited Liability Partnership Registration (Secretary of State Form LLP-1); see §7.35) must state this election and be accompanied by an executed alternative security provision confirming its net worth of at least \$10 million. See Limited Liability Alternative Security Provision (Secretary of State Form LLP-3) in §7.37.

**NOTE:** An LLP relying on this method of security must confirm, as of the last day of its most recently completed fiscal year, that it had a net worth equal to or exceeding the requisite amount. The LLP must file an annual confirmation with the Secretary of State's office, signed by an authorized member of the registered limited liability partnership or foreign limited liability partnership, accompanied by a transmittal form. Corp C §16956(c); see Corp C §16956(b). To be current in a given year, the partnership form must be on file within 4 months of the completion of the fiscal year. On its filing, the confirmation constitutes full compliance with the financial security requirements as of the beginning of the fiscal year. A confirmation filed during any particular fiscal year continues to be effective for the first 4 months of the next succeeding fiscal year. Corp C §16956(c).

**§7.31 c. Architectural Firms**

An LLP that engages in architecture must provide security in the form of one or some combination of three alternatives (Corp C §16956(a)(3), (b):

(1) A policy or policies of insurance in an amount for *each* claim of at least \$100,000, multiplied by the number of licensed persons rendering professional services on behalf of the LLP, but not less than \$1 million for firms with five or fewer licensees rendering professional services on behalf of the LLP. For LLPs with more than five licensees rendering professional services, an additional \$100,000 of liability coverage must be obtained for each additional licensee. However, the total aggregate limit of liability under the policy or policies of insurance is not required to exceed \$5 million for claims initially asserted in one designated period (see §7.29), less amounts paid in defending, settling, or discharging those claims. The policy or policies may be in a form reasonably available in the commercial insurance market, and subject to those terms, conditions, exclusions, and endorsements that are typically contained in professional liability policies. The policy may be subject to a deductible or self-insured retention. Corp C §16956(a)(3)(A).

**NOTE:** On the dissolution and winding up of an LLP, the LLP must, with respect to any insurance policy then maintained, maintain or obtain an extended reporting period endorsement, or an equivalent provision, in the maximum total aggregate limit of liability required under the statute, for a minimum of 3 years if such an endorsement is reasonably available from the insurer. Corp C §16956(a)(3)(A).

(2) Cash, bank certificates of deposit, United States Treasury obligations, bank letters of credit, or bonds of insurance or surety companies, maintained in a trust account or bank escrow account, in an amount for *all* claims of at least \$100,000, multiplied by the number of licensed persons rendering professional services (subject to the same minimum and maximum amounts as for security in the form of insurance). An architectural firm LLP electing this method of providing security for claims may do so even *after* a claim has been filed against the firm if, within 30 days after the claim is initially asserted against it through service of a summons, complaint, or comparable pleading in a judicial or administrative proceeding, the firm provides the required amount of security by designating and segregating funds in compliance with the collateral requirements. Corp C §16956(a)(3)(B).

(3) A written confirmation that the LLP had a net worth of at least \$10 million as of its most recently completed fiscal year. Corp C §16956(a)(3)(D). If the partnership elects this alternative, its application for registration (Registered Limited Liability Partnership Registrations (Secretary of State Form LLP-1); see §7.35) must state this election and be accompanied by an executed alternative security provision, confirming the LLP's net worth of at least \$10 million. See Limited Liability Alternative Security Provision (Secretary of State Form LLP-3) in §7.37.

**NOTE:** An LLP relying on this method of security must confirm, as of the last day of its most recently completed fiscal year, that it had a net worth equal to or exceeding the requisite amount. The LLP must file an annual confirmation with the Secretary of State's office, signed by an authorized member of the registered limited liability partnership or foreign limited liability partnership, accompanied by a transmittal form. Corp C §16956(c); see Corp C §16956(b). To be current in a given year, the partnership form must be on file within 4 months of the completion of the fiscal year. On its filing, the confirmation constitutes full compliance with the financial security requirements as of the beginning of the fiscal year. A confirmation filed during any particular fiscal year continues to be effective for the first 4 months of the next succeeding fiscal year. Corp C §16956(c).

## VI. CHECKLISTS

### §7.32 A. Checklist to Organize New California LLP

▶ To download **Word** version,  
right click and choose  
*Save Target As*

▶ To download **WordPerfect** version,  
right click and choose  
*Save Target As*

- Select name of LLP.
- Prepare LLP partnership agreement. See chap 5.
- Secure consents of partners.
- Register LLP:
  - File Form LLP-1 with the Document Filing Support Unit of the California Secretary of State, together with applicable fee of \$70. Corp C §16953(a); Govt C §12189(a). See §7.35.
  - If LLP will rely on net worth security alternative, file Form LLP-3 with Secretary of State. See §7.37.
  - Law Firms: File application for Certificate of Registration as an LLP with Office of Certification of the State Bar in San Francisco, together with the appropriate fee (\$50 per attorney not to exceed a maximum of \$2500 per LLP). See §§7.39-7.40.
  - Accounting Firms: File Board of Accountancy Form 11A-19 with State Board of Accountancy together with the applicable fee of \$350. See §7.42.
  - Architectural Firms: Although an architectural LLP is not required to file an initial form to qualify as an architectural LLP, licensed architects must annually file a business entity report identifying the entity through which they practice with the California Architects Board, together with applicable fee of \$150. See Bus & Prof C §5558. Licensed architects must also notify the Board within 30 days after any change. See §7.44.
- After initial organization, notify all professional organizations required or desirable to be notified as to each professional's partnership in or employment by the LLP.
- To the extent pre-existing clients of partners or associates are brought into the LLP, notify each client of the professional's employment or partnership in the LLP. See §§7.53-7.54.
- Explain the contemplated new relationship with the LLP, including scope of liability protection afforded partners.
- Consider executing new fee agreements with existing clients in LLP's name.
- Consider executing new authorizations in the LLP's name, including transferring trust fund balances to the trust account of the LLP.
- Make all other necessary arrangements to notify clients and third parties that the LLP, and not any of its predecessors or individual professionals (employee or partner), is the entity engaged in the professional activity. See §7.55.
- Analyze fee compensation provisions with respect to future services rendered to clients brought to the LLP. See *Howard v Babcock* (1993) 6 C4th 409, 25 CR2d 80 (departing attorney partner may agree to pay reasonable cost in form of revenue derived from clients taken with the departing partner from his former firm).
- Inform existing professionals and each new professional joining the LLP that future communications should be on the LLP's letterhead.
- File and maintain all partner consents and documents with partnership records.

*Comment:* If not addressed in the partnership agreement directly, consider obtaining all agreements between the partners and their business associations to ensure that a prospective partner is not subject to a noncompetition provision. See Bus & P C §16602.

For a discussion of the Secretary of State's preclearance and expedited filing services and fees, see Comment in §7.35.

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**Source:** Business Law/Selecting and Forming Business Entities/7 Limited Liability Partnerships/§7.33 B. Checklist to Register Foreign LLP in California

### §7.33 B. Checklist to Register Foreign LLP in California

► To download **Word** version, right click and choose **Save Target As**

► To download **WordPerfect** version, right click and choose **Save Target As**

- Register the LLP:
- Verify that LLP is in good standing in jurisdiction of organization.
- Secure certificate of good standing from appropriate official or, if not used in jurisdiction of organization, draft statement to effect that relevant jurisdiction does not allow certificates of good standing. Corp C §16959(a)(2).
- File Form LLP-1 with the Document Filing Support Unit of the California Secretary of State, together with applicable fee of \$70. Corp C §16959(a); Govt C §12189(b). See §7.35.
- If LLP will rely on net worth security alternative, file Form LLP-3 with Secretary of State. See §7.37.
- Law Firms: File application for Certificate of Registration as an LLP with Office of Certification of the State Bar in San Francisco, together with the appropriate fee (\$50 per attorney not to exceed a maximum of \$2500 per LLP). See §§7.39-7.40.
- Accounting Firms: File Board of Accountancy Form 11A-19 with State Board of Accountancy together with the applicable fee of \$350. See §§7.41-7.43.
- Architectural Firms: Although an architectural LLP is not required to file an initial form to qualify as an architectural LLP, licensed architects must annually file a business entity report identifying the entity through which they practice with the California Architects Board, together with applicable fee of \$150. See Bus & Prof C §5558. Licensed architects must also notify the Board within 30 days after any change. See §7.44.
- After initial organization, notify all professional organizations required or desirable to be notified as to each professional's partnership in or employment by the LLP.
- To the extent pre-existing clients of partners or associates are brought into the LLP, notify each client of the professional's employment or partnership in the LLP. See §7.55.
- Explain the contemplated new relationship with the LLP, including the scope of liability protection afforded partners.
- Consider executing new fee agreements executed with existing clients in LLP's name.
- Consider executing new authorizations in the LLP's name, including transferring trust fund balances to the trust account of the LLP.
- Make all other necessary arrangements to notify clients and third parties that the LLP, and not any of its predecessors or individual professionals (employee or partner), is the entity engaged in the professional activity. See §7.55.
- Analyze fee compensation provisions with respect to future services rendered to clients brought to the LLP. See *Howard v Babcock* (1993) 6 C4th 409, 25 CR2d 80 (departing attorney partner may agree to pay reasonable cost in form of revenue derived from clients taken with the departing partner from his former firm).
- Inform existing professionals and each new professional joining the LLP that future communications should be on the LLP's letterhead.
- File and maintain all partner consents and documents with partnership records.

*Comment:* If not addressed in the partnership agreement directly, consider obtaining all agreements between the partners and their business associations to ensure that a prospective partner is not subject to a noncompetition provision. See Bus & P C §16602.

For a discussion of the Secretary of State's preclearance and expedited filing services and fees, see Comment in

§7.35.

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**Source:** Business Law/Selecting and Forming Business Entities/7 Limited Liability Partnerships/§7.34 C. Checklist to Convert Domestic Partnership to Registered LLP

### §7.34 C. Checklist to Convert Domestic Partnership to Registered LLP

► To download **Word** version, right click and choose **Save Target As**

► To download **WordPerfect** version, right click and choose **Save Target As**

- Determine identity of client (partnership or one or more partners), and whether potential or actual conflict exists. Cal Rules of Prof Cond 3-310, 3-600. See chap 1.
- Obtain approval of the requisite number of partners for conversion. Corp C §16955(a).
- Amend partnership agreement to reflect conversion and name change and to make conforming amendments. See Corp C §16952. See forms in §§7.46-7.52.
- File certificate of registration on Secretary of State Form LLP-1 with the Document Filing Support Unit of the California Secretary of State, together with a filing fee of \$70. Corp C §16953(a)-(b); Govt C §12189(a). See form in §7.35.
- Law firms: File application for certificate of registration as LLP with Office of Certification of State Bar in San Francisco, together with fee of \$50 per partner (maximum \$2500). See forms in §§7.39-7.40.
- Accounting firms: File application to change name with State Board of Accountancy. See form in §7.43.
- Architectural firms: File Architect's Business Entity Report Form within 30 days of change to notify California Architects Board of current mailing address and proper name of LLP, together with applicable fee of \$150. Bus & P C §5558. See form in §7.44.
- File notifications or registrations with agencies or courts regulating profession in other jurisdictions in which firm does business.
- Make necessary modifications of or amendments to all employee benefit plans.
- Notify clients of firm conversion to LLP:
  - Carefully plan when and how to notify clients of conversion. See form in §7.53.
  - Consider revising engagement letters with clients for whom firm is providing ongoing services.
  - Revise standard form engagement letter to specify that firm is now LLP and explain what that means. See form in §7.54.
- Notify third parties of firm conversion to LLP, including banks, lessors, accountants, insurance carriers, as well as vendors, suppliers, and others who sell goods and services to the converting partnership on a regular basis. See form in §7.55.
- Review all leases (whether of real or personal property) to determine whether it is prudent to obtain the obligee's consent.
- Review all secured real property financing instruments to ensure that, notwithstanding the provisions of Corp C §16955(b), the conversion will not constitute a breach of any due on sale clause in any deed of trust.
- Stationery and Related Changes:
  - Revise letterhead, envelopes, business cards, and listings. Consider referencing for an interim period of time in signature blocks the former name such as Smith and Smith, LLC, f/k/a (formerly known as) Smith and Smith, a Law Partnership.
  - Notify all employees to use new firm name.
  - Establish procedures to file annual reports and updates, as required, with the Secretary of State, State Bar, California Board of Accountancy, and California Architects Board.

*Comment:* The partners possessing a majority of interests in the current profits of the partnership, or a different vote as may be required by their partnership agreement, must approve the conversion. See §7.45.

Conforming amendments that may be necessary for the partnership agreement include those modifying all

provisions that allocate losses to partners and those requiring partners to contribute capital to pay debts of partnership on its dissolution. The amendments should clarify that partners have no obligation, absent their agreement, to contribute capital to fund losses or debts of firm. Further, the amendments should address circumstances when the partnership will indemnify partners for liabilities incurred by them on behalf of partnership and when the partners may be individually responsible for firm debts. Corp C §16306. See forms in §§7.46-7.52.

The notice to third parties of the firm conversion should not only advise of the conversion, but should also state that the partners will no longer be obligated for the debts and obligations of the partnership after the effective date of the identified conversion date.

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**Source:** Business Law/Selecting and Forming Business Entities/7 Limited Liability Partnerships/ VII. FORMS/§7.35 A. Form: Registered Limited Liability Partnership Registration (Secretary of State Form LLP-1)

## **VII. FORMS**

**§7.35 A. Form: Registered Limited Liability Partnership Registration (Secretary of State Form LLP-1)**





# State of California Secretary of State

File # \_\_\_\_\_

## REGISTERED LIMITED LIABILITY PARTNERSHIP REGISTRATION

**A \$70.00 filing fee must accompany this form.  
IMPORTANT – Read instructions before completing this form.**

This Space For Filing Use Only

1. Name of the registered limited liability partnership or foreign limited liability partnership:  
(End the name with the word "Registered Limited Liability Partnership" or "Limited Liability Partnership" or one of the abbreviations "L.L.P.", "LLP", "R.L.L.P.", or "RLLP.")

2.  Domestic (California)      OR       Foreign (Not in California)      3. Jurisdiction

4. Address of the principal office:      City      State      Zip Code

5. Name the agent for service of process in this state and check the appropriate provision below:  
\_\_\_\_\_ which is  
 an individual residing in California. Proceed to item 6.  
 a corporation which has filed a certificate pursuant to California Corporations Code Section 1505. Proceed to item 7.

6. If an individual, California address of the agent for service of process:  
Address \_\_\_\_\_  
City \_\_\_\_\_ State CA Zip Code \_\_\_\_\_

7. Indicate the business in which the limited liability partnership shall engage: (check one)  
 Practice of Architecture       Practice of Public Accountancy  
 Practice of Law       Related: \_\_\_\_\_

8. Indicate whether the limited liability partnership is complying with the alternative security provisions (California Corporations Code 16956[c]):       Yes. Attach Alternative Security Provision (LLP-3)       No

9. Future Effective Date, if any      Month      Day      Year

10. Other matters to be included in this registration may be set forth on separate attached pages and are made a part of this registration. Total number of pages attached, if any:

11. **Declaration:** By filing this Registered Limited Liability Partnership (LLP-1) with the Secretary of State, the partnership named above is registering as a domestic registered limited liability partnership or foreign limited liability partnership. **(DO NOT ALTER THIS STATEMENT)** Further, I declare that I am the person who executed this instrument, which execution is my act and deed.

\_\_\_\_\_  
Signature of Authorized Partner/Person

\_\_\_\_\_  
Type or Print Name of Authorized Partner/Person      Date

12. RETURN TO:  
NAME      [ ]  
FIRM      [ ]  
ADDRESS  
CITY/STATE  
ZIP CODE      [ ]

## INSTRUCTIONS FOR COMPLETING THE REGISTERED LIMITED LIABILITY PARTNERSHIP REGISTRATION (LLP-1)

**DO NOT ALTER THIS FORM**  
Type or legibly print in black ink.

Statutory filing provisions are found in California Corporations Code Sections 16953 and 16959, unless otherwise indicated.

**FILING FEE:** The fee for filing the Registered Limited Liability Partnership Registration (LLP-1) is \$70 (Government Code Section 12189).

For further information contact the Business Filings Section at (916) 657-5448.

- **Make check(s) payable to the Secretary of State.** Send the executed document and filing fee to:  
California Secretary of State, Document Filing Support Unit, P.O. Box 944228, Sacramento, CA 94244-2280
- The original and at least two copies of the document should be included with your submittal. The Secretary of State will certify two copies of the filed document without charge, **provided that the copies are submitted to this office along with the original to be filed.** Any additional copies submitted with the original will be certified upon request and the payment of the \$8.00 (per copy) certification fee.

**Fill in the items as follows:**

- Item 1.** Enter the name of the registered limited liability partnership or foreign limited liability partnership. The name of the limited liability partnership shall contain the words "Limited Liability Partnership," "Registered Limited Liability Partnership," or one of the abbreviations "L.L.P.," "LLP," "R.L.L.P.," or "RLLP" (California Corporations Code Section 16952).
- Item 2.** Check if the registering limited liability partnership is Domestic (California) or Foreign (not in California). If it is a foreign limited liability partnership, attach an original certificate of good standing from an authorized public official of the jurisdiction under which the foreign limited liability partnership was formed. If issuance of such a certificate is not permissible in that jurisdiction, then attach a statement by the foreign limited liability partnership indicating such.
- Item 3.** Enter the jurisdiction of formation of the foreign limited liability partnership.
- Item 4.** Enter the complete address, including the zip code, of the principal office. Do not abbreviate the name of the city.
- Item 5.** Enter the name and address of agent for service of process in this state. The agent for service of process must be an individual residing in California or a corporation which has filed a certificate pursuant to California Corporations Code Section 1505. Check the appropriate provision.
- Item 6.** If an individual is designated as the agent for service of process, enter an address in California. Do not enter "in care of" (c/o) or abbreviate the name of the city. DO NOT enter an address if a corporation is designated as the agent for service of process.
- Item 7.** Check the appropriate provision indicating whether the limited liability partnership shall engage in the practice of architecture, the practice of public accountancy, the practice of law, or a related activity as provided in Section 16101(6)(A).  
**The inclusion of the practice of architecture as a professional limited liability partnership service permitted by Section 16101 commenced January 1, 1999 and shall extend only until January 1, 2012.**
- Item 8.** Upon registering as a registered limited liability partnership or foreign limited liability partnership, and while transacting intrastate business, the limited liability partnership shall provide security for claims against it. Check the appropriate provision indicating whether the limited liability partnership is complying with the alternative security provisions. If the limited liability partnership is complying with such alternative security provisions, attach the Alternative Security Provision using form LLP-3 (California Corporations Code Section 16956(c)).  
  
If the limited liability partnership is not utilizing the Alternative Security Provisions, information regarding the security for claims against the limited liability partnership or foreign limited liability partnership is not required to be filed with the Secretary of State.
- Item 9.** Enter the future effective date of the Registered Limited Liability Partnership Registration (LLP-1), if any. If none is indicated, the Registration shall be effective upon filing with the California Secretary of State.
- Item 10.** The Registered Limited Liability Partnership Registration (LLP-1) may include other matters that the person filing the Registration determines to include. If other matters are to be included, attach one or more pages setting forth the other matters. Enter the number of pages attached, if any. All attachments should be 8½" x 11", one-sided and legible.
- Item 11.** The Registered Limited Liability Partnership Registration (LLP-1) must be executed with the original signatures of one or more partners authorized to execute a registration, if a domestic limited liability partnership, or by an authorized person if a foreign limited liability partnership.

Execution of this document confirms the following statement, which has been preprinted on this form and may not be altered.  
"BY FILING THIS REGISTERED LIMITED LIABILITY PARTNERSHIP REGISTRATION (LLP-1) WITH THE SECRETARY OF STATE, THE PARTNERSHIP NAMED ABOVE IS REGISTERING AS A DOMESTIC REGISTERED LIMITED LIABILITY PARTNERSHIP OR FOREIGN LIMITED LIABILITY PARTNERSHIP."

- Item 12.** Enter the name and address of the individual or firm to whom a copy of the filing is to be returned.

*Comment:* This form is used to register a domestic or foreign LLP in California. The applicable fee is \$70. Govt C

§12189(a)-(b). The original and at least two copies of the form should be submitted. The Secretary will certify two copies of the original without charge, provided that the copies are submitted with the original. Additional copies submitted with the original may be certified on request and payment of an \$8 per copy certification fee. See the form instructions. The form is available at the Secretary of State's website, <http://www.sos.ca.gov/business/llp/forms/llp-1.pdf>.

The California Secretary of State has preclearance and expedited services for all business entity documents filed with the Secretary of State under the California Corporations Code. "Preclearance service" allows a customer to submit a business entity document in person at the Sacramento office before filing to determine if the document conforms to law and to receive a preclearance response within a guaranteed time frame. Only one copy of the document need be submitted. "Expedited filing" allows a customer to submit a business entity document in person in the Sacramento office and receive a filing response within a guaranteed time frame. For further information, consult the website at <http://www.sos.ca.gov/business/precexp.htm>.

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**Source:** Business Law/Selecting and Forming Business Entities/7 Limited Liability Partnerships/§7.36 B. Form: Limited Liability Partnership Amendment to Registration (Secretary of State Form LLP-2)

**§7.36 B. Form: Limited Liability Partnership Amendment to Registration (Secretary of State Form LLP-2)**





State of California Secretary of State

LIMITED LIABILITY PARTNERSHIP AMENDMENT TO REGISTRATION

A \$30.00 filing fee must accompany this form IMPORTANT - Read instructions before completing this form.

This Space For Filing Use Only

1. Secretary of State File Number: 2. Name of registered limited liability partnership or foreign limited liability partnership:

3. COMPLETE ONLY THE SECTIONS WHERE INFORMATION IS BEING CHANGED. ADDITIONAL PAGES MAY BE ATTACHED IF NECESSARY.

A. Registered limited liability partnership or foreign limited liability partnership name.

B. The address of the principal office:

Address

City

State

Zip Code

C. The name of the Agent for Service of Process.

D. If an individual, California address of the Agent for Service of Process:

Address

City

State CA

Zip Code

E. The business in which the limited liability partnership shall engage: (Check One)

Practice of Architecture

Practice of Public Accountancy

Practice of Law

Related

F. Indicate whether the limited liability partnership is complying with the alternative security provisions.

YES. Attach Alternative Security Provision (LLP-3).

NO

G. Other matters to be included in this Amendment to Registration. Attach additional pages, if necessary.

4. Total number of pages attached, if any:

5. Declaration: It is hereby declared that I am the person who executed this instrument, which execution is my act and deed.

Signature of Authorized Partner

Type or Print Name of Authorized Partner Date

Signature of Authorized Partner

Type or Print Name of Authorized Partner Date

6. RETURN TO:

NAME

FIRM

ADDRESS

CITY/STATE

ZIP CODE

SEC/STATE (REV. 03/2005)

FORM LLP-2 - FILING FEE: \$30.00 Approved by Secretary of State

## INSTRUCTIONS FOR COMPLETING THE AMENDMENT TO REGISTRATION (LLP-2)

- An Amendment to Registration (LLP-2) shall be filed as soon as reasonably practical after any information set forth in the Registration (LLP-1) or a previously filed Amendment to Registration (LLP-2) becomes inaccurate or to add information to the Registration (LLP-1) or Amendment to Registration (LLP-2).

### DO NOT ALTER THIS FORM

Type or legibly print in black ink.

- Attach the fee for filing the Amendment to Registration of Limited Liability Partnership (LLP-2). The fee is thirty dollars (\$30).
- Make check(s) payable to the California Secretary of State.
- Send the executed document and filing fee to:

California Secretary of State  
Document Filing Support Unit  
P.O. Box 944228  
Sacramento, CA 94244-2280

- Fill in the items as follows:

**Item 1.** Enter the file number issued by the California Secretary of State.

**Item 2.** Enter the name of the registered limited liability partnership or foreign limited liability partnership as filed with the California Secretary of State.

**Item 3.** Enter only the information which is being amended. Provide the text of each amendment adopted, using spaces A-G provided and/or attaching additional pages.

**Item 4.** Indicate the number of pages attached. All attachments should be 8½" X 11", one-sided and legible.

**Item 5.** The Amendment to Registration (LLP-2) must be executed with an original signature of one or more authorized partners. Attach additional signature pages, if necessary.

**Item 6.** Enter the name and mailing address of the individual or firm to whom a copy of the filing is to be returned.

- Statutory provisions can be found in Section 16954 and 16960 of the California Corporations Code, unless otherwise indicated.
- For further information contact the Business Filings Section at (916) 657-5448.

*Comment:* This form may be used to amend the registration of a domestic or foreign LLP. The executed document

must be filed with the Secretary of State's Document Filing Support Unit in Sacramento, together with the applicable fee of \$30 (Govt C §12189(c)-(d)), as specified in the form instructions.

An amendment to the LLP registration should be filed as soon as reasonably practicable after any information set forth in the registration (Form LLP-1) or a previously filed amendment to registration (Form LLP-2) becomes inaccurate. This form may also be used to add information to the registration (Form LLP-1) or a previously-filed amendment to registration (Form LLP-2). Corp C §16954. The form is available at <http://www.sos.ca.gov/business/llp/forms/llp-2.pdf>. For information on the Secretary of State's preclearance and expedited filing services, see Comment to the form in §7.35.

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**Source:** Business Law/Selecting and Forming Business Entities/7 Limited Liability Partnerships/§7.37 C. Form: Limited Liability Partnership Alternative Security Provision (Secretary of State Form LLP-3)

**§7.37 C. Form: Limited Liability Partnership Alternative Security Provision (Secretary of State Form LLP-3)**





State of California
Secretary of State

LIMITED LIABILITY PARTNERSHIP
ALTERNATIVE SECURITY PROVISION

IMPORTANT - Read instructions before completing this form.

This Space For Filing Use Only

- 1. [ ] INITIAL FILING (No filing fee is required.) [ ] ANNUAL CONFIRMATION (A \$30 filing fee is required.)

THE UNDERSIGNED HEREBY CONFIRMS THE FOLLOWING:

FILE NUMBER, IF ANY

- 2. CALIFORNIA SECRETARY OF STATE FILE NUMBER, IF ANY

ENTITY NAME

- 3. NAME OF THE REGISTERED LIMITED LIABILITY PARTNERSHIP OR FOREIGN LIMITED LIABILITY PARTNERSHIP

JURISDICTION

- 4. JURISDICTION WHERE THE PARTNERSHIP IS ORGANIZED

PRINCIPAL OFFICE ADDRESS (Do not abbreviate the name of the city.)

- 5. ADDRESS CITY AND STATE ZIP CODE

STATEMENT PURSUANT TO SECTION 16956 (The following statement is required by statute and may not be altered.)

- 6. The registered or foreign limited liability partnership chooses to satisfy the requirements of section 16956 by confirming, pursuant to section 16956(a)(1)(D), 16956(a)(2)(D), or 16956(a)(3)(D) and pursuant to section 16956(c), that, as of the most recently completed fiscal year, the partnership had a net worth equal to or exceeding ten million dollars (\$10,000,000) in the case of a partnership providing accountancy services, fifteen million dollars (\$15,000,000) in the case of a partnership providing legal services, or ten million dollars (\$10,000,000) in the case of a partnership providing architectural services.

EXECUTION

- 7. I DECLARE I AM THE PERSON WHO EXECUTED THIS INSTRUMENT, WHICH EXECUTION IS MY ACT AND DEED.

SIGNATURE OF AUTHORIZED PERSON EXECUTING THIS FORM

DATE

TYPE OR PRINT NAME OF AUTHORIZED PERSON EXECUTING THIS FORM

TITLE OF AUTHORIZED PERSON EXECUTING THIS FORM

- 8. RETURN TO:

NAME

FIRM

ADDRESS

CITY/STATE

ZIP CODE

## INSTRUCTIONS FOR COMPLETING THE ALTERNATIVE SECURITY PROVISION (Form LLP-3)

For easier completion, this form is available on the Secretary of State's website at <http://www.ss.ca.gov/business> and can be viewed, filled in and printed from your computer. The completed form along with the applicable fees can be mailed to Secretary of State, Document Filing Support Unit, P.O. Box 944228, Sacramento, CA 94244-2280 or delivered in person to the Sacramento office, 1500 11th Street, 3rd Floor, Sacramento, CA 95814. If you are not completing this form online, please type or legibly print in black or blue ink.

All statutory references are to the California Corporations Code, unless otherwise indicated.

At the time of registration pursuant to Section 16953, in the case of a registered limited liability partnership, and Section 16959, in the case of a foreign limited liability partnership, and at all times during which those partnerships shall transact intrastate business, every registered limited liability partnership and foreign limited liability partnership, as the case may be, shall be required to provide security for claims against it. (Section 16956.) If the limited liability partnership chooses to comply with the optional security requirement pursuant to Section 16956(c), the limited liability partnership must confirm compliance by filing the Alternative Security Provision (Form LLP-3) as follows:

- **Initial Filing:** The initial Alternative Security Provision (Form LLP-3) shall be filed together with the Registered Limited Liability Partnership Registration (Form LLP-1) at the time of registration with the Secretary of State. Statutory filing provisions can be found in Sections 16953(g) or 16959(g) and 16956(c).
- **Annual Confirmation:** The annual confirmation of the Alternative Security Provision (Form LLP-3) shall be filed annually with the Secretary of State within four months of the completion of the fiscal year. A confirmation filed during any particular fiscal year shall continue to be effective for the first four months of the next succeeding fiscal year. Statutory filing provisions can be found in Section 16956(c).

**FEES:** There is no fee for filing the initial filing of the Alternative Security Provision (Form LLP-3). The fee for filing the annual confirmation of the Alternative Security Provision (Form LLP-3) is \$30.00. A \$15.00 special handling fee is applicable for processing documents delivered in person to the Sacramento office. The \$15.00 special handling fee must be remitted by separate check for each submittal and will be retained whether the documents are filed or rejected. The special handling fee does not apply to documents submitted by mail. Check(s) should be made payable to the Secretary of State.

### Complete the Alternative Security Provision (Form LLP-3) as follows:

- Item 1.** Check the provision indicating whether the Alternative Security Provision (Form LLP-3) is being filed as an initial filing or an annual confirmation.
- Item 2.** Enter the file number issued by the California Secretary of State, if any.
- Item 3.** Enter the name of the registered limited liability partnership or foreign limited liability partnership as filed with the California Secretary of State. (Section 16956(b).)
- Item 4.** Enter the jurisdiction (state or place) in which the registered limited liability partnership or foreign limited liability partnership was organized. (Section 16956(b).)
- Item 5.** Enter the complete address, including the zip code, of the principal office. Please do not abbreviate the name of the city. (Section 16956(b).)
- Item 6.** This statement is required by statute and must not be altered. (Section 16956(b).)
- Item 7.** The Alternative Security Provision (Form LLP-3) must be signed by an authorized member of the registered limited liability partnership or foreign limited liability partnership. (Section 16956(c).)
- Item 8.** Enter the name and address of the individual or firm to whom a copy of the filing should be returned.

*Comment:* This alternative security provision (Secretary of State Form LLP-3) is used when an LLP relies on the net

worth alternative security provision to satisfy the LLP security requirements. See Corp C §§16953(g), 16956(a)(1)(D), (a)(2)(D), (a)(3)(D), (b)-(c), 16959(g). See also §§7.26-7.31. As noted in the form instructions, the form is available at the Secretary of State's website (see <http://www.sos.ca.gov/business/llp/forms/llp-3.pdf>); it can be viewed, completed, and printed from a computer, and the completed form may be mailed to the Document Filing Support Unit in Sacramento or delivered in person to the Sacramento office.

An LLP must confirm that as of the last day of its most recently completed fiscal year, it had a net worth equal to or exceeding the requisite amount: \$10 million for both architectural and accounting LLPs, and \$15 million for law LLPs. Corp C §16956(a)(1)(D), (a)(2)(D), (a)(3)(D). This form must be filed with the registration (Secretary of State Form LLP-1), and Form LLP-1 must state this election. There is no fee for the initial filing.

LLPs using this method must also file an annual confirmation with the Secretary of State's office. Secretary of State Form LLP-3 must be signed by an authorized member of the registered LLP or foreign LLP, and be accompanied by the applicable filing fee of \$30. Corp C §16956(b)-(c); see Govt C §12189(f). To be current in a given year, the partnership form must be on file within 4 months of the completion of the fiscal year. On its filing, the confirmation constitutes full compliance with the financial security requirements as of the beginning of the fiscal year. A confirmation filed during any particular fiscal year continues to be effective for the first 4 months of the next succeeding fiscal year. Corp C §16956(c).

For information on the Secretary of State's preclearance and expedited filing services, see Comment to the form in §7.35.

**Source:** Business Law/Selecting and Forming Business Entities/7 Limited Liability Partnerships/§7.38 D. Form: Limited Liability Partnership Notice of Change of Status (Secretary of State Form LLP-4)

**§7.38 D. Form: Limited Liability Partnership Notice of Change of Status (Secretary of State Form LLP-4)**





State of California Secretary of State

LLP-4

LIMITED LIABILITY PARTNERSHIP NOTICE OF CHANGE OF STATUS

A \$30.00 filing fee must accompany this form.

IMPORTANT - Read instructions before completing this form.

This Space For Filing Use Only

FILE NUMBER

1. Secretary of State File Number

ENTITY NAME (Enter the exact name of the registered limited liability partnership or foreign limited liability partnership.)

2. Name of Registered Limited Liability Partnership or Foreign Limited Liability Partnership

REQUIRED STATEMENT (Check the applicable statement. Note: Only one box may be checked.)

- 3. [ ] The above-named registered limited liability partnership is no longer a registered limited liability partnership... [ ] The above-named foreign limited liability partnership is no longer a foreign limited liability partnership... [ ] The above-named foreign limited liability partnership is, but is no longer required to be, registered under Section 16959 and is hereby withdrawing its registration as a foreign limited liability partnership.

EXECUTION (If additional signature space is necessary, the signature(s) may be made on an attachment to this notice. Any attachments to this notice are incorporated herein by this reference.)

4. I declare I am the person who executed this instrument, which execution is my act and deed.

Signature of Authorized Partner Date Type or Print Name of Authorized Partner

Signature of Authorized Partner Date Type or Print Name of Authorized Partner

Signature of Authorized Partner Date Type or Print Name of Authorized Partner

RETURN TO (Enter the name and the address of the person or firm to whom a copy of the filed document should be returned.)

5. NAME [ ] FIRM ADDRESS CITY/STATE/ZIP [ ]

**INSTRUCTIONS FOR COMPLETING THE NOTICE OF CHANGE OF STATUS (FORM LLP-4)**

For easier completion, this form is available on the Secretary of State's website at <http://www.ss.ca.gov/business> and can be viewed, filled in and printed from your computer. The completed form can be mailed to Secretary of State, Document Filing Support Unit, P.O. Box 944228, Sacramento, CA 94244-2280 or delivered in person to the Sacramento office, 1500 11<sup>th</sup> Street, 3<sup>rd</sup> Floor, Sacramento, CA 95814. If you are not completing this form online, please type or legibly print in black or blue ink. This form should not be altered. This form is only filed in the Sacramento office.

Statutory provisions are found in California Corporations Code section 16954 and 16960. All statutory references are to the California Corporations Code, unless otherwise stated.

- A registered limited liability partnership that ceases to be a registered limited liability partnership must notify the Secretary of State that it is no longer a registered limited liability partnership by filing this Form LLP-4. (Section 16954(b).)
- A foreign limited liability partnership that ceases to be a limited liability partnership in the foreign jurisdiction must notify the Secretary of State that it is no longer a foreign limited liability partnership by filing this Form LLP-4. (Section 16960(b).)
- A foreign limited liability partnership that is, but is no longer required to be, registered under Section 16959 may withdraw its registration by filing this Form LLP-4. (Section 16960(c).)

**FEES:** The fee for filing Form LLP-4 is \$30.00. However, there is a \$15.00 special handling fee for processing a document delivered in person to the Sacramento office. The special handling fee must be remitted by separate check for each submittal and will be retained whether the document is filed or rejected. The preclearance and/or expedited filing of a document *within a guaranteed time frame* can be requested for an additional fee (in lieu of the special handling fee). Please refer to the Secretary of State's website at <http://www.ss.ca.gov/business/precexp.htm> for detailed information regarding preclearance and expedited filing services. The special handling fee or preclearance and expedited filing services are not applicable to documents submitted by mail. Check(s) should be made payable to the Secretary of State.

**COPIES:** The Secretary of State will certify two copies of the filed document without charge, provided that the copies are submitted to the Secretary of State with the document to be filed. Any additional copies submitted will be certified upon request and payment of the \$8.00 per copy certification fee.

**Complete Form LLP-4 as follows:**

- Item 1.** Enter the file number issued by the California Secretary of State.
- Item 2.** Enter the name of the limited liability partnership exactly as it is of record with the California Secretary of State, including the entity ending.
- Item 3.** Check the box next to the applicable statement. Only one box may be checked. For information regarding a final annual tax return, please contact the Franchise Tax Board at (800) 852-5711 (from within the U.S.) or (916) 845-6500 (from outside the U.S.) or visit their website at <http://www.ftb.ca.gov>.
- Item 4.** Form LLP-4 must be signed by one or more partners authorized to execute the notice. If additional signature space is necessary, the signature(s) may be made on an attachment to the notice. All attachments should be 8½" x 11", one-sided and legible.
- Item 5.** Enter the name and the address of the person or firm to whom a copy of the filed document should be returned.

*Comment:* This Notice of Change of Status (Secretary of State Form LLP-4) is used in three situations:

- (1) When a registered LLP ceases to be a registered LLP, it must notify the Secretary of State (Corp C §16954(b));
- (2) When a foreign LLP ceases to be an LLP in the foreign jurisdiction, it must notify the Secretary of State (Corp C §16960(b));
- (3) When a foreign LLP is registered in California but is no longer required to be registered, it may withdraw its registration. Corp C §16960(b).

As noted in the form instructions, the form is available at the Secretary of State's website (see <http://www.sos.ca.gov/business/llp/forms/llp-4.pdf>) and can be viewed, completed, and printed from a computer; the completed form, together with the applicable fee of \$30, must be mailed to the Document Filing Support Unit in Sacramento or delivered in person to the Sacramento office. See Corp C §16954; Govt C §12189(e).

The original and at least two copies of the form should be submitted. The Secretary will certify two copies of the original without charge, provided that the copies are submitted with the original. Additional copies submitted with the original may be certified on request and payment of an \$8 per copy certification fee. See the form instructions.

For information on the Secretary of State's preclearance and expedited filing services, see Comment to the form in §7.35.

**Source:** Business Law/Selecting and Forming Business Entities/7 Limited Liability Partnerships/ E. State Bar Application for Certificate of Registration as LLP/§7.39 1. Form: Application for Issuance of a Certificate of Registration as Limited Liability Partnership (LLP) (State Bar of California)

**E. State Bar Application for Certificate of Registration as LLP**

**§7.39**      **1. Form: Application for Issuance of a Certificate of Registration as Limited Liability Partnership (LLP) (State Bar of California)**



**Application for Issuance of a Certificate of  
Registration as a**

**Limited Liability  
Partnership (LLP)**

FOR OFFICE USE ONLY

\$ \_\_\_\_\_  
 No check enclosed  
File No. \_\_\_\_\_

Complete the entire form. Please read the **instructions**. A **\$50 per partner (not to exceed \$2,500) non-refundable fee must accompany this application**. Make check payable to State Bar of California.

**1. Name of LLP**

\_\_\_\_\_

**2. Address for State Bar LLP Purposes**

\_\_\_\_\_

**3. Contact Person Name and Phone Number**

\_\_\_\_\_ ( ) \_\_\_\_\_

Is the mailing address of the contact person different than the LLP's mailing address in number 2 above?

Yes  No If yes, insert contact person address below:

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

Do you want all State Bar LLP mail (including the Annual Renewal of Certificate of Registration form) to be sent to the LLP address in number 2 above, or to the contact person address?

Check one:  LLP Address  Contact Person Address

**4. Partner(s) Authorized to Act on Behalf of the LLP**

\_\_\_\_\_

**5. Complete and Attach the Following:**

- Attachment 1**, LLP Partners
- Attachment 2**, Non-Partners
- Attachment 3**, Declaration of Compliance with Rule 1-400, Rules of Professional Conduct of the State Bar of California.
- Secretary of State Certification**. Attach an **original** certified copy (including the cover with red date stamp) of the Secretary of State's Registered Limited Liability Partnership Registration (LLP-1). The form is available from the office of the Secretary of State.

If this application is submitted without all required attachments listed above, certification cannot be issued with this application and will not be processed until the attachments are received in our office.

6. Declaration I am \_\_\_\_\_,  
(Name of Partner Authorized to Act on Behalf of the LLP)

and as such I have read the foregoing application and any attachments to it and know the contents thereof, and the same are true of my own knowledge. I declare under penalty of perjury under the laws of the State of California, that the foregoing and any attachments to it are true and correct.

Executed on: \_\_\_\_\_

Signature: \_\_\_\_\_

Print Name: \_\_\_\_\_

**NOTE:** If the authorized partner is a law corporation, set forth the complete name of the corporation. A shareholder of the law corporation may sign on behalf of the corporation wherever the signature of the authorized partner is required. Please specify that you are signing on behalf of the corporation.

---

Return to: State Bar of California  
Limited Liability Partnership (LLP)  
Department No. 05017  
P.O. Box 39000  
San Francisco, CA 94139-5017  
415/538-2100

**Attachment 1**

In Support of Application for Issuance of Certificate of Registration as

**Limited Liability  
Partnership (LLP)**

(Attach additional pages if necessary)

FOR OFFICE USE ONLY:

File No. \_\_\_\_\_

Complete Name of LLP:

**1. A. ATTORNEY PARTNERS**

**NOTE:** If an attorney is a shareholder in a law corporation partner in this LLP (see number 2 below), *do not* list the shareholder as an individual partner below unless the shareholder *and* the law corporation are separate partners in the LLP.

Name	Attorney License / Member Number	Jurisdiction(s) in Which Admitted to Practice

**B. Are any of the above-listed attorney partners:**

- o Shareholders in a California law corporation that is not a partner in the applicant LLP?  
 Yes     No
- o Partners in another LLP?  
 Yes     No

**C. If you checked Yes for any question in B above, complete the following.** In the third column, indicate which type of Law Practice Relationship with the Applicant LLP applies: C for "Of Counsel"; P for In Partnership; A for In Association; N for No Law Practice Relationship.

Name of Law Corporation or LLP	CA State Bar Cert. of Reg. No.	Law Practice Relationship: C, P, A or N

**NOTE:** If the Certificate of Registration for any law corporation listed above is suspended, the shareholder(s) must advise in writing whether they wish to reinstate the corporation to active status or revoke the Certificate of Registration. If you have recently resigned from an LLP and have not notified us, please send us a signed letter of resignation. If you have terminated an LLP and have not notified us, please send us an **original** certified copy (including the cover with the red date stamp) of the Limited Liability Partnership Notice of Change of Status form (LLP-4) from the **The Secretary of State**.

**2. LAW CORPORATION PARTNERS**

**NOTE:** If you list the name of a law corporation partner below, *do not* list the shareholder as an individual attorney partner in number 1 above unless the shareholder *and* the law corporation are separate partners in the LLP.

Name of Law Corporation	State of Incorporation	CA State Bar Cert. of Reg. No. (If Applicable)

**Attachment 2**

In Support of Application for Issuance of Certificate of Registration as a

**Limited Liability  
Partnership (LLP)**

(Attach Additional Pages if Necessary)

**FOR OFFICE USE ONLY:**

File No. \_\_\_\_\_

**Complete Name of LLP:**

\_\_\_\_\_

**NON-PARTNERS**

**1. Employees**

Name	Attorney License / Member Number	Jurisdiction(s) in Which Admitted to Practice

**2. Non-Partner Law Corporation**

In addition to naming the law corporation, you must list the name(s) of all shareholders and all individuals practicing law on behalf of the law corporation, including all persons practicing in association, partnership and/or "of counsel" with the corporation in a continuous relationship.

**NOTE:** Do not list any law corporation listed on Attachment 1 in this section.

A. Name of Law Corporation	State of Incorporation	CA State Bar Cert. of Reg. No. (If Applicable)	Relationship (e.g. employee, "of counsel")

B. Name of Shareholder	Attorney License / Member Number	Jurisdiction(s) in Which Admitted to Practice

C. Name of Non-Shareholder Practicing on Behalf of Law Corporation	Attorney License / Member Number	Jurisdiction(s) in Which Admitted to Practice

**3. Persons Practicing "Of Counsel" to the LLP**

Name	Attorney License / Member Number	Jurisdiction(s) in Which Admitted to Practice

**4. Persons Practicing on Behalf of a Partnership in Which the LLP Is a Partner**

Name	Attorney License / Member Number	Jurisdiction(s) in Which Admitted to Practice

**5. Persons Practicing on Behalf of an Association with Which the LLP Has Established a Relationship**

Name	Attorney License / Member Number	Jurisdiction(s) in Which Admitted to Practice

**6. Other (Co-Counsel, Contract Attorney, Person Sharing Office Space)**

Name/Relationship	Attorney License / Member Number	Jurisdiction(s) in Which Admitted to Practice

**Attachment 3**

In Support of Application for Issuance of Certificate of Registration  
as a

**Limited Liability  
Partnership (LLP)**

FOR OFFICE USE ONLY:

File No. \_\_\_\_\_

**LIMITED LIABILITY PARTNERSHIP**

**DECLARATION OF COMPLIANCE WITH RULE 1-400,  
RULES OF PROFESSIONAL CONDUCT  
OF THE STATE BAR OF CALIFORNIA**

The undersigned, on behalf of .

Complete Name of LLP: \_\_\_\_\_

does hereby certify that the name of this limited liability partnership complies with the Rules of Professional Conduct of the State Bar of California, Rule 1-400.

**DECLARATION**

I am \_\_\_\_\_,

(Partner Authorized to Act on Behalf of the LLP)

and do hereby make this declaration on behalf of said partnership. I have read the foregoing and the same is true of my own knowledge. I declare, under penalty of perjury under the laws of the State of California, that the foregoing is true and correct.

Executed on: \_\_\_\_\_

Signature: \_\_\_\_\_

Print Name: \_\_\_\_\_  
(Partner authorized to act on behalf of the partnership)

## **California Rules of Professional Conduct Rule 1-400. Advertising and Solicitation**

- (A) For purposes of this rule, "communication" means any message or offer made by or on behalf of a member concerning the availability for professional employment of a member or a law firm directed to any former, present, or prospective client, including but not limited to the following:
- (1) Any use of firm name, trade name, fictitious name, or other professional designation of such member or law firm; or
  - (2) Any stationery, letterhead, business card, sign, brochure, or other comparable written material describing such member, law firm, or lawyers; or
  - (3) Any advertisement (regardless of medium) of such member or law firm directed to the general public or any substantial portion thereof; or
  - (4) Any unsolicited correspondence from a member or law firm directed to any person or entity.
- (B) For purposes of this rule, a "solicitation" means any communication:
- (1) Concerning the availability for professional employment of a member or a law firm in which a significant motive is pecuniary gain; and
  - (2) Which is:
    - (a) delivered in person or by telephone, or
    - (b) directed by any means to a person known to the sender to be represented by counsel in a matter which is a subject of the communication.
- (C) A solicitation shall not be made by or on behalf of a member or law firm to a prospective client with whom the member or law firm has no family or prior professional relationship, unless the solicitation is protected from abridgment by the Constitution of the United States or by the Constitution of the State of California. A solicitation to a former present client in the discharge of a member's or law firm's professional duties is not prohibited.
- (D) A communication or a solicitation (as defined herein) shall not:
- (1) Contain any untrue statement; or
  - (2) Contain any matter, or present or arrange any matter in a manner or format which is false, deceptive, or which tends to confuse, deceive, or mislead the public; or
  - (3) Omit to state any fact necessary to make the statements made, in the light of circumstances under which they are made, not misleading to the public; or
  - (4) Fail to indicate clearly, expressly, or by context, that it is a communication or solicitation, as the case may be; or
  - (5) Be transmitted in any manner which involves intrusion, coercion, duress, compulsion, intimidation, threats, or vexatious or harrasing conduct.
  - (6) State that a member is a "certified specialist" unless the member holds a current certificate as a specialist issued by the Board of Legal Specialization, or any other entity accredited by the State Bar to designate specialists pursuant to standards adopted by the Board of Governors, and states the complete name of the entity which granted certification.

- (E) The Board of Governors of the State Bar shall formulate and adopt standards as to communications which will be presumed to violate this rule 1-400. The standards shall only be used as presumptions affecting the burden of proof in disciplinary proceedings involving alleged violations of these rules. "Presumption affecting the burden of proof" means that presumption defined in Evidence Code sections 605 and 606. Such standards formulated and adopted by the Board, as from time to time amended, shall be effective and binding on all members.
- (F) A member shall retain for two years a true and correct copy or recording of any communication made by written or electronic media. Upon written request, the member shall make any such copy or recording available to the State Bar, and, if requested, shall provide to the State Bar evidence to support any factual or objective claim contained in the communication.

(former rule 1-400 (D)(6) repealed by order of the Supreme Court effective November 30, 1992. New rule 1-400 (D)(6) added by order of the Supreme Court effective June 1, 1997.)

### **Standards:**

Pursuant to rule 1-400(E) the Board of Governors of the State Bar has adopted the following standards, effective May 27, 1989, unless noted otherwise, as forms of "communication" defined in rule 1-400(A) which are presumed to be in violation of rule 1-400:

- (1) A "communication" which contains guarantees, warranties, or predictions regarding the result of the representation.
- (2) A "communication" which contains testimonials about or endorsements of a member unless such communication also contains an express disclaimer such as "this testimonial or endorsement does not constitute a guarantee, warranty, or prediction regarding the outcome of your legal matter."
- (3) A "communication" which is delivered to a potential client whom the member knows or should reasonably know is in such a physical, emotional, or mental state that he or she would not be expected to exercise reasonable judgment as to the retention of counsel.
- (4) A "communication" which is transmitted at the scene of an accident or at or enroute to a hospital, emergency care center, or other health care facility.
- (5) A "communication," except professional announcements, seeking professional employment for pecuniary gain, which is transmitted by mail or equivalent means which does not bear the word "Advertisement," "Newsletter" or words of similar import in 12 point print on the first page. If such communication, including firm brochures, newsletters, recent legal development advisories, and similar materials, is transmitted in an envelope, the envelope shall bear the word "Advertisement," "Newsletter" or words of similar import on the outside thereof.
- (6) A "communication" in the form of a firm name, trade name, fictitious name, or other professional designation which states or implies a relationship between any member in private practice and a government agency or instrumentality or a public or non-profit legal services organization.
- (7) A "communication" in the form of a firm name, trade name, fictitious name, or other professional designation which states or implies that a member has a relationship to any other lawyer or a law firm as a partner or associate, or officer or shareholder pursuant to Business and Professions Code sections 6160-6172 unless such relationship in fact exists.
- (8) A "communication" which states or implies that a member or law firm is "of counsel" to another lawyer or a law firm is "of counsel" to another lawyer or a law firm unless the former has a relationship with the latter (other than as a partner or associate, or officer or shareholder pursuant to Business and Professions Code sections 6160-6172) which is close, personal, continuous, and regular.

- (9) A "communication" in the form of a firm name, trade name, fictitious name, or other professional designation used by a member or law firm in private practice which differs materially from any other such designation used by such member or law firm at the same time in the same community.
- (10) A "communication" which implies that the member or law firm is participating in a lawyer referral service which has been certified by the State Bar of California or as having satisfied the Minimum Standards for Lawyer Referral Services in California, when that is not the case.
- (11) Note: standard (11) was in effect until June 1, 1997, and as of that date was repealed (see rule 1-400 (D)(6).)
- (12) A "communication," except professional announcements, in the form of an advertisement primarily directed to seeking professional employment primarily for pecuniary gain transmitted to the general public or any substantial portion thereof by mail or equivalent means or by means of television, radio, newspaper, magazine or other form of commercial mass media which does not state the name of the member responsible for the communication. When the communication is made on behalf of a law firm, the communication shall state the name of at least one member responsible for it.
- (13) A "communication" which contains a dramatization unless such communication contains a disclaimer which states "this is a dramatization" or words of similar import.
- (14) A "communication" which states or implies "no fee without recovery" unless such communication also expressly discloses whether or not the client will be liable for costs.
- (15) A "communication" which states or implies that a member is able to provide legal services in a language other than English unless the member can actually provide legal services in such language or the communication also states in the language of the communication (a) the employment title of the person who speaks such language and (b) that the person is not a member of the State Bar of California, if that is the case.
- (16) An unsolicited "communication" transmitted to the general public or any substantial portion thereof primarily directed to seeking professional employment primarily for pecuniary gain which sets forth a specific fee or range of fees for a particular service where, in fact, the member charges a greater fee than advertised in such communication within a period of 90 days following dissemination of such communication, unless such communication expressly specifies a shorter period of time regarding the advertised fee. Where the communication is published in the classified or "yellow pages" section of telephone, business or legal directories or in other media not published more frequently than once a year, the member shall conform to the advertised fee for a period of one year from initial publication, unless such communication expressly specifies a shorter period of time regarding the advertised fee. (Amended by order of Supreme Court, operative September 14, 1992. Standard (5) amended by the Board of Governors, effective May 11, 1994. Standards (12) - (16) added by the Board of Governors, effective May 11, 1994.

**Instructions for Application for Issuance of Certificate of Registration as**

**a**

**Limited Liability  
Partnership (LLP)**

Office of Certification -  
LLP  
The State Bar of California  
415/538-2100  
[LLP@calbar.ca.gov](mailto:LLP@calbar.ca.gov)

**A \$50 per partner (not to exceed \$2,500) non-refundable fee must accompany this application.**

**SPECIFIC INSTRUCTIONS**

(Numbers Correspond to Questions on the Application Form.)

1. Fill in the **complete** name of the limited liability partnership (LLP). This name must be the same name set forth on the Secretary of State's Registered Limited Liability Partnership Registration (LLP-1).
2. Fill in the address of record for the LLP. Please note that the "official LLP address of record" is maintained by the **Office of Certification**. To change the address of record of the LLP or to file any special reports other than the Annual Report, notification must be forwarded in writing to The Office of Certification, LLP, The State Bar of California, 180 Howard Street, San Francisco, CA 94105. Note that change of an individual's bar member's official State Bar address must be sent to the Membership Records Office of the State Bar. **Changing your address with one office does not change it with the other office.**
3. Fill in the name and the direct dial telephone number, if available, of the person the State Bar will contact should issues arise. If the mailing address of the contact person is different than where the LLP practices, answer all questions in this box.
4. Fill in the name of the partner or partners authorized to act on behalf of the LLP for State Bar purposes. If the authorized partner is a law corporation, set forth the complete name of the corporation. A shareholder of the law corporation may sign on behalf of the corporation wherever the signature of the authorized partner is required. Please specify that you are signing on behalf of the corporation.
5. Complete and submit the following:

**A. Attachment 1.** List the names of all attorney and/or law corporation partners in the LLP. Attorney License/Member Number need only be provided for attorneys licensed to practice in California. For Jurisdiction(s) in which Admitted to Practice, list only states and/or countries. If your LLP includes a partner or partners who are licensed only in a non-U.S. jurisdiction, see State Bar LLP **Rule 4.3**. If a partner is licensed in more than one jurisdiction, list the primary jurisdiction first. (A partner licensed to practice law in California will be entered as a California partner unless you specify otherwise.) You may attach additional pages if necessary.

**NOTE:** If you list the name of a law corporation partner on Attachment 1, do not list the shareholder(s) as an individual attorney partner(s), unless the shareholder(s) *and* the law corporation are separate partners in the LLP.

B. **Attachment 2.** List the names of all non-partners, including employees and all other persons and/or law corporations practicing in partnership, association and/or "of counsel" with the LLP in a continuous relationship. "Continuous relationship" means co-counsel, contract attorneys, any person sharing office space, and/or any person practicing "of counsel" to the LLP. You may attach additional pages if necessary.

**NOTE:** Attorney License/Member Number need only be provided for attorneys licensed to practice in California. For Jurisdiction(s) in which Admitted to Practice, list only states and/or countries.

C. **Attachment 3.** See State Bar **LLP Rule 3.3** and **California Rule of Professional Conduct 1-400**.

D. **Secretary of State Certification.** Attach an **original** certified copy (including the cover with the red date stamp) of the Secretary of State's Registered Limited Liability Partnership Registration (LLP-1). The form is available from the office of **The Secretary of State**.

**NOTE:** Certification cannot be issued and the application will not be processed until all attachments are received in our office.

6. The declaration must be signed by a partner authorized to act on behalf of the LLP. If the authorized partner is a law corporation, set forth the complete name of the corporation. A shareholder of the law corporation may sign on behalf of the corporation. Please specify that you are signing on behalf of the corporation. The application is not complete unless it has an **original** signature. No copies of signature, please. Without the original signed declaration by a partner authorized to act on behalf of the LLP, certification cannot be issued and the application will not be processed until we receive a declaration with the original signature of an authorized partner.

#### **SPECIAL NOTE**

If you will be forwarding a separate list of partners, or separate lists of partners who practice in different offices or jurisdictions, as an addendum to Attachment 1, please use the following format:

Last Name, First Name, Middle Initial *in alphabetical order*; Jurisdiction(s) Where Licensed to Practice (list the primary jurisdiction first); California State Bar Attorney License Member Number (if applicable).

*Do not list partners and non-partners together on one list. If a "mixed list" is submitted, certification cannot be issued and the application will not be processed until you submit separate lists of partners and non-partners.*



**Source:** Business Law/Selecting and Forming Business Entities/7 Limited Liability Partnerships/§7.40 2. Form: Limited Liability Partnership Rules and Regulations (State Bar of California)

**§7.40      2. Form: Limited Liability Partnership Rules and Regulations (State Bar of California)**



## Limited Liability Partnership (LLP)

### Rules and Regulations

(adopted by the State Bar Board of Governors 10/26/95; revised 6/1/97; revised 6/10/00)

Office of Certification -  
LLP  
The State Bar of California  
180 Howard Street  
San Francisco, CA  
94105-1639  
415/538-2100  
[dina.diloreto@calsb.org](mailto:dina.diloreto@calsb.org)

- 1.0 Purpose
- 2.0 Definitions
- 3.0 Eligibility for Certification
- 4.0 Application for Certification
- 5.0 Security for Claims Against a Limited Liability Partnership
- 6.0 Denial of Application
- 7.0 Duration of Certificate of Registration
- 8.0 Involuntary Termination of Certificate of Registration
- 9.0 Termination at Request of Partnership
- 10.0 Annual Renewal
- 11.0 Special Reports
- 12.0 Confidentiality

#### 1.0 PURPOSE

The purpose of the Limited Liability Partnership Rules and Regulations is to provide for the registration of California attorneys to practice law as a limited liability partnership.

#### 2.0 DEFINITIONS

- 2.1 A "Limited Liability Partnership" is a partnership which has a currently effective certificate of registration as a limited liability partnership from the State Bar. It does not include "related" partnerships pursuant to Corporations Code Sections 16101(4)(A)(3) and 16101(6)(A)(iii).
- 2.2 The "Rules" are these Limited Liability Partnership Rules and Regulations.
- 2.3 The "State Bar" is the chief executive officer of the State Bar, or a person or persons designated by the chief executive officer, who shall have the authority to administer and interpret these Rules.

### 3.0 ELIGIBILITY FOR CERTIFICATION

To be eligible to become certified as a limited liability partnership, an applicant must:

- 3.1 Be organized and exist as a limited liability partnership certified by the Secretary of State pursuant to Corporations Code Sections 16953 or 16959;
- 3.2 Ensure that each partner is an active member of the State Bar or is licensed and entitled to practice law in another jurisdiction, and each partner and employee of the applicant who practices law in California on behalf of the limited liability partnership is a member of the State Bar of California on active status or is otherwise authorized to practice law in California;
- 3.3 Agree that the only name under which the limited liability partnership will practice law in California is the name filed with the office of the State Bar responsible for regulating the limited liability partnership program, that the name complies with the California Rules of Professional Conduct, and that the name shall include the words "Registered Limited Liability Partnership" or "Limited Liability Partnership" or one of the abbreviations "L.L.P.," "LLP," "R.L.L.P.," or "RLLP" as the last words or letters of its name.
- 3.4 Have at the time of application, and agree to maintain for the entire period of certification, the security for claims required pursuant to Corporations Code section 16956; and
- 3.5 Agree to comply with the laws of the State of California, the California Rules of Professional Conduct, the Rules and Regulations of the State Bar, and these Rules, insofar as they are applicable to partners and employees of an applicant.

### 4.0 APPLICATION FOR CERTIFICATION

All Applications for Certification must be submitted:

- 4.1 On the form provided by the State Bar;
- 4.2 With all the information requested on the form, including any supplemental documentation requested;
- 4.3 For each partner of the limited liability partnership licensed in a foreign country but not in this state or in any other state, territory, or possession of the United States, with a certificate from the authority having final jurisdiction over the practice of law, which shall verify the partner's admission to practice law in the foreign country, the date thereof, and the fact that the partner is currently in good standing and currently eligible to practice law as an attorney or counselor at law or the equivalent. If the certification is not in English, there shall be included with the certification a duly authenticated English translation of the certificate;
- 4.4 With the appropriate non-refundable processing fee;
- 4.5 At the office of the State Bar responsible for regulating the limited liability partnership program; and
- 4.6 Signed and verified by a partner authorized to act on behalf of the applicant.

## 5.0 SECURITY FOR CLAIMS AGAINST A LIMITED LIABILITY PARTNERSHIP

- 5.1 A limited liability partnership shall maintain security for claims against it for acts, errors and omissions arising out of the practice of law as set forth in Corporations Code Section 16956.
- 5.2 For purposes of determining the amount of security for claims to be provided by the limited liability partnership, "licensed persons rendering professional services" as used in Corporations Code Section 16956(a)(2) shall include all persons practicing law on behalf of:
  - 5.2.1 The limited liability partnership or held out by the limited liability partnership as being available to practice law on behalf of it, including "of counsel";
  - 5.2.2 A partnership in which the limited liability partnership is a partner or held out by such partnership as being available to practice law on behalf of the partnership, including "of counsel";
  - 5.2.3 An association with which the limited liability partnership has established a relationship of a continuous nature or held out by such association, with the consent of the limited liability partnership, as being available to practice law on behalf of the association, including "of counsel"; and
  - 5.2.4 A law corporation which is a partner in the limited liability partnership, or any person held out by such law corporation as being available to practice law on behalf of the law corporation, including "of counsel".

## 6.0 DENIAL OF APPLICATION

- 6.1 If the State Bar determines to deny an application for certification for any reason, the State Bar shall mail a Notice of Denial of Certification to the applicant that sets forth the reasons for the proposed denial. A request for additional information is not a denial of an application. If no response to the request for additional information is received within 60 days, the application shall be deemed to have been abandoned by the applicant. Thereafter, the applicant must submit a new application pursuant to Section 4.0.
- 6.2 An applicant may request, in writing, a hearing on the denial to approve its application within 15 days after such Notice of Denial of Certification is dated.
- 6.3 The appropriate Board Committee shall conduct a hearing within 60 days of the State Bar's receipt of the request.
- 6.4 Should the outcome of the hearing permitted by Section 6.2 be adverse to the applicant, the applicant may appeal such decision pursuant to the provisions of California Rule of Court 952(d).
- 6.5 All proceedings under Section 6.0 shall be confidential, unless otherwise requested by the applicant or ordered by the Board of Governors. Insofar as applicable, the Rules of Procedure of the State Bar shall apply to such proceedings. For the purpose of applying the Rules of Procedure, "member" therein shall be deemed to mean "limited liability partnership".

## 7.0 DURATION OF CERTIFICATE OF REGISTRATION

- 7.1 The effective date of the Certificate of Registration shall be the date on which the applicant has filed with the State Bar all material required pursuant to Section 4.0. A later effective date may be granted if requested by the applicant prior to the issuance of the Certificate of Registration. An earlier effective date may be granted only to an applicant who has registered as a limited liability partnership with the Secretary of State prior to the effective date of these Rules, but in no case shall the effective date be earlier than the date of registration with the Secretary of State.
- 7.2 A Certificate of Registration shall remain in effect until terminated pursuant to the earliest of the following occurrences:
- 7.2.1 The Certificate of Registration is terminated by the State Bar without the consent of the limited liability partnership pursuant to Section 8.0; or
  - 7.2.2 The Certificate of Registration is terminated by the State Bar at the written request of the limited liability partnership pursuant to Section 9.0.

## 8.0 INVOLUNTARY TERMINATION OF CERTIFICATE OF REGISTRATION

- 8.1 The Certificate of Registration of a limited liability partnership shall be deemed to be terminated if:
- 8.1.1 The limited liability partnership fails timely to file a completed Annual Renewal;
  - 8.1.2 There is only one partner in the limited liability partnership; or
  - 8.1.3 The State Bar is notified that the limited liability partnership has been suspended by the California Secretary of State or by the California State Franchise Tax Board.
- 8.2 When there is reason to believe that a limited liability partnership has violated or is about to violate these Rules or any other pertinent statute, rule or regulation, the State Bar shall mail a notice to the limited liability partnership directing the limited liability partnership to show cause why its Certificate of Registration should not be terminated for specified acts. These proceedings shall be conducted in accordance with the process set forth in Sections 6.2, 6.3, 6.4 and 6.5.

## 9.0 TERMINATION AT REQUEST OF PARTNERSHIP

To terminate a Certificate of Registration at the request of the limited liability partnership, the State Bar must receive an original document certified by the Secretary of State showing that the entity has ceased to exist as a limited liability partnership. The termination shall be effective as of the date the limited liability partnership is dissolved by the Secretary of State.

## 10.0 ANNUAL RENEWAL

Each limited liability partnership shall file an Annual Renewal. Pursuant to Section 8.1.1, failure to timely file a completed Annual Renewal shall result in termination of the limited liability partnership. All Annual Renewals must be submitted:

- 10.1 On the form provided by the State Bar;
- 10.2 On or before the date set by the State Bar;
- 10.3 With all the information requested on the Annual Renewal including any supplemental documentation requested;
- 10.4 With the appropriate renewal fee and any penalty for late filing, as appropriate;
- 10.5 At the office of the State Bar responsible for regulating the limited liability partnership program; and
- 10.6 Signed and verified by a partner authorized to act on behalf of the limited liability partnership.

## 11.0 SPECIAL REPORTS

Each limited liability partnership shall file a Special Report with the office of the State Bar responsible for regulating the limited liability partnership program, in a form acceptable to the State Bar, signed and verified by a partner authorized to act on behalf of the limited liability partnership, setting forth any changes in the limited liability partnership within 45 days of the change, as follows:

- 11.1 Any change in the limited liability partnership's official State Bar address (filing of an address change with Membership Records does not satisfy the requirement set forth in this Section);
- 11.2 Any change in the name of the limited liability partnership; or
- 11.3 Any change in the designated partner or partners authorized to act on behalf of the limited liability partnership.

## 12.0 CONFIDENTIALITY

An applicant's or a limited liability partnership's status as it relates to the limited liability partnership program and any other information provided to the State Bar or its representatives pursuant to these Rules is not confidential and shall be disclosed upon request of any interested person, except to the extent that disclosure is prohibited by law. In addition, any partnership agreements provided to the State Bar or its representatives pursuant to these Rules shall be confidential.



**Source:** Business Law/Selecting and Forming Business Entities/7 Limited Liability Partnerships/ F. State Board of Accountancy Packet/§7.41 1. Form: General Partnership/Limited Liability Partnership Check Sheet (Board of Accountancy Form 11L-35)

**F. State Board of Accountancy Packet**

- §7.41**      **1. Form: General Partnership/Limited Liability Partnership Check Sheet (Board of Accountancy Form 11L-35)**



**CALIFORNIA BOARD OF ACCOUNTANCY**

2000 EVERGREEN STREET, SUITE 250  
 SACRAMENTO, CA 95815-3832  
 TELEPHONE: (916) 263-3680  
 FACSIMILE: (916) 263-3676  
 WEB ADDRESS: <http://www.dca.ca.gov/cba>

**GENERAL PARTNERSHIP / LIMITED LIABILITY PARTNERSHIP CHECK SHEET**

**A GENERAL PARTNERSHIP OR A LIMITED LIABILITY PARTNERSHIP (LLP) IS REQUIRED TO BE APPROVED FOR LICENSURE BY THE CALIFORNIA BOARD OF ACCOUNTANCY (Board) BEFORE PRACTICING OR HOLDING OUT TO THE PUBLIC AS AN ACCOUNTANCY PARTNERSHIP.**

- ❖ The application must be completed in its entirety.
- ❖ All requested documents must accompany the application.
- ❖ Copies of the requested documentation are acceptable.
- ❖ The application and initial license fees of \$350 must accompany the application.

If the application is not complete, it will be returned for appropriate documentation. Once an application is complete, allow eight to ten weeks for processing.

The following check sheet is intended to assist you in filing a complete application.

**COMPLETION OF THE APPLICATION FOR LICENSURE AS A GENERAL PARTNERSHIP**

General Partnerships are not required to register with the Secretary of State.

 FEES FOR LICENSURE

The application and initial license fees are \$350. A check, money order or cashier's check payable to the California Board of Accountancy must accompany the application.

 APPROPRIATE USE OF PARTNERSHIP NAME

The name of the firm must meet the requirements set forth in Sections 5060 and 5073 of the Business and Professions Code and Section 75.5 of Title 16 of the California Code of Regulations. Because Board staff are unable to provide guidance regarding firm structure and whether a particular firm name will be considered false or misleading by your clients, licensees are encouraged to contact their legal counsel for guidance.

 PARTNERS OF THE FIRM

Section 5072(b)(1) of the Business and Professions Code requires at least one general partner to hold a valid California license to practice as a certified public accountant (CPA), public accountant (PA) or accountancy corporation, or to be an applicant for a certificate as a CPA under Sections 5087 and 5088. Section 5072(b)(3) requires each partner not personally engaged in the practice of public accountancy within California to be a CPA or PA in good standing of some state, except as permitted by Section 5079.

 OUT-OF-STATE PARTNERS

Section 5072(b)(2) of the Business and Professions Code requires each partner personally engaged in the practice of public accountancy in this state as defined by Section 5051 to hold a valid permit to practice or to have applied for a certificate as a CPA in good standing of some state, except as permitted by Section 5079.

An out-of-state CPA or PA wanting to practice in California must file an application for licensure and meet the requirements set forth in Sections 5087 and 5088 of the Business and Professions Code, as well as Section 21 of Title 16 of the California Code of Regulations.

Section 5073(e) of the Business and Professions Code requires that any registration of a partnership granted in reliance upon Sections 5087 and 5088 must be terminated if the Board rejects the application under Sections 5087 and 5088 of the general partner who signed the application for registration as a partnership, or any partner personally engaged in the practice of public accountancy in California, or any resident manager of a partnership in charge of an office in California.

RESIDENT MANAGER(S)

Section 5072(b)(4) of the Business and Professions Code requires each resident manager in charge of an office of the firm in California to be a licensee in good standing in California or to have applied for a certificate as a CPA under Sections 5087 and 5088.

Section 5078 of the Business and Professions Code requires in each office of a CPA or PA in California, which is not under the personal management of such an accountant, respectively, that the work be supervised by a CPA or PA.

NONLICENSEE PARTNER(S)

Section 5079 of the Business and Professions Code permits minority ownership of public accounting firms by individuals who are not licensed as CPAs or PAs. This section applies to both accountancy partnerships and accountancy corporations.

At initial licensure and at license renewal, Section 51 of Title 16 of the California Code of Regulations requires firms with nonlicensee owners to certify that any nonlicensee owner with his or her principal place of business in this state has been informed of the rules of professional conduct applicable to accountancy firms.

This declaration must be signed by a licensed partner of the firm (see page 3 of the application).

The number of licensed partners must be greater than the number of nonlicensed partners. The only exception is that a firm with only two partners may have one partner who is a nonlicensee.

FEDERAL EMPLOYER ID NUMBER

Disclosure of the firm's federal employer identification number (FEIN) is mandatory. Section 30 of the Business and Professions Code and Public Law 94-455 (42 USCA 405(c)(2)(C)) authorize collection of the FEIN. The FEIN will be used exclusively for tax enforcement purposes, for purposes of compliance with any judgment or order for family support in accordance with Section 17520 of the Family Code, or for verification of licensure by a licensing entity where licensure is reciprocal with the requesting state. **Applications without a FEIN will be returned** (see page 2 of the application).

GENERAL PARTNERSHIP STATEMENT

The declaration statement must be signed and dated by a partner who is a licensee with a valid license to practice public accounting. Firms with nonlicensee owners must complete the nonlicensee owner(s) declaration (see page 2 of the application).

PARTNERSHIP RENEWAL CYCLE

Pursuant to Sections 5070.5, 5070.6, 5070.7, and 5070.8 of the Business and Professions Code, a partnership license must be renewed every two years to remain in good standing. The expiration date is based on the month and year the Board originally approved the application.

If approved in an even-numbered year, the license will expire each even-numbered year on the last day of the month in which it was originally approved. If approved in an odd-numbered year, the license will expire each odd-numbered year on the last day of the month in which it was originally approved.

The Board mails renewal forms with instructions approximately two months before the firm's license expiration date. If your renewal form is not completed, mailed, and postmarked by the license expiration date, your firm's practice rights cease until all deficiencies are corrected, and the license is renewed by the Board.

An expired partnership license may be renewed up to five years after its expiration date. A license that is not renewed within five years is cancelled and cannot be renewed, restored, or reinstated.

CHANGE OF ADDRESS, PARTNERS, AND/OR FIRM NAME

Section 3 of Title 16 of the California Code of Regulations requires a licensed firm to notify the Board of any change in its address of record within 30 days after the change. Section 5073(d) of the Business and Professions Code also requires notification be given to the Board within one month after the admission to, or withdrawal of, a partner from any registered partnership.

If you are changing the firm's address, telephone number, or adding or disassociating a partner without changing the firm's name, you may notify the Board on your firm's letterhead.

If the firm's name is changing as a result of adding or disassociating a partner, you must complete the *Partnership Name Change Application*. The firm's name change must be approved by the Board before holding out and practicing under an amended name. The name change application and accompanying information is available on the Board's Web site at [www.dca.ca.gov/cba](http://www.dca.ca.gov/cba) or by calling the Board at (916) 263-3947.

CHANGE TO A LIMITED LIABILITY PARTNERSHIP

To change a general partnership to a LLP, contact the California Secretary of State at its Web site at [www.ss.ca.gov/business](http://www.ss.ca.gov/business) for filing information.

DISSOLUTION OF A GENERAL PARTNERSHIP

To dissolve a general partnership, submit a letter to the Board stating the firm has dissolved and provide the effective date. Upon receipt of the letter, your firm's license will be cancelled.

**COMPLETION OF THE LIMITED LIABILITY PARTNERSHIP APPLICATION FOR LICENSURE**

LLPs are required to file and be approved as a LLP with the California Secretary of State before filing an application for licensure with the Board. An endorsed copy of the LLP Registration from the Secretary of State must accompany the application.

Information on filing for *Registration of Limited Liability Partnership* is available on the Secretary of State's Web site at [www.ss.ca.gov/business](http://www.ss.ca.gov/business).

FEES FOR LICENSURE

The application and initial license fees are \$350. A check, money order, or cashier's check made payable to the California Board of Accountancy must accompany the application.

APPROPRIATE USE OF PARTNERSHIP NAME

The name of the firm must meet the requirements set forth in Sections 5060 and 5073 of the Business and Professions Code and Section 75.5 of Title 16 of the California Code of Regulations. Because Board staff are unable to provide guidance regarding firm structure and whether a particular firm name will be considered false or misleading by your clients, licensees are encouraged to contact their legal counsel for guidance.

Section 16952 of the Corporations Code (Limited Liability Partnerships) requires that the name of a registered limited liability partnership contains the words "Registered Limited Liability Partnership," "Limited Liability Partnership," or one of the abbreviations "L.L.P.," "LLP," "R.L.L.P.," or "RLLP" as the last words or letters of its name.

Section 16958 of the Corporations Code requires that the name of a foreign limited liability partnership transacting intrastate business in California contains the words "Registered Limited Liability Partnership," "Limited Liability Partnership," or one of the abbreviations "L.L.P.," "LLP," "R.L.L.P.," or "RLLP" as the last words or letters of its name.

PARTNERS OF THE FIRM

Section 5072(b)(1) of the Business and Professions Code requires at least one general partner to hold a valid license to practice as a CPA, PA or accountancy corporation, or to be an applicant for a certificate as a CPA under Sections 5087 and 5088. Section 5072(b)(3) requires each partner not personally engaged in the practice of public accountancy within California to be a CPA or PA in good standing of some state, except as permitted by Section 5079.

OUT-OF-STATE PARTNERS

Section 5072(b)(2) of the Business and Professions Code states each partner personally engaged in the practice of public accountancy in California as defined by Section 5051 to hold a valid permit to practice or to have applied for a certificate as a CPA in good standing of some state, except as permitted by Section 5079.

An out-of-state CPA or PA who wants to practice in California must file an application for licensure and meet the requirements set forth in Sections 5087 and 5088 of the Business and Professions Code, as well as Section 21 of Title 16 of the California Code of Regulations.

Section 5073(e) of the Business and Professions Code states that any registration of a partnership under this section granted in reliance upon Sections 5087 and 5088 shall terminate if the Board rejects the application under Sections 5087 and 5088 of the general partner who signed the application for registration as a partnership, or any partner personally engaged in the practice of public accountancy in California, or any resident manager of a partnership in charge of an office in California.

RESIDENT MANAGER(S)

Section 5072(b)(4) of the Business and Professions Code requires each resident manager in charge of an office of the firm in California to be a licensee in good standing of California, or to have applied for a certificate as a CPA under Sections 5087 and 5088.

Section 5078 of the Business and Professions Code requires in each office of a CPA or PA in California, which is not under the personal management of such an accountant, respectively, that the work be supervised by a CPA or PA.

NONLICENSEE PARTNERS

Section 5079 of the Business and Professions Code permits minority ownership of public accounting firms by individuals who are not licensed as CPAs or PAs. This section applies to both accountancy partnerships and accountancy corporations.

At initial licensure and at license renewal, Section 51 of Title 16 of the California Code of Regulations requires firms with nonlicensee owners to certify that any nonlicensee owner with his or her principal place of business in this state has been informed of the rules of professional conduct applicable to accountancy firms. This declaration shall be completed and signed by a licensed partner of the firm (See page 3 of the application).

The number of licensed partners as owners shall be greater than the number of nonlicensed partners. The only exception is that a firm with only two partners may have one partner who is a nonlicensee.

FEDERAL EMPLOYER ID NUMBER

Disclosure of the firm's federal employer identification number (FEIN) is mandatory. Section 30 of the Business and Professions Code and Public Law 94-455 (42 USCA 405(c)(2)(C)) authorize collection of the FEIN. The FEIN will be used exclusively for tax enforcement purposes, for purposes of compliance with any judgment or order for family support in accordance with Section 17520 of the Family Code, or for verification of licensure by a licensing entity where licensure is reciprocal with the requesting state. **Applications without a FEIN will be returned** (see page 2 of the application).

LIMITED LIABILITY PARTNERSHIP STATEMENT

The declaration statement must be signed and dated by a partner who is a licensee with a valid license to practice public accounting. Firms with nonlicensee owners must complete and sign the nonlicensee owner(s) declaration (see page 3 of the application).

PARTNERSHIP RENEWAL CYCLE

Pursuant to Sections 5070.5, 5070.6, 5070.7, and 5070.8 of the Business and Professions Code, a partnership license must be renewed every two years to remain in good standing. The expiration date is based on the month and year the Board originally approved the application.

If approved in an even-numbered year, the license will expire each even-numbered year on the last day of the month in which it was originally approved. If approved in an odd-numbered year, the license will expire each odd-numbered year on the last day of the month in which it was originally approved.

The Board mails renewal forms with instructions approximately two months before the firm's license expiration date. If your renewal form is not completed, mailed, and postmarked by the license expiration date, your firm's practice rights cease until all deficiencies are corrected, and the license is renewed by the Board.

An expired partnership license may be renewed up to five years after its expiration date. A license not renewed within five years is cancelled and cannot be renewed, restored, or reinstated.

CHANGE OF ADDRESS, PARTNERS, AND/OR FIRM NAME

Section 3 of Title 16 of the California Code of Regulations requires a licensed firm to notify the Board of any change in its address of record within 30 days after the change. Section 5073(d) of the Business and Professions Code also requires notification be given to the Board within 30 days after the admission to, or withdrawal of, a partner from any registered partnership.

If you are changing the firm's address, telephone number, or disassociating a partner without changing the firm's name, you may notify the Board on your firm's letterhead.

However, if the firm's name is changing you must file for and have approved a *Limited Liability Partnership Amendment to Registration* from the California Secretary of State before the Board will process a name change application. An endorsed copy of the *Limited Liability Partnership Name Amendment to Registration* must accompany the name change application when submitted to the Board for processing. Information on filing the name change is available on the Secretary of State's Web site at [www.ss.ca.gov/business](http://www.ss.ca.gov/business).

Upon completion of the name change with the Secretary of State, the Board's name change application must be completed and approved before the firm can hold out and practice under an amended name. The name change application and accompanying information is available on the Board's Web site at [www.dca.ca.gov/cba](http://www.dca.ca.gov/cba) or by calling the Board at (916) 561-1701.

**DISSOLUTION OF A LIMITED LIABILITY PARTNERSHIP**

To dissolve a LLP, you must contact the California Secretary of State and file a *Notice of Change of Status*. The firm must receive a *Tax Clearance Certificate* from the Franchise Tax Board before the *Notice of Change of Status* can be filed. Information on dissolving a LLP is available on the Secretary of State's Web site at [www.ss.ca.gov/business](http://www.ss.ca.gov/business). Information on obtaining a *Tax Clearance Certificate* is available on the Franchise Tax Board's Web site at [www.ftb.ca.gov](http://www.ftb.ca.gov).

Upon completion of the above, submit a letter to the Board stating that your firm has been dissolved and provide the effective date. Upon receipt of the letter, your firm's license will be cancelled.

**QUESTIONS**

If you have questions or are unable to locate the information you need, please fax your questions to (916) 263-3676, e-mail to [firminfo@cba.ca.gov](mailto:firminfo@cba.ca.gov) or contact Board staff at (916) 561-1701.

## PERSONAL INFORMATION COLLECTION AND ACCESS

The information provided in this form will be used by the California Board of Accountancy, to determine qualifications for a Certified Public Accountant Partnership License. Sections 5035 through 5185 of the Business and Professions Code authorize the collection of this information. Failure to provide any of the required information is grounds for rejection of the application as being incomplete.

Information provided may be transferred to the Department of Justice, a District Attorney, a City Attorney, or to another government agency as may be necessary to permit the Board, or the transferee agency, to perform its statutory or constitutional duties, or otherwise transferred or disclosed as provided in Civil Code Section 1798.24.

Each individual has the right to review his or her file, except as otherwise provided by the Information Practices Act. Certain information provided may be disclosed to a member of the public, upon request, under the California Public Records Act.

The Executive Officer of the California Board of Accountancy is responsible for maintaining the information in this application, and may be contacted at 2000 Evergreen Street, Suite 250, Sacramento, CA 95815, telephone number (916) 263-3680 regarding questions about this notice or access to records.



**Source:** Business Law/Selecting and Forming Business Entities/7 Limited Liability Partnerships/§7.42 2. Form: Partnership Application for Licensure (Board of Accountancy Form 11A-19)

**§7.42 2. Form: Partnership Application for Licensure (Board of Accountancy Form 11A-19)**





**CALIFORNIA BOARD OF ACCOUNTANCY**  
 2000 EVERGREEN STREET, SUITE 250  
 SACRAMENTO, CA 95815-3832  
 TELEPHONE: (916) 263-3680  
 FACSIMILE: (916) 263-3676  
 WEB ADDRESS: <http://www.dca.ca.gov/cba>



For Office Use Only	
Cert. No.	_____
Date	_____

**PARTNERSHIP**

**APPLICATION FOR LICENSURE**

**Application Type:**

- General Partnership
- General Partnership – Nonlicensee Partner(s)
- Limited Liability Partnership
- Limited Liability Partnership – Nonlicensee Partner(s)
- California (Domestic)     Out-of-State (Foreign) – Name of State \_\_\_\_\_
- LLP Secretary of State Registration No. \_\_\_\_\_

**The following must accompany the application:**

1. Application and initial license fees of \$350.
2. Copy of LLP Registration Certificate endorsed by the California Secretary of State, if registering as a LLP.

(Please Type or Print)

**ALL ITEMS MUST BE COMPLETED**

1. Partnership Name		Firm Telephone Number (Optional)		
		(      )		
2. Place of Practice	(Street Address)	City	State	ZIP Code No.
3. Mailing Address, if Different from Place of Practice Address	(Street Address)	City	State	ZIP Code No.
4. Section 5072(b)(1) & (2). Information for each partner of firm personally engaged in the practice of public accounting. Out-of-state partners must submit certification attesting to a valid license to practice public accounting.				
Name of CPA, PA, Corporation or applicant for licensure under Sections 5087 and 5088.	Street Address		License Certificate No.	
5. Section 5072(b)(3). Information for each out-of-state partner not personally engaged in the practice of public accounting.				
Name of CPA or PA	Street Address		License Certificate No.	

6. Section 5072(b)(4). Information for each Resident Manager in charge of an office of the firm.

Name of CPA, PA or applicant for licensure under Section 5087 or 5088.	Street Address	License Certificate No.

7. Sections 5072(b)(4) and 5078. Do you have offices not under the personal management of a licensed CPA/PA partner?  Yes  No  
If yes, provide information for each CPA/PA supervising the work.

Name	Street Address	License Certificate No. and State

8. Section 5079. Complete the following information for each nonlicensee partner. The number of nonlicensed persons as partners must be equal to or less than the number of CPA/PA partners. The only exception is a firm with only two partners may have one partner who is a nonlicensee.

Name, Address, Telephone #	Business Name, Address, Telephone #	Type of Business

9. Disclosure of the federal employer identification number (FEIN) of a partnership is mandatory. Section 30 of the Business and Professions Code and Public Law 94-455 (42 USCA 405(c)(2)(C)) authorize collection of your FEIN. Your FEIN will be used exclusively for tax enforcement purpose, for purposes of compliance with any judgment or order for family support in accordance with Section 17520 of the Family Code, or for verification by a licensing entity where licensure is reciprocal with the requesting state. **If you fail to disclose your FEIN, your application for initial or renewal will not be processed, AND you will be reported to the Franchise Tax Board, which may assess a \$100 penalty against you.**

**Federal Employer ID Number**

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**COMPLETE AND SIGN THE APPROPRIATE STATEMENT**

(Attach supplemental sheet if more space is required)

**GENERAL PARTNERSHIP STATEMENT**

I certify under penalty of perjury and under the laws of the State of California, that the foregoing is true and correct.

Date \_\_\_\_\_

Signature \_\_\_\_\_

---

### GENERAL PARTNERSHIP WITH NONLICENSEE PARTNER(S) STATEMENT

We, the undersigned, certify under penalty of perjury under the laws of the State of California that the foregoing is true and correct and that this general partnership with nonlicensee partner(s) complies with the requirements of Section 51 of Title 16 of the California Code of Regulations and Section 5079 of the Business and Professions Code, as well as with all applicable regulations.

Date \_\_\_\_\_ Type or Print Authorized CPA/PA Partner Name \_\_\_\_\_  
Signature of Authorized CPA/PA Partner \_\_\_\_\_

Date \_\_\_\_\_ Type or Print Authorized Nonlicensee Owner Name \_\_\_\_\_  
Signature of Authorized Nonlicensee Owner \_\_\_\_\_

---

### LIMITED LIABILITY PARTNERSHIP INSURANCE STATEMENT

The undersigned certifies under penalty of perjury under the laws of the State of California, that the foregoing is true and correct and that this limited liability partnership complies with the requirements of Section 16956 of the California Corporations Code regarding security for claims.

Date \_\_\_\_\_ Type or Print Name of Authorized CPA/PA Partner \_\_\_\_\_  
Signature of Authorized CPA/PA Executing This Form \_\_\_\_\_

---

### LIMITED LIABILITY PARTNERSHIP WITH NONLICENSEE PARTNER(S) STATEMENT

We, the undersigned, certify under penalty of perjury under the laws of the State of California, that the foregoing is true and correct and that this general partnership with nonlicensee partner(s) complies with the requirements of Section 51 of Title 16 of the California Code of Regulation, Section 5079 of the Business and Professions Code and Section 16956 of the California Corporations Code regarding security for claims, as well as with all applicable regulations.

Date \_\_\_\_\_ Type or Print Authorized CPA/PA Partner Name \_\_\_\_\_  
Signature of Authorized CPA/PA Partner \_\_\_\_\_

Date \_\_\_\_\_ Type or Print Authorized Nonlicensee Owner Name \_\_\_\_\_  
Signature of Authorized Nonlicensee Owner \_\_\_\_\_

---



**Source:** Business Law/Selecting and Forming Business Entities/7 Limited Liability Partnerships/§7.43 3. Form: Partnership Name Change Application for Licensure (Board of Accountancy Form 11A-36)

**§7.43            3. Form: Partnership Name Change Application for Licensure (Board of Accountancy Form 11A-36)**





**CALIFORNIA BOARD OF ACCOUNTANCY**  
 2000 EVERGREEN STREET, SUITE 250  
 SACRAMENTO, CA 95815-3832  
 TELEPHONE: (916) 263-3680  
 FACSIMILE: (916) 263-3676  
 WEB ADDRESS: <http://www.dca.ca.gov/cba>



For Office Use Only	
Cert. No.	_____
Date	_____

## PARTNERSHIP NAME CHANGE APPLICATION FOR LICENSURE

**Application Type:**

- General Partnership
- General Partnership – Nonlicensee Partner(s)
- Limited Liability Partnership
- Limited Liability Partnership – Nonlicensee Partner(s)
- California (Domestic)     Out-of-State (Foreign) – Name of State \_\_\_\_\_  
 LLP Secretary of State Registration No. \_\_\_\_\_

**The following must accompany the application:**

- Application and name change fee of \$150.
- Copy of LLP Registration Certificate endorsed by the California Secretary of State, if registering as a LLP.

(Please type or print)

**ALL ITEMS MUST BE COMPLETED**

1. New Partnership Name	Firm Telephone Number (Optional) (      )	
Former Name of Partnership		
Par. No.		
2. New Place of Practice (Street Address)	City	
	State	
	ZIP Code No.	
Former Street Address (if any)	City	
	State	
	ZIP Code No.	
3. Mailing Address if Different than Place of Practice Address (Street Address)	City	
	State	
	ZIP Code No.	
4. Section 5072(b)(1) & (2). Information for each partner of firm personally engaged in the practice of public accounting. Out-of-state partners must submit certification attesting to a valid license to practice public accounting.		
Name of CPA, PA, Corporation or applicant for licensure under Sections 5087 and 5088.	Street Address	License Certificate No.
5. Section 5072(b)(4). Information for each Resident Manager in charge of an office of the firm.		
Name of CPA, PA, or applicant for licensure under Sections 5087 or 5088.	Street Address	License Certificate No.



---

**GENERAL PARTNERSHIP WITH NONLICENSEE PARTNER(S) STATEMENT**

We, the undersigned, certify under penalty of perjury under the laws of the State of California that the foregoing is true and correct and that this general partnership with nonlicensee partner(s) complies with the requirements of Section 51 of Title 16 of the California Code of Regulations and Section 5079 of the Business and Professions Code, as well as with all applicable regulations.

Date \_\_\_\_\_ Type or Print Authorized CPA/PA Partner Name \_\_\_\_\_  
Signature of Authorized CPA/PA Partner \_\_\_\_\_

Date \_\_\_\_\_ Type or Print Authorized Nonlicensee Owner Name \_\_\_\_\_  
Signature of Authorized Nonlicensee Owner \_\_\_\_\_

---

**LIMITED LIABILITY PARTNERSHIP INSURANCE STATEMENT**

The undersigned certifies under penalty of perjury under the laws of the State of California that the foregoing is true and correct and that this limited liability partnership complies with the requirements of Section 16956 of the California Corporations Code regarding security for claims.

Date \_\_\_\_\_ Type or Print Name of Authorized CPA/PA Partner \_\_\_\_\_  
Signature of Authorized CPA/PA Executing This Form \_\_\_\_\_

---

**LIMITED LIABILITY PARTNERSHIP WITH NONLICENSEE PARTNER(S) STATEMENT**

We, the undersigned, certify under penalty of perjury under the laws of the State of California, that the foregoing is true and correct and that this general partnership with nonlicensee partner(s) complies with the requirements of Section 51 of Title 16 of the California Code of Regulations, Section 5079 of the Business and Professions Code, Section 16956 of the California Corporations Code regarding security for claims, as well as with all applicable regulations.

Date \_\_\_\_\_ Type or Print Authorized CPA/PA Partner Name \_\_\_\_\_  
Signature of Authorized CPA/PA Partner \_\_\_\_\_

Date \_\_\_\_\_ Type or Print Authorized Nonlicensee Owner Name \_\_\_\_\_  
Signature of Authorized Nonlicensee Owner \_\_\_\_\_

---



**Source:** Business Law/Selecting and Forming Business Entities/7 Limited Liability Partnerships/§7.44 G. Form: Architect's Business Entity Report Form (California Architects Board Form)

**§7.44 G. Form: Architect's Business Entity Report Form (California Architects Board Form)**





CALIFORNIA ARCHITECTS BOARD  
PUBLIC PROTECTION THROUGH EXAMINATION, LICENSURE, AND REGULATION  
2420 DEL PASO ROAD, SUITE 105 • SACRAMENTO, CA 95834 • (916) 574-7220

## Architect's Business Entity Report Form

Legislation enacted on January 1, 2002 (Assembly Bill 1144 – Chapter 313, Statutes of 2001), added Business and Professions Code (BPC) Section 5558 to the Architects Practice Act. This section requires every person holding an architect license to report to the California Architects Board (CAB) the name and address of the business entity (sole proprietorship, partnership, corporation, or limited liability partnership) through which he or she provides architectural services. For purposes of this form, the term "architectural services" is defined in BPC Section 5500.1 (see bottom of page).

All licensees who provide architectural services whether they are sole proprietors, owners, part-owners or employees of a business entity providing architectural services are required to comply with this reporting provision of the Architects Practice Act. The CAB must be notified of any and all changes in your Business Entity Report by submitting a new report within 30 days after any change. Please print your responses and mail this report form to the CAB at 2420 Del Paso Road, Suite 105, Sacramento, CA 95834 within 30 days of receipt.

INDIVIDUAL'S NAME AS LICENSED (PLEASE PRINT)	LICENSE NUMBER
	C-

- I do not currently provide architectural services, but I am aware that when I do I am required to provide a Business Entity Report to the CAB within 30 days of this change in status.
- I provide architectural services through the following business entity (Multiple entities: If you provide architectural services through more than one entity, please copy this form and provide the name and address of each separate entity):

### Business Entity Name and Address

NAME OF BUSINESS ENTITY (SOLE PROPRIETORSHIP, PARTNERSHIP, CORPORATION OR LIMITED LIABILITY PARTNERSHIP)		
STREET ADDRESS OF BUSINESS ENTITY		
CITY	STATE	ZIP CODE
DATE OF INITIAL LICENSED AFFILIATION WITH THIS BUSINESS ENTITY	AREA CODE	TELEPHONE NUMBER
LICENSEE'S SIGNATURE	DATE	

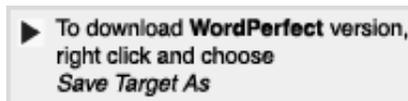
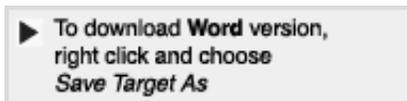
*Note: Name and address of the business entity should be the exact business name and address through which services are offered and provided.*

Remember to keep your Address of Record current. If you have recently moved or wish to change your Address of Record, contact the CAB for a Change of Address form at (916) 574-7220 or on the Web site [www.cab.ca.gov](http://www.cab.ca.gov).

#### BUSINESS AND PROFESSIONS CODE

- § 5500.1 Practice of Architecture Defined
- (a) The practice of architecture within the meaning and intent of this chapter is defined as offering or performing, or being in responsible control of, professional services which require the skills of an architect in the planning of sites, and the design, in whole or in part, of buildings, or groups of buildings and structures.
  - (b) Architects' professional services may include any or all of the following:
    - (1) Investigation, evaluation, consultation, and advice.
    - (2) Planning, schematic and preliminary studies, designs, working drawings, and specifications.
    - (3) Coordination of the work of technical and special consultants.
    - (4) Compliance with generally applicable codes and regulations, and assistance in the governmental review process.
    - (5) Technical assistance in the preparation of bid documents and agreements between clients and contractors.
    - (6) Contract administration.
    - (7) Construction observation.

**§7.45 H. Form: Resolutions Authorizing Firm Conversion**



7.45-1 Resolutions authorizing firm conversion

**Resolutions Authorizing Firm Conversion**

**RESOLVED, that:**

**A. The Firm convert from a general partnership to a registered limited liability partnership under Corporations Code §§16951-16962.**

**B. The Partners hereby adopt, ratify, and approve those specific resolutions required in connection with the registration of the Firm as a foreign limited liability partnership under the laws of any state or jurisdiction in which the Firm transacts intrastate business.**

**C. The members of the Firm's management committee are authorized in the name and on behalf of the Firm to take the following actions:**

**1. Execute and file with the California Secretary of State a Registration as a Limited Liability Partnership on Secretary of State Form LLP-1.**

*[Add one of the following alternatives]*

*[Alternative 1: Law firms]*

**2. Execute and file with the Office of Certification of the State Bar of California an Application for Issuance of a Certificate of Registration as a Limited Liability Partnership.**

*[Alternative 2: Accounting firms]*

**2. Execute and file with the California Board of Accountancy an Application for Licensure as a Limited Liability Partnership.**

*[Alternative 3: Architecture firms]*

**2. Ensure that all licensees in the firm will execute and file with the California Architects Board the Architect's Business Entity Report Form indicating that each licensee renders services through the Limited Liability Partnership.**

*[Continue]*

**3. Execute and file any applications for registration or notifications that may be required of the Firm in states or jurisdictions other than California in which the Firm transacts business.**

**4. Certify the adoption, ratification, and approval of any resolutions that the partners of this Firm may be required to adopt in connection with the registration or notification under the laws of any state or jurisdiction in which the Firm transacts intrastate business.**

**5. Make any arrangements, pay any fees and expenses, perform any acts, and execute and deliver any instruments, documents, and agreements that may be considered necessary or appropriate to carry out the purpose of these resolutions.**

**D. Any action taken by the members of the Firm's management committee before the date of these resolutions that is within the authority conferred in this document is approved as the act and deed of the Firm.**

*Comment:* These resolutions are designed for adoption by a law, accounting, or architect firm that is managed by a management committee. It may be adapted for use when the firm does not have a management committee.

A converting partnership is not technically required to adopt this resolution unless otherwise provided in the partnership agreement. A similar authorization may be obtained by any writing subscribed by the requisite majority in interest necessary to make the conversion election and authorize some partners to carry out the activities necessary to complete the conversion to a registered LLP.

The conversion of a partnership to an LLP requires either (1) the approval of the partners possessing a majority in interest of all partners in the current profits of the partnership or (2) a different vote specified in the firm's partnership agreement. Corp C §16955(a). See Corp C §§16951-16962.

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**Source:** Business Law/Selecting and Forming Business Entities/7 Limited Liability Partnerships/ I. Amendments to Partnership Agreement/§7.46 1. Form: Conversion to LLP; Name Change

## I. Amendments to Partnership Agreement

### §7.46 1. Form: Conversion to LLP; Name Change

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §7.46 and ends in §7.52

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7.46-1 Conversion to LLP; name change

## ARTICLE I

### CONVERSION TO LIMITED LIABILITY PARTNERSHIP; NAME CHANGE

**A. Formation.** The Firm was organized as a general partnership on \_\_ *[date]* \_\_ to engage in the practice of \_\_ *[law/accounting/architecture]* \_\_.

**B. LLP Election.** The Firm elects to and will convert to a registered limited liability partnership under Corporations Code §§16951-16962.

**C. Name.** The name of the Firm will be \_\_ *[e.g., Jones & Smith LLP]* \_\_.

*[Add one of the following alternatives]*

*[Alternative 1: For accounting and architectural LLPs]*

**D. Effective Date.** The effective date of the conversion will be the later of (1) the date on which the Firm files a Certificate of Registration as a Limited Liability Partnership with the California Secretary of State on Secretary of State Form LLP-1, or (2) any date set forth in Secretary of State Form LLP-1.

*[Alternative 2: For law LLPs]*

**D. Effective Date.** The effective date of the conversion will be the later to occur of (1) the date on which the Firm files a Certificate of Registration as a Limited Liability Partnership with the California Secretary of State on Secretary of State Form LLP-1; (2) the date on which the Firm files with the State Bar of California its Application for Issuance of Certificate of Registration as a Limited Liability Partnership; or (3) any date set forth in Secretary of State Form LLP-1.

*[Continue]*

**E. Registration in Foreign Jurisdictions.** The Firm will register as a foreign limited liability partnership in each of the states or jurisdictions in which the firm transacts intrastate business that requires such registration.

**F. Renewals and Amendments.** The Firm will file any renewals or amendments to its registrations as may be necessary from time to time to preserve and maintain the Firm's status as a limited liability partnership.

*Comment:* These amendments may be made to the general partnership agreement of a law, accounting, or architecture firm contemplating a conversion to an LLP.

**Source:** Business Law/Selecting and Forming Business Entities/7 Limited Liability Partnerships/§7.47 2. Form: Limited Guaranty by Partners of Firm Debt (Corp C §16306(d))

## §7.47 2. Form: Limited Guaranty by Partners of Firm Debt (Corp C §16306(d))

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7.47-1 Limited guaranty of firm debt

### ARTICLE II

#### LIMITED GUARANTY BY PARTNERS OF FIRM DEBT

***Responsibility for Firm Obligations.*** Except as provided in this Article II, the Firm will not enter into any agreement (Guaranty Agreement) that obligates a partner to be personally responsible for the Firm's obligations. However, the management committee may enter into a Guaranty Agreement on behalf of the firm obligating each partner of the Firm to guarantee a portion of the Firm's obligations, subject to satisfaction of the following conditions:

1. The personal liability of each partner of the Firm under the Guaranty Agreement together with any other previously executed guaranty agreements may not exceed the total of the lesser of \$\_\_*[amount]*\_\_ or that portion of the total liability of the Firm under the Guaranty Agreement equal to that partner's share of the Current Profits of the Firm for the year in which the Guaranty Agreement is entered into; and

2. The Guaranty Agreement is approved by partners holding \_\_*[specify percentage]*\_\_ or more of the interest in the Current Profits of the Firm for the year in which the Guaranty Agreement is entered into.

*Comment:* This amendment to the partnership agreement provides for individual liability of partners under Corp C §16306(d) and grants the management committee the authority to negotiate guaranties of the partners under limited circumstances, subject to approval by the partners.

**Source:** Business Law/Selecting and Forming Business Entities/7 Limited Liability Partnerships/§7.48 3. Form: Elimination of Partners' Vicarious Liability for Firm Obligations

### §7.48 3. Form: Elimination of Partners' Vicarious Liability for Firm Obligations

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7.48-1 Elimination of partners' vicarious liability

## ARTICLE III

### ELIMINATION OF PARTNERS' VICARIOUS LIABILITY FOR FIRM OBLIGATIONS

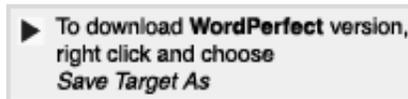
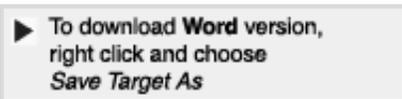
***Vicarious Liability for Firm Obligations.*** Except as otherwise explicitly provided in Partnership Agreement section(s) \_\_[specify number(s)/letter(s)]\_\_, no partner of the Firm, by reason of being a partner of the Firm or acting in the conduct of the business or activities of the Firm, will be directly or indirectly liable or accountable (by indemnification, contribution, assessment, or otherwise) for the debts, obligations, or liabilities of the Firm or chargeable to the Firm, or to another partner of the Firm (arising in tort, contract, or otherwise) that are incurred, created, or assumed by the Firm while the Firm is a registered limited liability partnership under the Corporations Code and otherwise to the fullest extent permissible under applicable law.

*Comment:* This amendment to the partnership agreement adopts the LLP liability shield by incorporating Corp C §16306(c) into the partnership agreement. The amendment supersedes all but explicit provisions in the partnership agreement to the contrary to prevent inadvertent loss of the liability shield through provisions of the partnership agreement that allocate losses (and therefore liabilities) to the partners. For discussion of the liability shield, see §§7.4-7.6.

**Source:** Business Law/Selecting and Forming Business Entities/7 Limited Liability Partnerships/§7.49 4. Form: Firm Indemnification of Partners; Partners' Indemnification of Firm

#### §7.49 4. Form: Firm Indemnification of Partners; Partners' Indemnification of Firm

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §7.46 and ends in §7.52



7.49-1 Indemnification

### ARTICLE IV

#### FIRM INDEMNIFICATION OF PARTNERS; PARTNERS' INDEMNIFICATION OF FIRM

**Indemnity.** The Firm agrees, to the extent of its partnership assets, to indemnify and hold each partner harmless from and against, and to reimburse each partner on demand for, any damage, loss, cost, or expense (including attorney fees and costs of investigation incurred in defending against or settling such damage, loss, cost, or expense) reasonably incurred by the partner arising out of or in connection with the ordinary and proper conduct of the business of the Firm or incurred by the partner for the preservation of the Firm's business or property. No partner, when acting in the ordinary and proper conduct of the business of the Firm or for the preservation of its business or property, will be liable to the Firm, or to any other partner of the Firm, for any loss suffered by the Firm that arises out of any action or inaction of the partner, provided that the partner acted in good faith and the partner's conduct did not constitute gross negligence, willful or wanton misconduct, or breach of the partner's duty of loyalty to the Firm. If a partner is found by any court or other forum of competent jurisdiction (e.g., arbitration) to have acted in bad faith, engaged in gross negligence or willful or wanton misconduct, or breached the partner's duty of loyalty to the Firm, the partner will indemnify and reimburse the Firm for any damage, loss, cost, or expense (including attorney fees and costs of investigation incurred in defending the Firm or the partner) reasonably incurred by the Firm arising out of or in connection with the conduct of the partner giving rise to the damage, loss, cost, or expense.

*Comment:* With the elimination of vicarious liability for firm debts, partners will be concerned about the circumstances under which they will be indemnified by the partnership for liabilities incurred when carrying out the firm's business. This amendment to the partnership agreement tracks Corp C §16401(c) by providing for the firm's indemnification of its partners. The amendment also contains a reciprocal agreement under which the partners indemnify the firm if it incurs liability as a result of a partner's gross negligence, willful or wanton misconduct, or breach of the duty of loyalty (e.g., self-dealing). Each partner should carefully review this amendment to ensure that its standards of partner negligence and misconduct are satisfactory.

This amendment provides for partner indemnification of the firm only if the partner is found by any court or other forum of competent jurisdiction, such as an arbitral forum, to have acted in bad faith, engaged in gross negligence or willful or wanton misconduct, or breached the partner's duty of loyalty to the firm. The firm may prefer to vest the decision of whether the standard of partner indemnification has been met in the management committee of the firm or in the partners, to be decided by the standards governing decisions made by the management committee or the partners.

Holding partners liable to the partnership for a breach of the duty of loyalty should invite no controversy when a partner diverts partnership business to an entity in which the partner has an equity interest and from which the partner earns profits, without disclosing this arrangement to his or her fellow partners. See, e.g., *Galardi v State Bar* (1987) 43 C3d 683, 693, 238 CR 774. In the law firm context, the duty of loyalty may be invoked when partners, by concealment and other forms of overreaching, leave the firm and take existing clients with them. See *Rosenfeld, Meyer & Susman v Cohen* (1983) 146 CA3d 200, 194 CR 180, overruled on other grounds in *Applied Equip. Corp. v Litton Saudi Arabia Ltd.* (1994) 7 C4th 503, 521, 28 CR2d 475. However, the duty of loyalty should not be invoked when a partnership's clients elect to send new business to departing partners of the firm. See, e.g., *Fraser v Bogucki* (1988) 203 CA3d 604, 250 CR 41, superseded by statute on other grounds as stated in *Howard v Babcock* (1993) 6 C4th 409, 423, 25 CR2d

80.

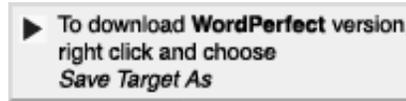
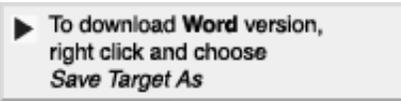
In light of the foregoing, a law firm should not expect the indemnification in this amendment to resolve potential disputes between the firm and departing partners over client business. Instead, this issue should be addressed in a separate provision in the partnership agreement. For guidance on the validity of noncompetition provisions in partnership agreements, see *Howard v Babcock* (1993) 6 C4th 409, 25 CR2d 80.

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**Source:** Business Law/Selecting and Forming Business Entities/7 Limited Liability Partnerships/§7.50 5. Form: Power of Attorney

**§7.50 5. Form: Power of Attorney**

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7.50-1 Power of attorney

**ARTICLE V**

**POWER OF ATTORNEY**

***Power of Attorney.*** Each partner, by the execution or adoption of this amendment, irrevocably constitutes and appoints each of the members of the Firm's management committee as his or her attorney-in-fact (with full power of substitution in his or her name, place, and stead) to execute, acknowledge, deliver, swear to, file, and record any document that may be necessary or appropriate to carry out the provisions of this amendment.

*Comment:* Under this power of attorney, each partner appoints each of the members of the management committee as his or her attorney-in-fact.

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**Source:** Business Law/Selecting and Forming Business Entities/7 Limited Liability Partnerships/§7.51 6. Form: No Personal Liability to Make Capital Contribution

## §7.51 6. Form: No Personal Liability to Make Capital Contribution

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7.51-1 No personal liability for capital contributions

### ARTICLE VI

#### NO PERSONAL LIABILITY TO MAKE CAPITAL CONTRIBUTION

**A. Personal Liability for Debts of Firm.** No partner will be personally liable for any of the debts of the Firm beyond the amount of his or her capital contribution to the Firm, plus the amount equal to his or her share of the undistributed profits of the Firm, if any. No partner will be personally liable to restore any deficit in the partner's capital account, unless and to the extent that the deduction(s) giving rise to the deficit in the partner's capital account \_\_ *[was/were]* \_\_ incurred and debited to the partner's capital account under an agreement approved by the partners under Partnership Agreement section \_\_ *[specify number/letter of clause dealing with power of firm management committee to enter into agreements personally obligating partners]* \_\_ or unless the deduction(s) \_\_ *[was/were]* \_\_ incurred and debited to the partner's capital account under the express written agreement of the partner.

**B. Personal Liability for Repayment of Another Partner's Capital Contribution.** No partner will have any personal liability for the repayment of the capital contribution of any other partner of the Firm. However, if a partner receives a distribution from the Firm, he or she will be obligated to return the distribution to the Firm if, after giving effect to the distribution,

1. The Firm would not be able to pay its debts as they become due in the usual course of business, or

2. The Firm's total assets would be less than the sum of its total liabilities plus the amount that would be needed, if the Firm were to be dissolved at the time of the distribution, to satisfy the preferential rights of other partners upon dissolution of the Firm that are superior to the rights of the partners receiving the distribution.

For this purpose, a "distribution" means the transfer of money or property by the Firm to its partners without consideration. A cause of action with respect to an obligation to return a distribution under this section \_\_ *[specify number/letter]* \_\_ is extinguished unless the action is brought within 4 years after the distribution is made.

*Comment:* This provision makes it clear that no partner has an obligation to make a capital contribution to the firm, except under an agreement of the partners as set forth in §7.47, or as explicitly agreed to by that partner. This provision also incorporates the provisions of Corp C §16957, governing the partners' obligation to return distributions made by the firm to the partners.

**Source:** Business Law/Selecting and Forming Business Entities/7 Limited Liability Partnerships/§7.52 7. Form: Partnership Agreement to Remain in Full Force and Effect

## **§7.52 7. Form: Partnership Agreement to Remain in Full Force and Effect**

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7.52-1 Partnership agreement to remain in full force

### **ARTICLE VII**

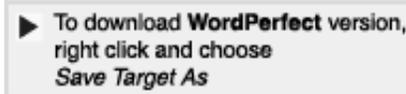
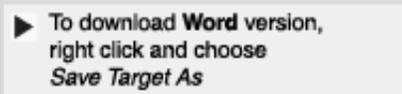
#### **PARTNERSHIP AGREEMENT TO REMAIN IN FULL FORCE AND EFFECT**

**Other than as amended in these amendments, the terms and provisions of the Partnership Agreement will remain in full force and effect in accordance with the provisions of Corporations Code §16955. The Partnership Agreement is not amended or modified other than as necessary to give effect to these amendments.**

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## J. Client Letters

### §7.53 1. Form: Letter Explaining Conversion



7.53-1 Letter explaining conversion

Dear \_\_ *[Name of client]* \_\_:

On \_\_ *[date]* \_\_, our firm converted to a registered limited liability partnership (LLP). An LLP is a general partnership that elects to be treated as an LLP. You will notice no difference in our operations, including the manner in which we provide \_\_ *[legal representation/accounting services/architectural services]* \_\_ to you, other than

*[Add one of the following alternatives]*

*[Alternative 1: LLP designation spelled out]*

the designation \_\_ *[Limited Liability Partnership/Registered Limited Liability Partnership]* \_\_ at the end of our name.

*[Alternative 2: LLP designation abbreviated]*

the letters \_\_ *[L.L.P./LLP/R.L.L.P./RLLP]* \_\_ at the end of our name.

*[Continue]*

All 50 states have enacted LLP legislation, allowing firms such as ours to convert to LLP status. State legislators have recognized that, with the increased breadth of services rendered by firms operating in partnership form, individual partners should not be required to place their personal savings at risk for firm activities in which the partner does not participate. Partners of an LLP have no personal responsibility for the debts or obligations of the firm solely by reason of their being a partner of the firm.

The partners and other professionals of the firm will continue, of course, to be responsible for the services they render to their clients.

*[If applicable, add the following option]*

*[Option: If firm maintains errors and omissions policy]*

In addition, the firm maintains an errors and omissions insurance policy that provides coverage for claims made by clients of the firm arising out of the professional services rendered by the firm.

*[Continue]*

By converting to LLP status, we have joined many of our colleagues throughout the country in electing the LLP form of doing business. This option provides partners of the firm with the peace of mind of knowing that their personal assets are not at risk for misconduct in which they take no part, while at the same time preserving the fundamental principle that a professional is responsible for his or her own conduct.

*[Add one of the following alternatives]*

*[Alternative 1: No action required to continue representation]*

Unless we otherwise hear from you in writing, we will assume that you will continue as a client of the firm without interruption.

*[Alternative 2: If existing clients must execute new engagement letter]*

Toward the end of completing the transition of the firm to its new form of doing business, it will be necessary for our existing clients to execute an engagement letter clarifying that you, our client, acknowledge your understanding of the conversion to LLP status and agree to substitute the name of the converted firm for the firm currently acting as your legal counsel.

[Continue]

If you have any questions concerning the conversion of the firm to LLP status, please feel free to call me.

Sincerely,

\_\_ [Signature of attorney] \_\_

\_ \_ [Typed name] \_ \_

*Comment:* This letter may be sent to new and existing clients to inform them of the firm's conversion to an LLP and explain the nature of an LLP. The letter should be modified to fit individual circumstances. If the firm intends to ask clients to sign new engagement letters, the second alternative, this letter will assist in obtaining their informed consent to this request.

LLPs engaged in the practice of law might find it advisable to have the new engagement letter done as soon as possible after conversion to afford partners not involved in a particular client's matter the limited liability for which the conversion was undertaken in the first place. Further, such a new engagement letter for attorneys will assist in limiting disputes as to whether or not legal services were provided by the LLP in compliance with the provisions of the Business and Professions Code requiring that representation of certain clients and types of matters be in writing.

**Source:** Business Law/Selecting and Forming Business Entities/7 Limited Liability Partnerships/§7.54 2. Form: Engagement Letter Clause Explaining LLP Status

**§7.54 2. Form: Engagement Letter Clause Explaining LLP Status**

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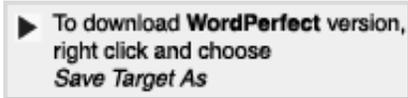
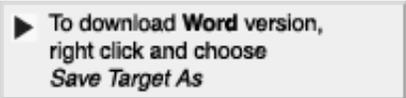
7.54-1 Engagement letter LLP clause

**The firm is a limited liability partnership (LLP), registered with the California Secretary of State \_\_ [and the \_\_ [State Bar of California/California Board of Accountancy]\_ ]\_ . The partners and other professionals of an LLP are responsible for their own tortious conduct but not for the misconduct of others. The assets of an LLP, including amounts payable to clients under any policies of insurance covering errors and omissions of professionals of the firm, are available to satisfy claims against the LLP.**

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**Source:** Business Law/Selecting and Forming Business Entities/7 Limited Liability Partnerships/§7.55 3. Form: Letter to Vendors, Suppliers, and Service Providers

**§7.55 3. Form: Letter to Vendors, Suppliers, and Service Providers**



7.55-1 Letter to third parties

Dear \_\_ *[name]* \_\_ :

**This is to advise you that \_\_ *[old partnership name]* \_\_ has converted into a California limited liability partnership named \_\_ *[new partnership name]* \_\_. \_\_ *[All/Some]* \_\_ of the partners of the old firm have become a partners in \_\_ *[new partnership name]* \_\_.**

**Although we previously dealt with you as a general partnership in which the partners may have been obligated for the partnership's obligations, we want you to be aware that we will continue to use your \_\_ *[specify, e.g., services or products]* \_\_, but that neither the new limited liability partnership nor any of its partners individually or collectively will be responsible for any debts or obligations incurred with you going forward. If you have any questions please do not hesitate to contact \_\_ *[me/ \_\_ *[name]* \_\_, the designated partner in charge/ \_\_ *[name]* \_\_, the office manager]* \_\_.**

Sincerely,

\_\_ *[Signature of attorney]* \_\_  
\_\_ *[Typed name]* \_\_

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## 8

# S and C Corporations

Whitney M. Skala

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**§8.1 I. SCOPE OF CHAPTER**

This chapter discusses the formation requirements for S and C corporations. The chapter assumes that decisions have already been made to do the following:

- Conduct business in a corporate form;
- Incorporate in California; and
- Form the corporation under the General Corporation Law (Corp C §§100-2319) rather than as a nonprofit corporation (Corp C §§5000-10841) or a corporation for certain specialized purposes, such as a professional corporation (Corp C §§12000-14551).

The primary documentation discussed in this chapter consists of the articles of incorporation (see §§8.38-8.57), the bylaws (see §§8.59-8.104), and the organizational minutes of the first meeting of the board of directors (see §§8.107-8.124). Occasionally, other initial documents are needed, such as a shareholders' buy-sell agreement, or a business buy-sell agreement. See generally Business Buy-Sell Agreements (Cal CEB 1991); Organizing Corporations in California (3d ed Cal CEB 2001). Close corporations are covered in chap 9, although much of the discussion in this chapter will also apply to them. Chapter 9 includes a close corporation shareholders' agreement. See §§9.36-9.51.

The checklists and charts that follow are intended to elicit the information needed to plan the corporation. The annotated forms that follow are intended for use in completing formation of the corporation.

## **II. PLANNING A CALIFORNIA BUSINESS CORPORATION**

### **§8.2 A. Limited Liability**

Shareholders typically choose the corporate form because of its shield against personal liability. As a practical matter, this shield is more often a consideration for large, well-capitalized business enterprises. Financial institutions and suppliers doing business with small or newly formed corporations will often require personal guarantees from shareholders on the corporation's debts. Additionally, business enterprises ordinarily rely on liability insurance to protect the personal liability of shareholders. As a corporation becomes larger and more distinct from its shareholders, the limited liability of shareholder assets becomes a greater concern.

Nevertheless, if a court determines that the corporation is the "alter-ego" of its shareholders, or a "mere corporate shell," a third party claimant may be permitted to "pierce the corporate veil" to satisfy contract, tort, and state and federal tax claims from the shareholders' personal assets.

The complete incorporation of the business, including its adequate capitalization, and the subsequent observance of corporate formalities of shareholder and director meetings, drafting of minutes, electing directors and officers, and maintaining corporate accounting records, will substantiate the integrity of the corporate entity and minimize the potential for application of the alter-ego doctrine. As further protection, many corporations provide for the indemnification of their directors, officers, employees, or agents, some or all of whom may also be shareholders, from certain liabilities to the extent permitted by the Corporations Code. See Corp C §317.

For further information, see *Organizing Corporations in California*, chap 1 (3d ed Cal CEB 2001). On "alter-ego" and adequate capitalization, see *Organizing Corps*, chap 1A.

### **§8.3 B. Management and Control**

In the simplest and most common corporate structure, the shareholders have the right to elect the directors, the directors have the right to elect the officers and exercise overall control over the management of the enterprise, and the senior corporate officers have the right to conduct the day-to-day business and make day-to-day decisions, including the hiring and firing of employees.

California's General Corporation Law (Corp C §§100-2319) allows great flexibility in the structuring of control and management relationships. Many of its rules can be altered by contrary provisions in the articles or bylaws, by resolutions of the board of directors, or by agreement of the parties. A few of the permissible control variations require inclusion in the articles of incorporation to be valid; other variations must appear either in the articles or the bylaws. Some control provisions that are made by written agreement of the participants may be valid among them, but may not be binding on third parties.

Within the corporate structure itself, several classes of stock may be used to achieve varying degrees of control. Most simply, voting and non-voting classes may be created. Alternatively, more detailed and complex share structures may be crafted, such as preferred stock with distinct rights, preferences, and privileges or debt instruments convertible into equity. Altering the default voting structure to require a supermajority vote for certain corporate actions is also commonly used to maintain control.

Aside from the corporate structure itself, written agreements among shareholders are commonly used to govern certain negotiated rights of the parties. Institutional lenders (*e.g.*, banks), while insisting on strong economic rights, typically have little express power over the management of the enterprise. In contrast, private investors and debtholders (such as venture capital companies) may insist on present or contingent control rights, including voting rights, the right to designate one or more directors, the right of prior consent to significant corporate transactions, the right of first refusal to purchase shares that may be sold by the corporation or the initial shareholders, or the right to participate in planning and structuring the enterprise. For further discussion, consult *Financing and Protecting California Businesses* (Cal CEB 2006).

These diverse sets of rights and structures are most typical of private corporations. Before becoming publicly held, any market for the corporation's shares will require a more uniform predictable corporate structure. Thus, most of such negotiated rights are relinquished or converted by shareholders and third party rights holders before a corporation's shares become publicly held. Once publicly held, a corporation becomes subject to the reporting requirements of the federal securities laws and the corporate governance requirements of the Sarbanes-Oxley Act of 2002 (15 USC §§7201-7266), as well as any self-regulatory organizations or stock exchanges on which the corporation's shares are traded.

**NOTE:** If the client wants to vary the structure substantially from that which would otherwise apply under the General Corporation Law, and if there are only a few participants, the attorney, after considering the advantages, disadvantages, costs, and risks, may wish to discuss with the client the possibility of electing statutory close corporation status. See §8.4.

**Source:** Business Law/Selecting and Forming Business Entities/8 S and C Corporations/§8.4 C. Determining Whether to Form Statutory Close Corporation

#### **§8.4 C. Determining Whether to Form Statutory Close Corporation**

In California the words "close corporation" or "statutory close corporation" are terms of art, referring to a specific type of organization available to some closely held corporations. See Corp C §§158, 300(b).

The shareholders of a "statutory close corporation" are entitled to substantially modify certain provisions of the Corporations Code pertaining to matters such as the division of profits, the allocation of control over corporate affairs, and the modification of corporate procedural formalities set forth in the "default" provisions of the Code. In effect, shareholders may run the corporation as though it were a partnership while retaining a corporation's limitations on liability.

A close corporation must limit itself to 35 shareholders, calculated in accordance with Corp C §158(d). On other limitations of close corporations, as well as the requirements for forming such an entity, see chap 9.

**PRACTICE TIP:** The practitioner should consider whether electing close corporation status is advantageous as early as possible in the preincorporation meetings to allow time to draft and obtain approval of a shareholders' agreement covering the corporate structure. Either the original articles or amended articles must state the election to be a statutory close corporation. The election may be ineffectual without a unanimously approved shareholders' agreement.

**NOTE:** The close corporation provisions of the Corporations Code have rarely received judicial review. Uncertainty as to the outer bounds of the shareholders' ability to modify the Corporations Code through a shareholders agreement may lead some practitioners to recommend that the shareholders be more traditional in their approach or seek a different form of entity altogether.

**Source:** Business Law/Selecting and Forming Business Entities/8 S and C Corporations/§8.5 D. Determining Whether to Elect S Corporation Status

## **§8.5 D. Determining Whether to Elect S Corporation Status**

Corporations that meet certain qualifications, listed in §2.129, may file an "S election" with the Internal Revenue Service under IRC §1362.

**NOTE:** The IRS has provided a simplified method for taxpayers to request relief for a late S corporation election and a late corporate classification election intended to be effective on the same date that the S corporation election was intended to be effective. See Rev Proc 2007-62, 2007-41 Int Rev Bull 786.

The S corporation election permits the corporation to avoid most federal and state taxes on income at the corporate level, and to "pass-through" items of income, loss, deduction, gain, and credit to the shareholders. See IRC §§1361-1379. The election does not change the nature of the entity as a corporation for state corporate law purposes.

The election to be treated as an S corporation also obviates the concern over whether salary payments to shareholder employees might be found excessive and thus disguised dividends subject to corporate level taxation under IRC §162(a) and Treas Reg §1.162-8. Also, because S corporation shareholders are taxed on net corporate income, certain additional federal income taxes (*e.g.*, corporate alternative minimum tax, personal holding company tax, and accumulated earnings tax) do not apply.

S corporations have their disadvantages. Internal Revenue Code §1361(b) limits S corporations to no more than 100 shareholders, who must be individuals, estates, tax-exempt organizations, or certain trusts; no shareholder may be a nonresident alien. The S corporation can be a member of an affiliated group only as an 80-percent owner of a C corporation or as a 100-percent owner of a qualified subchapter S subsidiary. IRC §§1361(b)(3), 1504.

Another limitation on S corporations is that they may have only one class of stock. Therefore, it is important to avoid de facto creation of multiple classes of stock through shareholder agreements or certain kinds of debt. See IRC §§1361(c)(4)-(5); Treas Reg §1.1361-1(l)(4)-(5). In addition, California imposes a 1.5-percent franchise tax on the net taxable income of an S corporation. See Rev & T C §23801(a). S corporation shareholders should also consider the limits on their ability to deduct losses from activities in which they do not "materially participate." See IRC §469.

An additional disadvantage relates to fringe benefits available to corporations. If an S corporation deducts payments for fringe benefits, including insurance plans, cafeteria plans, and medical reimbursement plans, they must be included as income on the returns of greater than 2-percent shareholders. See IRC §1372.

Finally, an S corporation, under IRC §1378, must ordinarily have a calendar year-end (although in certain circumstances, an S corporation may have a September, October, or November year-end). See IRC §§444, 1378.

For a chart comparing attributes of S and C corporations, see §8.28.

**Source:** Business Law/Selecting and Forming Business Entities/8 S and C Corporations/§8.6 E. Covenants Not to Compete; Misappropriation of Trade Secrets

## **§8.6 E. Covenants Not to Compete; Misappropriation of Trade Secrets**

The formation of a corporation may be the first step in launching a new business. However, a client may be restricted from competing with a former employer by an employment termination agreement or a business buy-out agreement. Covenants not to compete are generally prohibited by Bus & P C §16600, but important exceptions and qualifications exist with which the practitioner should be familiar.

The client might also intend to begin his or her new business activity while still in the employ of his or her soon-to-be competitor. This activity may lead to liability and may also be grounds for termination. See, *e.g.*, *Reeves v Hanlon* (2004) 33 C4th 1140, 17 CR3d 289.

The business idea itself, or the intended customers of the enterprise, may constitute trade secrets of another venture, and their use may be unlawful. See generally Trade Secrets Practice in California (2d ed Cal CEB 1996); California Business Litigation, chap 3 (Cal CEB 2002); Skala, *Ten (or More) Pitfalls in Incorporating a Business*, 10 CEB Cal Bus L Prac 32 (Winter 1995).

California's trade secret laws are codified in CC §§3426-3426.11. Civil Code §3426.1(d) defines a "trade secret" as information, including a formula, pattern, compilation, program, device, method, technique, or process, that:

- (1) Derives independent economic value, actual or potential, from not being generally known to the public or to other persons who can obtain economic value from its disclosure or use; and
- (2) Is the subject of efforts that are reasonable under the circumstances to maintain its secrecy.

Actual or threatened misappropriation may be enjoined, and exemplary damages are available when misappropriation of the trade secret is willful and malicious. CC §§3426.2(a), 3426.3(c).

## **§8.7 F. Securities Regulation Considerations**

Analyzing and complying with the applicable federal and state securities laws can be the most demanding and expensive legal aspect of an incorporation. Therefore, these matters should be considered during the planning stage.

In general, unless a statutory exemption applies, shares of corporate stock and other securities cannot be sold, or even offered for sale, without first:

- Obtaining a permit from the California Department of Corporations under the Corporate Securities Law of 1968 (Corp C §§25000-25707);
- Registering with the Securities and Exchange Commission (SEC) under the federal Securities Act of 1933 (15 USC §§77a-77aa); and
- Complying with the securities laws ("blue sky" laws) of each other state in which an offeree or purchaser resides, unless in each case an exemption is applicable, identified, and complied with.

Under federal law, several exemptions to the registration requirements are available, depending on the size and location of the offering, and the persons to whom the securities are offered. For a complete discussion, see *Organizing Corporations in California*, chap 4 (3d ed Cal CEB 2001). Under California Law, the most common exemption from obtaining a permit from the California Department of Corporations is found in Corp C §25102(f). This exemption requires that the offering may not be publicly advertised, may not include more than 35 purchasers (each of whom must either meet certain financial qualifications or have a preexisting relationship with the issuer), and may not make certain investment representations. See *Organizing Corps*, chap 4.

In addition, both federal and state securities laws may require disclosure of all material information in the context of a securities offering. Even when exemptions eliminate particular disclosure requirements, federal and state antifraud strictures apply. The penalties for violations, even unintentional ones, can be severe.

**PRACTICE TIP:** Federal and state securities regulation is a technically complex area of the law. Before planning for the offer, sale, or issuance of shares or other securities, it is advisable to consult counsel with the requisite expertise. For further information, see the reference material cited in §11.8.

### **III. PREINCORPORATION ACTIONS**

#### **§8.8 A. Preincorporation Subscription Agreements**

A preincorporation subscription agreement is an agreement among the proposed initial shareholders establishing the number of shares that each will purchase and the consideration to be paid for those shares. See, e.g., *Brown v North Ventura Road Dev. Co.* (1963) 216 CA2d 227, 233, 30 CR 568. A preincorporation subscription agreement is ordinarily used when the client wants firm commitments from all the proposed investors before completing the incorporation.

Subscription agreements may also set forth business points of the intended venture, the identity of the initial officers and directors, whether the shareholders will elect S corporation status, and the state and federal securities law registration exemptions under which the corporation will be formed, including, if necessary, representations and warranties required from the investors in order to satisfy those exemptions.

**NOTE:** A preincorporation subscription agreement is a security. Corp C §25019; 15 USC §77b(a)(1). Preincorporation subscription agreements are not commonly used in corporations of only a few shareholders because of their cost and because they require compliance with state and federal securities laws unless exempt or not subject to qualification. See Corp C §§25102(a), 25110; see also 15 USC §77e.

**Source:** Business Law/Selecting and Forming Business Entities/8 S and C Corporations/§8.9 B. Shareholders' Agreements

## **§8.9 B. Shareholders' Agreements**

A "shareholders' agreement" is an agreement among the shareholders of a statutory close corporation formed in conformity with Corp C §158. See Corp C §186.

**PRACTICE TIP:** If the parties have decided to form a statutory close corporation (see §8.4), a shareholders' agreement should ordinarily be drafted and circulated among the principals for review, independent legal advice, and signature before the attorney begins drafting the more standardized articles and bylaws. For a form of shareholders' agreement for a statutory close corporation, see §§9.36-9.51.

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**Source:** Business Law/Selecting and Forming Business Entities/8 S and C Corporations/§8.10 C. Preincorporation Contracts

### **§8.10 C. Preincorporation Contracts**

The principals may plan to enter into contracts for property or services needed by the proposed new corporation before the incorporation formalities can be completed. In general, the principals will be personally liable on preincorporation contracts unless they are able to negotiate a contractual provision to the effect that, once the corporation is formed and ratifies or adopts the contract, (a) the contracting party will look solely to the corporation for performance, and (b) the principals will be released from all further liability under the contract. Although the corporation becomes liable when it adopts, ratifies, or accepts the benefits of the contract (Corp C §208(b)), the contracting principals are not relieved of personal liability unless the contract so provides or unless a formal novation is made.

**NOTE:** A business entity that comes into existence after the establishment of a contract made on its behalf may enforce that preorganization contract if it adopted or ratified the agreement. *02 Dev., LLC v 607 S. Park, LLC* (2008) 159 CA4th 609, 71 CR3d 608.

**PRACTICE TIP:** Preincorporation contracts should refer to the corporation being formed, either by disclosure or stipulation, and include an assignment clause.

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**Source:** Business Law/Selecting and Forming Business Entities/8 S and C Corporations/§8.11 D. Selecting Corporate Name

### **§8.11 D. Selecting Corporate Name**

California law allows broad flexibility in the choice of a corporate name. Most often, the words "corporation" or "incorporated" need not be included. However, some rules limit the selection of the corporate name. These restrictions are discussed in chap 3, together with the procedure for reserving the corporate name with the Secretary of State's office. For the address and telephone numbers of the Secretary of State's office, see the Directory.

**PRACTICE TIP:** The procedure for checking the availability of and reserving a corporate name is so simple and inexpensive that it should be followed whenever circumstances permit to avoid the possibility that the corporate documents will have to be resubmitted.

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**Source:** Business Law/Selecting and Forming Business Entities/8 S and C Corporations/§8.12 E. Selecting Initial Agent for Service of Process

## **§8.12 E. Selecting Initial Agent for Service of Process**

The articles of incorporation must include the name of the corporation's initial agent for service of process, who must be either (Corp C §§202(c), 1502(b), 1505):

- A natural person with a California business or residence address, or
- A qualified corporate agent with an office in California.

Accordingly, the initial agent must be selected fairly early in the incorporation process. For a relatively nominal annual fee, a corporate agent will contract to act as the corporation's agent for service of process, thus ensuring the corporation of continuity of responsibility in this matter regardless of turnover among the corporation's directors, officers, or employees. A corporate agent may provide additional services, such as notifying the corporation of due dates and providing blank forms for required filings.

The most common use of corporate agents is by foreign corporations qualifying to do business in California. Similarly, a California corporation qualifying to do business in another state will ordinarily engage a corporate agent for service of process in that state. Most California-based corporations prefer to designate one of their officers as agent for service of process, using the corporation's business address as the agent's address. This choice typically allows earlier receipt of any process served on the corporation. If the officer listed as agent resigns or dies, the corporation must immediately file a designation of a new agent. See Corp C §1504.

**NOTE:** A corporation may not act as its own agent for service of process. However, a corporate officer or director may serve as agent for service of process.

**PRACTICE TIP:** Attorneys frequently name themselves in the articles as the corporation's initial corporate agent for service of process. This procedure enables the attorney to be aware of claims relating to the corporation before its first annual statement is filed with the Secretary of State under Corp C §1502. However, some practitioners believe an attorney should not serve as the corporation's initial agent for service of process. One reason is that, if the corporation does not file its first annual statement and fails to complete its formation activities, the attorney will continue to receive notices from state agencies relating to, e.g., its incomplete filings. Moreover, the attorney must then know where any such notices are to be forwarded.

For a provision in the articles designating the initial agent, see §8.39.

## **IV. FORMING CORPORATION**

### **A. Articles of Incorporation**

#### **§8.13 1. Filing Articles as Commencing Corporate Existence**

A California business corporation commences its existence when the California Secretary of State files its articles of incorporation. Corp C §200(c). This is the only event necessary to begin the corporation's existence. The articles must be accompanied by the appropriate filing fee (see §8.17). Govt C §12186(c).

The Secretary of State examines the articles of incorporation before filing. The Secretary will return them to the sender if they do not conform to the law. Returned articles may be resubmitted with a California lawyer's written opinion on the questioned point of law. The Secretary will rely on the written opinion (except with regard to any disputed point of law under Corp C §201, §2101, or §2106) in determining whether the articles conform to law. In this situation, the filing date and the date of incorporation is the date that the articles are received on resubmission. Corp C §110(b).

**PRACTICE TIP:** The filing date (which is the date of incorporation) is ordinarily the date that articles conforming to the law are received and accepted by the Secretary of State. However, the incorporators may request a delayed filing date for any date, including a Saturday, Sunday, or legal holiday, up to 90 days after the date the articles are received by the Secretary of State. Corp C §110(a), (c). To request a future filing date, the counter sheet or correspondence accompanying the articles should include instructions such as "Please file on [date]."

## **§8.14 2. Required Contents of Articles**

There are six specific minimum requirements for articles of incorporation for business corporations (see Corp C §§200(b), 202):

- (1) The name of the corporation;
- (2) A statement of the purpose of the corporation, in the exact language specified in Corp C §202(b);
- (3) The name and address of the agent for service of process;
- (4) If the corporation is authorized to issue one class of shares, the total number of shares;
- (5) If the corporation is authorized to issue more than one series or class of shares, the total number authorized, the designation of each series or class, and rights and restrictions of each series or class; and
- (6) The signatures and acknowledgments of the initial directors, if they are named in the articles, or, if not, the signatures of the incorporators.

The Secretary of State does not prescribe any preprinted form or required format for the articles of incorporation. However, the Secretary of State does publish general information, sample articles, and fees on its website. In addition, the legal section of the Secretary of State's office will give assistance and advice regarding possible problems in the articles that might render them unacceptable for filing. For the website address, street address, and telephone number, see the Directory.

**NOTE:** The articles of incorporation may contain any provision that is required or permitted to be stated in the bylaws, but the converse is not true. Corp C §204(d).

### 3. Optional Provisions

#### §8.15 a. Optional Provisions That Must Be Stated in Articles to Be Effective

In addition to the matters that are required to be in all articles of incorporation, certain optional provisions must be expressly stated in the articles to be effective. Some of the most important of these matters are listed in Corp C §204(a) and include the following:

- Granting the right to levy assessments on shares. The articles may grant the board of directors the power to levy assessments on any or all classes of shares; without such a provision in the articles, all shares are nonassessable. Corp C §§204(a)(1), 423(a). The statutory rules and procedures for assessments and remedies on delinquency are very detailed. See Corp C §423. But see 10 Cal Code Regs §260.140.7 (stating that securities "should be nonassessable," with rare exceptions).
- Granting preemptive rights to shareholders. Corp C §204(a)(2).
- Establishing special qualifications for shareholders. Corp C §204(a)(3).
- Limiting the duration of the corporation's existence to a specified date. Without a provision limiting corporate existence, the corporation will exist in perpetuity. Corp C §204(a)(4).
- Requiring more votes than the number required by statute for action by directors or shareholders. The articles may require a supermajority vote, unanimous vote, or quorum of the directors on any or all matters (except an election to voluntarily wind up and dissolve the corporation). Unless otherwise provided in the articles, the affirmative vote of a majority of the directors present at a meeting at which a quorum is present is sufficient for any board action (Corp C §§151, 204(a)(5), 307(a)(8)), except that the bylaws may require the affirmative vote of a majority of the authorized directors.
- Limiting the corporation's business or powers. If the articles do not limit the corporation's business or powers in the articles, the corporation will have the broad powers conferred by Corp C §§206-207. Corp C §204(a)(6).
- Granting voting rights to debtholders. Corp C §204(a)(7).
- Giving shareholders the right to determine the consideration for which shares are to be issued. Absent a provision in the articles reserving the right to set the consideration for which shares may be issued to the shareholders, the board of directors has this authority. Corp C §§204(a)(8), 409(a), (c).
- Requiring shareholder approval or approval of the outstanding shares for corporate acts if not otherwise required by the statute. Corp C §204(a)(9).
- Limiting directors' personal liability by adopting a provision in the articles to that effect. Corp C §204(a)(10).
- Authorizing a bylaw, an agreement, or another mechanism that permits indemnification of corporate agents in excess of the limits set by Corp C §317.

**NOTE:** It is ordinarily preferable to keep the articles of incorporation brief and to place optional provisions and recitals of statutory rules (if desired) in the bylaws, where they can be more easily adapted to changing circumstances. However, to ensure that a statutory rule (or variation from the statutory rule) cannot be altered by board action alone, it should be set forth in the articles rather than merely in the bylaws. On matters subject to variation by bylaw, see §8.30.

## **§8.16            b. Other Optional Provisions**

Additional miscellaneous article provisions include the following:

- Restricting the board's power regarding bylaws. The articles may restrict or eliminate the board of directors' power to adopt, amend, or repeal bylaws. Corp C §211.
- Filling vacancies on the board of directors. The articles (or a special bylaw adopted by the shareholders) may permit the board to fill vacancies on the board caused by removal of directors; otherwise, these vacancies can be filled only by the shareholders. Vacancies caused by other reasons can normally be filled by a majority of the remaining directors, but the articles or bylaws may vary this procedure (e.g., by requiring either unanimous action by the board or a special shareholders' election). See Corp C §305(a).
- Establishing meeting procedures for the board of directors. The articles may provide special rules and procedures for board meetings, including how they are called, notice requirements, frequency, and most other procedural matters for board and committee meetings. However, the articles may not provide that a quorum of the board is less than one-third of the total authorized number of directors or fewer than two, whichever is larger (except for corporations with only one director). Corp C §307(a)(7).
- Limiting or appointing officers. The articles or bylaws may limit the offices that can be held by the same individual; otherwise, there is no such restriction. Corp C §312(a). The board normally appoints the corporation's officers, who serve at the board's pleasure, but the articles, the bylaws, or a board resolution may provide otherwise. Corp C §312(b).
- Providing for corporate dissolution. Procedures available on voluntary or involuntary corporate dissolution may need to be in the articles of incorporation to be effective. Failure to include them in the articles subjects the corporation to Corp C §2000, which provides a procedure for avoiding dissolution and the appointment of a receiver "[s]ubject to any contrary provision in the articles."

**NOTE:** The articles may contain any provision not in conflict with the law, for managing the business or conducting the affairs of the corporation, including provisions required or permitted to be stated in the bylaws. Corp C §204(d).

#### **§8.17 4. Prohibited Article Provisions**

Certain provisions are ordinarily prohibited in the articles of incorporation. These include the following:

- Provisions for a future date. Original articles may not specify a future date at which they are to become effective. Corp C §110(c). However, the Secretary of State will hold articles and file them on a specified date (including a Saturday, Sunday, or holiday) up to 90 days in the future, if requested. Corp C §110(a).
- Prohibited name; unlawful contents. Certain words in the proposed corporate name will cause the Secretary of State to reject the articles (see chap 3), as will provisions in the articles that are inconsistent with the law. See §8.13. For example, the articles should not state the value or selling price for shares, although a minimum price may be stated. Similarly, recitals concerning the purpose or powers of the corporation, with certain limited exceptions, are prohibited.
- Denial of all voting rights. The articles may not deny or limit voting rights, dividend rights, or liquidation rights unless one or more classes of shares (or in the case of voting rights, debt securities) are, singly or in the aggregate, unrestricted on the matter. See Corp C §400(a). Subject to certain exceptions, the articles may not make common shares redeemable (see Corp C §402(c)) or make any shares convertible into debt securities. See Corp C §403.
- Provisions for a quorum of less than one-third. The articles may not ordinarily provide that a quorum for shareholders' meetings is less than one third or more than a majority of the shares entitled to vote at the meeting. Corp C §602(a). The articles may not require a supermajority or unanimous vote of shares for the election of directors (see Corp C §708(c)) or the removal of directors without cause (see Corp C §303(a)). Further, the articles may not require supermajority votes by the board or the shareholders for a decision to dissolve the corporation voluntarily and wind up its affairs (see Corp C §1900). Corp C §204(a)(5).
- Nonvoting shares voting on quorum. The articles may not provide that shares disqualified by law from voting on any matter are to be counted in determining whether a quorum is present or whether the required vote for passage has been obtained. Corp C §112.
- Dispensing with notice. The articles or bylaws may not dispense with notice for special meetings of the board. Corp C §307(a)(2). The articles or bylaws may not set a quorum for board meetings of less than either one-third of the authorized number of directors or two, whichever is larger, unless the corporation has only one director. Corp C §307(a)(7). The articles or bylaws may not provide for board approval of any matter by the vote of less than a majority of directors present at a meeting. Corp C §307(a)(8).

**PRACTICE TIP:** To avoid return of the articles by the Secretary of State, it is advisable to discuss informally any unusual provision with the legal staff of the Secretary of State's office before submitting the articles for filing, or to submit them for preclearance. See §8.17. In addition, if timing is critical, it may also be advisable to submit a draft of particularly complex provisions to the Secretary of State's legal staff for preapproval. For the address, telephone number, and website of the Secretary of State, see the Directory.

## **§8.18 5. Filing Requirements**

The original and at least two copies of the articles of incorporation should be submitted for filing, together with the applicable fee of \$100. Govt C §12186(c). Checks should be made payable to the Secretary of State. The articles may be mailed or hand delivered to the Sacramento office, or hand delivered to one of the regional offices in Fresno, Los Angeles, San Diego, or San Francisco. If documents are submitted to a regional office, a duplicate original is required. The Secretary of State will certify two copies of the filed document without charge if submitted with the document to be filed. Additional copies may be submitted, and will be certified on request and payment of the per-copy certification fee. Govt C §§12183, 12185. For addresses and telephone numbers, see the Directory.

**NOTE:** The Secretary of State offers a "preclearance" service, which allows a customer to submit a business entity document in person in the Sacramento office before filing to determine if the document conforms to law and to receive a preclearance response within a guaranteed time frame. Only one copy of the document need be submitted. The Secretary of State also permits "expedited filing," which allows a customer to submit a business entity document in person in the Sacramento office and receive a filing response within a guaranteed time frame. For further information, consult the Secretary of State's website at the address listed in the Directory.

To facilitate processing of mailed documents, the submission should include a self-addressed envelope and a letter referencing the corporate name as well as the name, return address, and telephone number of the person filing the articles.

**NOTE:** If the client wishes to begin doing business as a corporation immediately, the preclearance and expedited filing services, including hand delivery, should be used if possible.

**§8.19            6. Resubmitting Rejected Articles**

If the Secretary of State finds, after examining the articles, that they do not conform to law, the person submitting the articles will be informed by telephone or letter. The articles may be resubmitted with a written opinion of a member of the State Bar of California (either the person submitting the articles or that person's attorney), stating the opinion that the objectionable provision does conform to law and presenting the points and authorities on which the opinion is based. Except for matters concerning the choice of a corporate name, the Secretary of State must rely on the written opinion in determining whether the articles conform to law and may then file the articles, effective from the date of resubmission. Corp C §110(b).

**PRACTICE TIP:** Even though the opinion procedure may resolve the issue favorably, a questionable provision in the articles may delay the incorporation, and furthermore, the attorney's opinion is not binding for any other purpose. Thus, in most instances, counsel should discuss informally any unusual provision with the legal staff of the Secretary of State before submitting the articles for filing, to work out in advance a provision that will not be questioned or attacked later. On the Secretary of State's preclearance procedure, see §8.18. For contact information for the Secretary of State's office, see the Directory.

## **§8.20 7. Certificate of Determination of Preferences**

The articles of incorporation may provide that the rights and preferences of preferred shares will be determined in whole or in part by the board of directors. See Corp C §202(e)(3). However, an officers' certificate of determination of preferences must be executed, verified, and filed with the Secretary of State before any shares of such a class or series may be issued. Corp C §§173, 401(a). The certificate must set forth a copy of the resolution adopted by the board, state the number of shares in the class or series, and recite the fact that no shares of that class or series have yet been issued. Corp C §401(a). See Counseling California Corporations (3d ed Cal CEB 2008). If the rights, preferences, privileges, and restrictions of the class or series contain a supermajority vote provision (see Corp C §710(b)), subject to Corp C §710, the officers' certificate must also state that the provision has been approved by the shareholders in accordance with Corp C §710(c). Corp C §401(g). For a form of certificate of preferences, see §8.58.

The provisions of the certificate of determination can become complex, depending on the specific preferences the corporation wishes to make a part of the package. The matters covered may include dividends, redemption, a sinking fund, if any, conversion (including antidilution protection), and liquidation rights. In general, these provisions are substantially similar to those that would be included in the articles when the preferences are included in the articles of incorporation.

The certificate must also indicate whether there is any limitation on the voting rights of the holders of the preferred shares; otherwise, the preferred shares will have the same voting rights as the common shares. Often, preferred shares will have contingent voting rights—the right to elect a majority of the board if, for example, dividends are a stated number of quarters in arrears.

The certificate may contain what are referred to as "protective provisions," requiring the approval of a majority (or more) of the preferred shareholders before the corporation can take certain stated actions. Such actions may include the following:

- Amending the articles of incorporation (at least if the amendment would adversely affect the preferred shareholders);
- Increasing the authorized number of preferred shares;
- Creating any class of stock with senior preferences;
- Repurchasing any common stock;
- Merging or consolidating the corporation;
- Selling or transferring substantially all of the corporation's assets; and
- Incurring or guaranteeing debt in excess of a stated ceiling.

Dividends may be made fully or partially cumulative, or noncumulative. When preferred shares are issued in connection with a private financing, the investor may also negotiate for a provision in the certificate or a contractual commitment that dividends must be declared and paid if the corporation has funds legally available under Corp C §500.

After a certificate of determination has been filed, but before the corporation issues any shares of the class or series covered by the certificate, the board may alter or revoke any right, preference, privilege, or restriction fixed or determined by the resolution set forth in the certificate by the adoption of another resolution appropriate for that purpose and the execution and filing of an officers' certificate setting forth a copy of the resolution, and stating that none of the shares of the class or the series affected has been issued. Corp C §401(b).

In addition, after a certificate of determination has been filed, the board may, if authorized in the articles (see Corp C §202(e)), increase or decrease the number of shares constituting any series, by the adoption of another resolution appropriate for that purpose and the execution and filing of an officers' certificate setting forth a copy of the resolution, the number of shares of the series then outstanding, and the increase or decrease in the number of shares constituting the series. Corp C §401(c).

**NOTE:** Certificates of determination constitute a part of the articles within the meaning of Corp C §910, which governs restated articles of incorporation. If the articles are restated, the provisions of the certificate must be given an

article designation in the restated articles. Corp C §910(c). If a certificate of determination has been incorporated in restated articles filed pursuant to Corp C §910, the action authorized by Corp C §401(c) may, notwithstanding Corp C §902, be accomplished by an amendment of the articles approved by the board alone. Corp C §401(c). If an amending certificate is filed to decrease the number of shares of a series to zero, the certificate of determination under which the series was established is no longer in force and the series is no longer an authorized series of the corporation. Corp C §401(f).

Once shares of a class or series have been issued, the provisions of the resolution set forth in a certificate of determination may be amended only by the adoption and approval of an amendment in accordance with Corp C §§902-904 and the filing of a certificate of amendment in accordance with Corp C §§905 and 908. However, a certificate to increase or decrease the number of shares of a series may also be filed as permitted by Corp C §401(c). Corp C §401(d).

**NOTE:** When a certificate of determination is amended (Corp C §401(b)-(d)), the provision being amended must be identified in the amendment as prescribed. Corp C §907(a).

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**Source:** Business Law/Selecting and Forming Business Entities/8 S and C Corporations/§8.21 B. Franchise Tax Requirements

**§8.21 B. Franchise Tax Requirements**

Businesses incorporating in California are subject to California corporation franchise tax requirements. However, new corporations in California are not subject to the minimum franchise tax for their first taxable year (Rev & T C §23153(f)(1)), and no franchise tax deposit is required when the articles of incorporation are submitted to the Secretary of State for filing. See the Franchise Tax Board website at the address listed in the Directory. On estimated California franchise taxes, see Organizing Corporations in California §3.14 (3d ed Cal CEB 2001).

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## **C. Bylaws**

### **§8.22 1. Purpose and Drafting of Bylaws**

A corporation's bylaws typically set forth the rules and procedures that govern the management of the corporation's business and the conduct of its corporate affairs. Bylaws serve two principal functions. First, they provide a useful reference that the officers, directors, and counsel may consult to ensure that their acts comply with the articles, the Corporations Code, other laws, regulations, and agreements. Second, the bylaws may vary some of the standard rules set forth in the Corporations Code, and may establish rules in areas not covered by the Code.

The basic statute relating to the corporate bylaws, Corp C §212, is very liberal. It imposes only one requirement—that the bylaws state the number, or the maximum and minimum number, of directors. Even this statement is not required in the bylaws if it appears in the articles. Corp C §212(a).

Forms for bylaws are set forth in §§8.59-8.104. They are designed, for the most part, to follow the standard rules, which give the board of directors broad flexibility in conducting corporate affairs. They may be supplemented by provisions derived from other sources, *e.g.*, the federal securities laws on proxy statements, annual reports, and attributes of shares; agreements with stock exchanges; shareholder agreements; special statutes or regulations to which the corporation is subject, such as the insurance or banking laws; or major loan agreements containing special restrictions on dividends or voting.

**PRACTICE TIP:** Counsel should always review the corporation's current articles of incorporation to ensure that no inconsistencies exist between the bylaws and the articles. Any bylaw in conflict with the articles will be ineffective. See Corp C §212(b).

## **§8.23 2. Contents**

Corporations Code §212(b) states that the bylaws may contain any provision for the management of the business and the conduct of the corporation's affairs that is "not in conflict with law or the articles." It then sets forth, by way of description rather than limitation, various matters that are permitted to be dealt with in the bylaws, including the following (Corp C §212(b)(1)-(8)):

- Reasonable restrictions on the right to transfer or hypothecate shares (see Corp C §204(b));
- The names and addresses of the initial directors (see Corp C §204(c));
- The manner of managing the business and conducting the affairs of the corporation (see Corp C §204(c));
- Procedural details on meetings of shareholders, directors, and committees of the board;
- The manner of execution, revocation, and use of proxies;
- The qualifications, duties, and compensation of directors, the time of their annual election, and the quorum requirements for directors' and committee meetings;
- The appointment and authority of committees of the board;
- The appointment, duties, compensation, and tenure of officers;
- The method of determining shareholders of record; and
- The making of annual reports and financial statements to the shareholders.

A bylaw is invalid if it is contrary to the articles of incorporation or law. Corp C §212(b). See *Morris v Richard Clark Missionary Baptist Church* (1947) 78 CA2d 490, 177 P2d 811. In addition to conforming to the articles and applicable law, the bylaws should also be consistent with other documents to which the corporation is bound (e.g., contracts, stock exchange agreements, and rules). See Corp C §154 ("articles" includes original articles, subsequent amendments and restatements, and certificates of determination of preferences). Therefore, before drafting bylaws, the attorney should check for possible conflicts with the articles. Finally, even though valid in form and on its face, a bylaw may be invalid if it is unreasonable or inherently unfair, or if it was adopted under circumstances constituting an abuse of the corporate machinery. *McKee & Co. v First Nat'l Bank* (SD Cal 1967) 265 F Supp 1, 6, aff'd (9th Cir 1968) 397 F2d 248 (validity of bylaw is purely question of law for court not jury).

**PRACTICE TIP:** Counsel or the corporate secretary should review the bylaws at least annually and recommend any appropriate revisions.

**NOTE:** Certain statutory rules or standards relating to the conduct of corporate affairs may be varied only by contrary provisions in the articles. See §8.14. A mere provision in the bylaws to vary those rules would accordingly be ineffective. See Corp C §204(a)(1)-(11). Perhaps the most significant of these provisions concerns establishing a supermajority vote requirement for shareholder or director action when not otherwise required by law. Corp C §204(a)(5). To be effective, such a requirement must be contained in the articles or, in the case of a statutory close corporation, in a valid shareholders' agreement. Corp C §204(a).

### **§8.24 3. Matters Subject to Variation by Bylaw**

A number of statutory rules specifically state that they can be varied by provisions in the bylaws (or by provisions in the articles or bylaws). These include the following.

- Vote requirements for board action. The bylaws may provide that the affirmative vote of a majority of the authorized number of directors is required for valid action by the board of directors. Corp C §204(a). (The normal rule requires a majority of the directors present at a duly held meeting if a quorum is present; see Corp C §307(a)(8).)
- Vacancies on board. Ordinarily, vacancies on the board can be filled by the remaining directors unless the vacancy was created by the removal of a director. A bylaw may expand or restrict this power, but it must be approved by the shareholders if it authorizes the board to fill vacancies created by removal. Corp C §305(a).
- Transferability of shares. The bylaws may restrict the right to transfer or hypothecate any class or series of shares (but restrictions regarding previously issued shares are not binding unless the holders of such shares voted in favor of the restriction). Corp C §§204(b), 212(b)(1).
- Time, place, and notice of meetings. The bylaws may contain any provision, not in conflict with law or with the articles, regarding the time, place, and manner of calling, conducting, and giving notice of meetings of shareholders, directors, and committees of the board. Corp C §212(b)(2). However, the bylaws may not dispense with notice of a special meeting of the board of directors. Corp C §307(a)(2).
- Directors. The bylaws may set the qualifications, duties, and compensation of directors and the time of their annual election. Corp C §212(b)(4). Although the bylaws may establish quorum requirements for board meetings, the quorum may not be reduced to fewer than one-third of the authorized directors or fewer than two, whichever is larger (except for corporations with a single director). Corp C §§212(b)(4), 307(a)(7).
- Committees of the board. The bylaws may provide for committees of the board that have all the authority of the board except with regard to certain enumerated matters. Corp C §§212(b)(5), 311.
- Officers. The bylaws may provide for officers in addition to those required by law, may prescribe their duties, and may limit the number of offices that may be held by a single person. Corp C §§212(b)(6), 312(a). The bylaws may vary the general rule that officers are appointed by the board of directors and serve at the board's pleasure. Corp C §312(b).
- Shareholders of record. The bylaws may establish the mode of determining the holders of record of its shares. Corp C §212(b)(7).
- Shareholders' meetings. The bylaws may prescribe the location or a procedure for determining the location of shareholders' meetings (Corp C §600(a)), fix the date or a procedure for determining the date of the annual meeting of shareholders (Corp C §600(b)), expand the list of persons who may call a special meeting of shareholders (Corp C §600(d)), require notice of adjournment of a shareholders' meeting that has been adjourned for less than 45 days (Corp C §601(d)), require that written waivers of notice of a shareholders' meeting specify the business to be transacted and the purpose of the meeting (Corp C §601(e)), and require that any election of directors be by written ballot (Corp C §708(e)).
- Annual report. The bylaws may contain provisions for making annual reports and financial statements to the shareholders (Corp C §212(b)(8)) and may expressly waive the requirement of an annual report if the corporation has fewer than 100 shareholders (Corp C §1501(a)(1)).
- Indemnification of agents. The bylaws may limit the corporation's power to indemnify its directors and other agents for legal expenses except when the agent has been successful on the merits or a court has determined that the agent is entitled by law to indemnification. See Corp C §317(h)(1). On the other hand, if so authorized by the articles, the bylaws may expand the power to indemnify or may exculpate directors and officers from much liability expense. See §§8.87-8.88.
- Dividends and share repurchases. The bylaws may provide restrictions, in addition to those in the statute, on the declaration of dividends and on the purchase or redemption of the corporation's own shares. Corp C §505.

- Loans to officers. For corporations with 100 or more shareholders, a bylaw that is approved by the outstanding shares (Corp C §152) may authorize the board alone to approve loans or guaranties to officers or to approve an employee benefit plan that authorizes such loans or guaranties. See Corp C §315(b).

For a chart summarizing permissible variations from statutory rules, see §8.31.

**Source:** Business Law/Selecting and Forming Business Entities/8 S and C Corporations/§8.25 4. Statutory Rules That Cannot Be Changed by Bylaw

#### **§8.25 4. Statutory Rules That Cannot Be Changed by Bylaw**

A few provisions of the Corporations Code expressly state that they cannot be varied by the bylaws. Among other things, the bylaws cannot:

- Vary the statutory provisions for appointment by the court of a provisional director (Corp C §308(a));
- Expand the corporation's power to indemnify its directors or officers beyond the statutory authorization (Corp C §317(g)); or
- Limit the right of shareholders to inspect and copy the corporate records (Corp C §1601) or the list of shareholders. Corp C §1600.

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**Source:** Business Law/Selecting and Forming Business Entities/8 S and C Corporations/§8.26 5. Adoption, Amendment, and Repeal of Bylaws

## **§8.26 5. Adoption, Amendment, and Repeal of Bylaws**

Bylaws may be adopted, amended, or repealed by the approval of a majority of the outstanding shares or by the board of directors (Corp C §211); or by the incorporators if no directors have been elected. Corp C §210. Either the articles or the bylaws may restrict or eliminate the board's power to adopt, amend, or repeal any or all of the bylaws. Corp C §211.

The only specific statutory limitations on the board's power to adopt or change the bylaws are:

- A bylaw changing the number or maximum or minimum number of directors must be approved by the shareholders (Corp C §212(a); see Corp C §152);
- A bylaw granting the board of directors the authority to fill vacancies caused by the removal of directors must be adopted by the shareholders (Corp C §305(a)); and
- For corporations with 100 or more shareholders of record, a bylaw may authorize the board alone to approve loans or guaranties to officers, but the bylaw must be approved by a vote of the outstanding shares. Corp C §315(b).
- Note that, unless a bylaw adopted by the shareholders or the articles provides that the board may fill vacancies in the board caused by removal, the vacancies may only be filled by the approval of the shareholders. Corp C §§152, 305(a).

**Source:** Business Law/Selecting and Forming Business Entities/8 S and C Corporations/§8.27 6. Location and Inspection of Bylaws

**§8.27            6. Location and Inspection of Bylaws**

Any shareholder may inspect the bylaws at any reasonable time during office hours. Corp C §213. Every corporation must maintain an original or a copy of the bylaws, as amended to date, at the principal executive office of the corporation in California. If the principal executive office is located outside California, the current bylaws must be maintained at the principal business office in California. If there is none, the corporation must furnish a copy of the current bylaws to any shareholder who so requests in writing. Corp C §213.

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**Source:** Business Law/Selecting and Forming Business Entities/8 S and C Corporations/§8.28 D. Initial Organizational Meeting of Corporation

## **§8.28 D. Initial Organizational Meeting of Corporation**

After the articles have been filed, the incorporator (or initial directors, if they are to be replaced by permanent directors) should adopt bylaws and should elect the permanent directors of the corporation. See §8.105. The permanent directors will then meet or act by written consent to complete the corporate organization. See §8.106. These separate actions of the incorporator are not necessary if the incorporators are also the permanent directors.

The first meeting of the board of directors serves to acquaint the directors with each other and counsel, and provides an opportunity for the directors to discuss the business of the corporation in a formal setting.

**NOTE:** Although it is permissible to take the initial directors' actions by unanimous written consent without a meeting, it is usually preferable to convene an actual meeting. The meeting can also be used to emphasize the importance of the corporate formalities that are critical in maintaining the corporation's separate existence.

This initial meeting also allows the chair or president to lead the directors through the matters to be acted on, using the draft minutes as a guide. The presiding officer, attorney, and others, as appropriate, can respond to questions and provide explanations. Counsel may wish to advise the board on additional start-up considerations that were not discussed previously and to confirm the availability of any exemptions relied on for federal and California securities regulation purposes.

**PRACTICE TIP:** Counsel should prepare draft minutes in advance of the initial board meeting, which may serve as a guide for the meeting. For forms of draft minutes, see §§8.107-8.124. An agenda distributed to the participants may also be helpful. During the meeting, the board of directors may decide to defer action on matters in the draft minutes, or to take action on other items. After the meeting, the attorney can easily modify the draft minutes as necessary and recirculate them for approval and signing.

Basic formation tasks are also discussed at this meeting, resolutions are signed, and duties are assigned. These basic tasks include opening bank accounts, handling employment-related matters (such as applying for a federal employer identification number and securing workers' compensation coverage), and obtaining any necessary state and local licenses.

**Source:** Business Law/Selecting and Forming Business Entities/8 S and C Corporations/ V. CHARTS AND CHECKLISTS/ A. Charts/§8.29 1. Chart: Comparison of C and S Corporations

## V. CHARTS AND CHECKLISTS

### A. Charts

#### §8.29 1. Chart: Comparison of C and S Corporations

<i>Attributes</i>	<i>C Corporation</i>	<i>S Corporation</i>
Limited liability	Yes	Yes
Tax at corporate level	Yes	California, but not federal
Shareholders taxed	Only if dividend distribution	Yes, on corporate income
Year-end	Fiscal or calendar	Calendar, with limited exceptions (see IRC §444)
Restrictions on legal form of shareholders	No	Yes
Restriction on United States residency of shareholders	No	Yes
Restriction on number of shareholders	No (subject to securities issuance exemption requirements)	Yes
May conduct certain foreign business	Yes	No
More than one class of stock	Yes	No
May own more than 80% of another corporation	Yes	Yes, in certain circumstances

## **2. Permissible Variations From Statutory Rules**

### **§8.30 a. Introduction**

The Corporations Code sets forth many rules and procedures for the governing of corporations which can generally be divided into three categories:

- Rules that cannot be varied at all (see, *e.g.*, Corp C §§202, 213, 402(b));
- Rules that can be effectively varied only by a provision in the articles; and
- Rules that can be varied by contrary provisions in the articles or bylaws (see, *e.g.*, Corp C §§305(a), 307, 312(b)).

The chart in §8.30 provides a synopsis of this statutory scheme.

**Source:** Business Law/Selecting and Forming Business Entities/8 S and C Corporations/§8.31 b. Chart: Permissible Variations From Statutory Rules

**§8.31 b. Chart: Permissible Variations From Statutory Rules**

<i>Change or Variation</i>	<i>How Achieved</i>	<i>Corp C §§</i>
SHAREHOLDER VOTING		
Granting more or less than one vote per share for shares of any class or series	Articles	203, 400, 700(a)
Requiring shareholder voting as a class or series on any subject matter	Articles	152-153
Providing for election of director(s) by class or series of shares	Articles	194.5, 301
Requiring approval by shareholders (Corp C §153) or all outstanding shares (Corp C §152) for specified or all corporate actions	Articles	204(a)(9), 300(a)
Requiring supermajority or unanimous vote of any class or series of shares for specified or all corporate actions	Articles	204(a)(5)
Varying the normal quorum requirements for shareholders' meetings	Articles	602(a)
Allowing persons other than the board, its chair, the president, or 10 percent of the shareholders to call special shareholders' meetings	Bylaws or articles	600(d)
Prohibiting action by written consent of shareholders, or requiring written consents to be unanimous or by supermajority vote	Articles	603(a)
Granting debtholders the right to vote on election of directors or other matters subject to shareholder vote	Articles	204(a)(7)
Requiring shareholder approval of mortgages of corporate property	Articles	1000
Granting shareholders the right to determine the consideration for which shares will be issued	Articles	204(a)(8)
Varying statutory rules as to record date (for determining shareholders entitled to various rights, including voting rights)	Articles	701(d)
BOARD OF DIRECTORS		
Raising the vote or quorum requirements for board action on all or any matters	Articles	204(a)(5)
Requiring the affirmative vote of a majority of the authorized number of directors for all board actions	Bylaws or articles	204(a)(5), (d)
Restricting or eliminating board's power to adopt, amend, or repeal bylaws	Bylaws (subject to Corp C §204(a)(5)) or articles	211
Varying rule that shareholder approval necessary to amend articles to increase number of shares of a series	Articles	203.5(b)
Varying rule that directors may fill board vacancies	Bylaws or articles	305(a)

except those caused by removal of a director		
Varying rules and procedures applicable to board meetings	Bylaws (subject to Corp C §204(a)(5)) or articles	307(a)
Varying rule that board hires and fires officers	Bylaws or articles	312(b)
Prohibiting or limiting indemnification for legal expenses of officers, directors, and other agents	Bylaws or articles	317(h)(1)
Limiting liability of officers, directors, and other agents	Articles	204(a)(10), 204.5
For corporations with more than 100 shareholders, authorizing loans or guaranties to officers by board action alone	Bylaws or article that is approved by outstanding shares	315(b)
OTHER MATTERS		
Authorizing levy of assessments on shares	Articles	204(a)(1)
Granting shareholders preemptive rights	Articles	204(a)(2)
Establishing special qualifications for shareholders	Articles	204(a)(3)
Limiting duration of corporation's existence	Articles	204(a)(4)
Limiting corporate powers or business in which it may engage	Articles	204(a)(6)
Restricting right to transfer or hypothecate shares	Bylaws or articles	204(b)(1), 212(b)(1)
For corporations in existence on Jan. 1, 1977, electing to be governed by all provisions of law not otherwise applicable to such corporations	Article amendment, board action alone	2302
Limiting liability of officers, directors, and other agents	Articles or bylaws	204(a)(11)
For corporations with less than 100 shareholders, waiving requirement of annual report to shareholders	Bylaws	204(d), 1501(a)(1)
Prohibiting corporation from avoiding dissolution by purchasing shares of shareholders who initiated dissolution proceedings	Articles	2000(a)
For statutory close corporations, varying shareholder vote requirement for approval of merger or reorganization	Articles	1111, 1201(e)
Providing for issuance of redeemable classes or series of shares	Articles	402
Providing for issuance of convertible shares	Articles	403(a)
Prohibiting or limiting issuance of convertible debt securities	Articles	403(b)

## B. Checklists

### §8.32 1. Preformation Checklist: Selected Issues

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- If assets other than cash are to be contributed to corporation, ascertain whether contribution may result in realization of taxable gain (or loss) for contributor and, if so, whether it is possible and desirable to avoid that result by compliance with IRC §351. See §2.119.
- If the issuance of promotional shares is desired, is it allowed under applicable securities laws? See 10 Cal Code Regs §§260.140.30-260.140.33.
- Will initial shareholders be individuals, trusts, or other entities? The answer has securities consequences. See Corp C §25102. It also has tax consequences. S corporation election is not available if shareholders include certain trusts and other entities. See IRC §1361(b).
- Are any proposed initial shareholders not California residents? Out-of-state shareholders may complicate securities laws considerations by requiring counsel to investigate other states' laws and federal registration exemptions other than the intrastate exemption. See 15 USC §77c(a)(11).
- What are the financial acumen (educational background, financial situation, and business experience) and net worth of the proposed initial shareholders? The answers have securities consequences.
- Will shareholders also be employees? Salary may be recharacterized as "disguised dividend" under IRC §162(a)(1). See Counseling California Corporations (3d ed Cal CEB 2008). Also consider whether corporation will have stock repurchase rights on employment termination.
- Will corporation be a statutory close corporation? See §8.4; chap 9.
- Will stock be issued to additional persons soon after incorporation? Future issuance may have implications under securities laws and may affect close corporation election (see Corp C §158) and S corporation election (see IRC §1361). See §8.7.
- Will corporation (or shareholders) have rights to purchase shares of retired or deceased shareholders? See generally Business Buy-Sell Agreements (Cal CEB 1991).
- Will corporation's business require permits or licenses peculiar to the business? What is application procedure? Will permit issuance date relate back to date application was submitted, or will there be lengthy processing period? See §§2.24, 2.203.
- Are incorporators, proposed directors or officers, or potential shareholder-employees currently employed by companies competing in same general market as proposed corporation? Could corporation's proposed activities constitute unfair competition or misappropriation of trade secrets, or involve violation of noncompetition or other employment agreement provisions? See generally Trade Secrets Practice in California (2d ed Cal CEB 1996).
- Do regulations applicable to the business place any restrictions or limitations on who may be shareholders?
- Are losses and even financial failure likely, so as to require structuring under IRC §1244, which allows certain losses to be treated as ordinary losses rather than capital losses?
- Will special privileges or unusual restrictions granted in connection with certain shares of stock create, in effect, two classes of stock? If so, S corporation tax treatment is unavailable. IRC §1361(b)(1)(D). Certain securities registration or qualification exemptions may also be unavailable. See Corp C §25102(h).
- Will there be any impediments to transfer of assets into corporation? Consider:
  - Will California sales tax be due? See 18 Cal Code Regs §1595(b); Rev & T C §6006.5.
  - Will transfer trigger property tax reassessment?

- Will lienholders' consents be required?
- Must notice be given to any government entities?
- If corporation intends to take on debt, will debt disqualify corporation from electing S corporation tax treatment? See IRC §1361(c)(5).
- Will another state's laws affect formation or business of corporation? Consider:
  - "Blue Sky" securities laws.
  - Qualification to do business in foreign jurisdictions.
  - Foreign licensing and permit requirements (including, perhaps, a local agent for service of process).
- What is appropriate level of capitalization? See *Minton v Cavaney* (1961) 56 C2d 576, 15 CR 641; *Harris v Curtis* (1970) 8 CA3d 837, 87 CR 614.
- How many directors will there be?
- Will any party's intentions regarding corporate governance require modification of statutory default provisions?

**§8.33 2. Preformation Checklist: Selected Tasks**

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- Send fee agreement letter (including conflict waiver, if necessary). See chap 1.
- Conduct initial interview of client. See §2.206.
- Reserve corporate name with Secretary of State. See §§3.20-3.26.
- Advise client of Secretary of State's filing fees. See §8.17.
- Draft preincorporation agreement, if necessary. See §8.8.
- Draft shareholders' agreement if forming statutory close corporation. See §§9.36-9.51.
- Determine exemption, qualification, or registration requirements of share issuance under state and federal securities laws. See §8.7.
- If shares will not be exempt under state and federal securities laws, summarize fees for client.
- Determine division of responsibilities between attorney and client's accountant.
- Draft preincorporation contracts. See §8.10.

**Source:** Business Law/Selecting and Forming Business Entities/8 S and C Corporations/§8.34 3. Preformation Checklist: Information Required to Draft Articles

### §8.34 3. Preformation Checklist: Information Required to Draft Articles

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The following items of information are either required for the articles of incorporation or should be considered before preparing them:

- Corporate name
- Purpose
- Limitation on corporate purposes, if any
- Name and address of agent for service of process
- Authorized number of common shares
- Designation of shares in multiple-class structure
- Rights, preferences, privileges, and restrictions of preferred shares in multiple-class structure (unless these are to be set forth in a separate Certificate of Determination of Preferences; see §8.19)
- Name of incorporator(s)
- Names and addresses of initial directors, if incorporators are not used
- Authorized number of directors, or minimum and maximum number of directors
- If desired, percentage of supermajority shareholder vote required for changing number of directors or other specified matters
- For statutory close corporation, maximum number of shareholders
- Preemptive rights, if desired
- If desired, a provision limiting the liability of the corporation's directors (to the extent permitted by California law) and allowing the corporation to indemnify its directors against liability (to the extent permitted by California law)

**Source:** Business Law/Selecting and Forming Business Entities/8 S and C Corporations/§8.35 4. Formation Checklist: Selected Issues

#### §8.35 4. Formation Checklist: Selected Issues

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- Should additional provisions be added to standard form articles of incorporation? See §8.32.
- Should articles contain close corporation election language? See Corp C §§158, 202; §8.57. See also chap 9.
- Should date of filing of articles of incorporation be timed to take advantage of prepayment of franchise taxes? See 18 Cal Code Regs §23222.
- Do corporate governance agreements require modification of statutory default rules?
- Will shareholders be entitled to subscribe to new issues of stock in proportion to their interests in the corporation (*i.e.*, are there preemptive rights)? See Corp C §§204(a)(2), 406.
- Will shares be subject to a right of first refusal?
- Will there be any committees of the board of directors?

**§8.36 5. Formation Checklist: Selected Tasks**

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- Prepare and file articles of incorporation, pay filing fees, and prepay franchise taxes.
- Prepare bylaws.
- Order corporate minute book, stock certificates, and seal.
- Prepare draft minutes of organizational meeting of board of directors.
- Conduct organizational meeting and conform minutes if necessary.
- If preferred stock will be issued, prepare, execute, verify, and file with Secretary of State a Certificate of Determination of Preferences.
- Transfer the consideration for shares to corporation.
- Obtain executed subscription agreements and buy-sell agreements.
- Issue shares with appropriate legends.
- Open bank account (requires corporate resolution, often on lender's form).
- File Application for Employer Identification Number (IRS Form SS-4) with Internal Revenue Service. See form in §2.207.

**Source:** Business Law/Selecting and Forming Business Entities/8 S and C Corporations/ VI. FORMS/ A. Articles of Incorporation/§8.37 1. Articles of Incorporation: Minimum Required Provisions

## **VI. FORMS**

### **A. Articles of Incorporation**

#### **§8.37 1. Articles of Incorporation: Minimum Required Provisions**

Taken together, the forms in §§8.37-8.42 include the specific minimum requirements for articles of incorporation for business corporations. See §8.14. In addition to the required contents, the articles may include optional provisions. See §§8.14-8.15. A few provisions are prohibited. See §8.17.

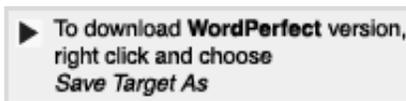
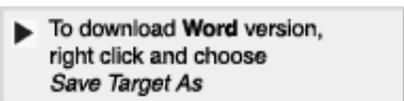
The only signature provided for by the form is that of the incorporator, which need not be acknowledged unless the initial directors are named in the articles. If the initial directors are named, then each of them must sign and acknowledge the articles (see §8.41). Corp C §200(b).

**CAVEAT:** These articles of incorporation are not suitable for corporations subject to the Banking Law, insurers subject to the Insurance Code, and professional corporations. See Corp C §202(b)(1)(ii), (b)(4). For sample articles for professional corporations, see chap 10.

**Source:** Business Law/Selecting and Forming Business Entities/8 S and C Corporations/§8.38 a. Form: Heading; Name; Purpose

**§8.38 a. Form: Heading; Name; Purpose**

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §8.38 and ends in §8.42



8.38-1 Heading; name; purpose of corporation

**ARTICLES OF INCORPORATION OF**  
\_ \_[NAME OF CORPORATION]\_ \_

**ARTICLE I**

**NAME AND PURPOSE OF CORPORATION**

**A. Corporate Name.** The name of this corporation is \_ \_[provide full name of corporation]\_ \_.

**B. Purpose.** The purpose of the corporation is to engage in any lawful act or activity for which a corporation may be organized under the General Corporation Law of California other than the banking business, the trust company business, or the practice of a profession permitted to be incorporated by the California Corporations Code.

*Comment:* The corporation's purpose must be set forth in the articles, and the statement must be one of those provided by Corp C §202(b). No further or additional statements about the corporate purposes or powers are permitted except statements limiting the corporate purposes or powers (see Corp C §§204(a)(6), 206-207) or expressly required by regulations or laws other than the General Corporation Law (Corp C §202(b)). Any limitation in the corporation's business or powers must be in the articles to be effective. Corp C §204(a)(6). Any desired limitations on the corporation's powers and purposes or any additional statements required by other laws should be set forth after the required statutory language, in a separate paragraph of the articles.

**Source:** Business Law/Selecting and Forming Business Entities/8 S and C Corporations/§8.39 b. Form: Agent for Service of Process

## §8.39 b. Form: Agent for Service of Process

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §8.38 and ends in §8.42

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8.39-1 Agent

### ARTICLE II

#### AGENT FOR SERVICE OF PROCESS

*[Add one of the following alternatives]*

*[Alternative 1: California resident as agent for service of process]*

The name and complete \_\_ *[business/residence]* \_\_ address in California of this corporation's initial agent for service of process are \_\_ *[name]* \_\_.

*[Alternative 2: Corporate agent for service of process]*

The name of this corporation's initial agent for service of process is \_\_ *[name]* \_\_, a corporation incorporated under the laws of \_\_ *[state of incorporation]* \_\_.

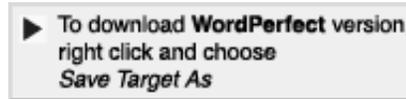
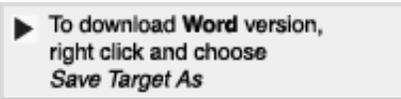
*Comment:* The articles must designate as the corporation's initial agent for the service of process either a natural person residing in California, or a domestic or foreign corporation that has complied with the requirements of Corp C §1505. Corp C §§202(c), 1502(b). If a natural person is designated, his or her business, residence, or post office box address in California must be set forth. If a corporate agent is designated, the articles do not include the agent's address. Corp C §§202(c), 1502(b). However, before a corporation may be designated as agent for the service of process, the corporation must first file an officer's certificate with the Secretary of State (see Corp C §1505(a)), which requires that the corporation be currently authorized to engage in business in California and be in good standing. Corp C §1505(c). The Secretary of State does not permit a corporation to act as its own agent for service of process, but an officer or a director may do so.

The provision designating the initial agent for service of process may be deleted after the corporation files its first annual statement with the Secretary of State under Corp C §1502(a). Corp C §§900(b), 902(d), 910(a). See §8.125.

**Source:** Business Law/Selecting and Forming Business Entities/8 S and C Corporations/§8.40 c. Form: One-Class Share Structure

## §8.40 c. Form: One-Class Share Structure

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §8.38 and ends in §8.42



8.40-1 One-class share structure

### ARTICLE III

#### CAPITALIZATION

**A. One Class of Shares.** This corporation is authorized to issue only one class of shares, which shall be designated "common" shares. The total number of such shares authorized to be issued is \_\_[number]\_\_ shares.

*[If applicable, add the following option]*

*[Option: Par value of shares]*

**B. Par Value.** The par value is \$ \_\_[amount]\_\_ per share.

*Comment:* If the articles do not authorize more than one class or series, the only information on capitalization that must be set forth in the articles is the total authorized number of shares, as shown here. See Corp C §202(d). When the corporation has only one authorized class, it is not necessary to name the class. However, it may be desirable to name the shares "common" shares (*i.e.*, shares with no preference over other shares with respect to dividends or distributions on liquidation; see Corp C §159) to avoid confusion if a preferred class is added later. For an articles provision to be used when the corporation is authorized to issue more than one class of shares, or if any class will have two or more series, see §8.45.

The concept of par value (or stated value, or shares without par value) is obsolete, and no value for shares need be stated in the articles. However, the articles are permitted to establish a par value. If for some reason this is considered desirable (*e.g.*, to minimize the cost of compliance with the securities regulations of another state), the provision in the articles must state the authorized number of shares and the par value per share. Corp C §205. If no par value is stated, shares are deemed to have a value of \$1 per share for purposes of taxes or fees based on capitalization. Corp C §205.

## §8.41 d. Form: Signature Block

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §8.38 and ends in §8.42

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8.41-1 Signatures

*[Add one of the following alternatives]*

*[Alternative 1: Signature of individual incorporator]*

\_\_ *[Signature of individual incorporator]*\_\_

\_\_ *[Typed name]*\_\_

**Incorporator**

*[Repeat as necessary]*

*[Alternative 2: Signature of entity incorporator(s)]*

\_\_ *[Name of entity incorporator]*\_\_

\_\_ *[Typed name]*\_\_

**Incorporator**

*[Repeat as necessary]*

*[Alternative 3: Signature of initial director(s)]*

\_\_ *[Name of initial director]*\_\_

\_\_ *[Typed name]*\_\_

**Director**

*[Repeat as necessary]*

*Comment:* A corporation may be formed by one or more natural persons, partnerships, associations, corporations, or trusts. Corp C §§200(a), 200.5(a). Incorporators are persons signing the articles who are not initial directors. A single incorporator is legally sufficient.

Each incorporator or named initial director must sign the articles. In addition, named initial directors must have their signatures acknowledged. Corp C §200(b). It is not necessary to name the initial directors in the articles, but any directors so named must sign the articles (in which case incorporators are not needed). Corp C §204(c).

Natural persons, whether signing as individual incorporators, on behalf of entity incorporators, or as directors, must sign in person; the signature of an agent or an appointee under a power of attorney is not acceptable.

**Source:** Business Law/Selecting and Forming Business Entities/8 S and C Corporations/§8.42 e. Form: Declaration by Initial Director

## §8.42 e. Form: Declaration by Initial Director

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §8.38 and ends in §8.42

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8.42-1 Declaration

**I declare that I am the person who executed the above instrument, and that this instrument is my act and deed.**

\_\_ [Signature of initial director] \_\_

\_ \_ [Typed name] \_ \_

[Repeat as necessary for other individual signatories]

*Comment:* Each signature of an initial director named in the articles must be acknowledged by either (a) a declaration by the person who signed the articles or (b) a certificate of acknowledgment, usually by a notary public, as provided in CC §§1180-1207. See Corp C §§149, 200(b).

A declaration is permitted even when the articles are executed outside California and need not be signed by a notary or other official. The declaration must state that the declarant is the person who signed the articles and that the articles are his or her act and deed (or that of the corporation or other entity on whose behalf he or she signed).

**Source:** Business Law/Selecting and Forming Business Entities/8 S and C Corporations/ 2. Articles of Incorporation: Optional Provisions/§8.43 a. Form: Number of Directors; Change in Number or Range

## 2. Articles of Incorporation: Optional Provisions

### §8.43 a. Form: Number of Directors; Change in Number or Range

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §8.43 and ends in §8.57

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8.43-1 Number of directors; change in number or range

#### ARTICLE [IV]

#### DIRECTORS

*[Add one of the following alternatives]*

*[Alternative 1: Fixed number of directors]*

**A. Number of Directors.** The number of directors of the corporation is \_\_[number]\_\_.

*[Alternative 2: Variable number of directors]*

**A. Number of Directors.** The number of directors shall be not fewer than \_\_[minimum number of directors]\_\_ nor more than \_\_[maximum number of directors, not greater than twice the minimum minus one]\_\_. The exact number of directors shall be fixed within these specified limits by the board of directors or the shareholders in the manner provided in the Bylaws.

*[Alternative 3: Changing number or range in number of directors]*

**A. Number of Directors.** The \_\_[number/minimum and maximum number]\_\_ of directors may be changed only by an amendment of these Articles. However, no such amendment shall reduce the \_\_[number/minimum number]\_\_ of directors to a number fewer than five if the shares opposing the change at a meeting, or failing to consent to an action by written consent, are more than one-sixth of the outstanding shares entitled to vote for the election of directors.

*[Alternative 4: Specific percentage required to approve change]*

**A. Number of Directors.** The \_\_[number/minimum and maximum number]\_\_ of directors may be changed only by an amendment of these Articles adopted by the affirmative vote of at least \_\_[number]\_\_ percent of the shares entitled to vote on the change. However, no such amendment shall reduce the \_\_[number/minimum number]\_\_ of directors to a number fewer than five if the shares opposing the change at a meeting, or failing to consent to an action by written consent, are more than one-sixth of the outstanding shares entitled to vote for the election of directors.

*Comment:* The provision as to number of directors may be set forth in either the articles or the bylaws. Placing this provision in the articles is not ordinarily desirable because any change will require an amendment to the articles. Corp C §212(a).

Ordinarily, a corporation must have at least three directors, except in the following circumstances (Corp C §212(a)):

- Before shares are issued, the number of directors may be one or two;
- If there is only one shareholder, the number of directors may be one or two; and
- If there are only two shareholders, the number of directors may be two directors.

If the articles or bylaws provide for fewer than three directors under one of these three exceptions, and the exception later becomes inapplicable because more shares have been issued, the applicable provision in the articles or bylaws must be amended to increase the number of authorized directors.

Rather than stating a fixed number of directors, the articles (or bylaws) may state minimum and maximum numbers within which the shareholders or the board will set the exact number. The minimum number ordinarily cannot be less than three, and the maximum number cannot be greater than twice the minimum number, minus one. For example, if the minimum number is five, the maximum number cannot be greater than nine. See Corp C §212(a). A variable board is convenient for flexibility in adding new board members, but it may be undesirable if minority shareholders need protection. The procedure for deciding the exact number must be set forth in the bylaws. Corp C §212(a).

After shares have been issued, any amendment changing the number or range in number of directors, whether set forth in the articles or the bylaws, must be approved by the shareholders. Corp C §§212(a), 902(a). If a supermajority or unanimous vote of the shareholders is desired, it must be set forth in the articles. Corp C §§153, 204(a)(5).

The fourth alternative restates the statutory rule, *i.e.*, that once shares have been issued and the number or range in number of directors has been established, an amendment to the articles or bylaws that would reduce the number or minimum number of directors below five cannot be adopted if more than one-sixth of the outstanding shares entitled to vote in directors' elections vote against the change at a meeting or fail to consent to an action by written consent. Corp C §§194.5, 212(a). This requirement prevents a simple majority from eliminating minority representatives on the board by reducing the number of directors.

**Source:** Business Law/Selecting and Forming Business Entities/8 S and C Corporations/§8.44 b. Form: Names and Addresses of Initial Directors

## §8.44 b. Form: Names and Addresses of Initial Directors

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §8.43 and ends in §8.57

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8.44-1 Names and addresses of initial directors

**B. Names and Addresses.** The names and addresses of the initial directors are as follows: \_\_ *[list names and addresses]*\_\_.

*Comment:* Former practice called for setting forth in the articles the names and addresses of persons appointed to act as initial directors of the corporation (Corp C §204(c)). This practice is still permitted, but is now rarely done. When directors are named in the articles, they must sign and acknowledge the articles.

Some practitioners see an advantage to naming the initial directors in the articles in that it permits them to complete the formalities and begin the corporation's business activities without any intermediate action by incorporators. However, incorporators may be preferred if the parties want to incorporate quickly and defer decisions on the number and selection of directors for several days or weeks. Moreover, speed can also be achieved by having the incorporator act quickly to name directors.

Directors may show either their residence address or the corporation's business address. See Corp C §204(c). This information is a matter of public record and, for reasons of privacy, many individuals prefer to use a business address. If the new company does not yet have a principal office it may be desirable to use an "in care of" address, perhaps that of the attorney preparing the articles. This temporary expedient should be superseded on the information statement that must be filed within 90 days after incorporation. Corp C §1502(a).

The names and addresses of the initial directors can be deleted from the articles by an amendment once the initial information statement required by Corp C §1502(a) has been filed. An amendment deleting the names and addresses of the initial directors (or the name and address of the initial agent for service of process) may be adopted with the approval of the board alone. Corp C §§900(b), 902(d). Similarly, the names and addresses of the initial directors can be deleted from the articles by restating the articles in their entirety after the requisite information statement (Corp C §1502(a)) has been filed. See Corp C §§900(b), 902(d), 910. The restated articles must omit the names and addresses of the initial directors (and the initial agent for service of process), and these omissions do not constitute amendments to the articles. Corp C §910.

**Source:** Business Law/Selecting and Forming Business Entities/8 S and C Corporations/§8.45 c. Form: Capitalization (Two-Class Share Structure)

### §8.45 c. Form: Capitalization (Two-Class Share Structure)

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §8.43 and ends in §8.57

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8.45-1 Capitalization (two-class share structure)

## ARTICLE [V]

### CAPITALIZATION

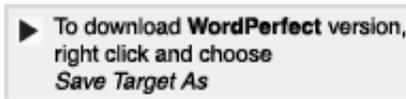
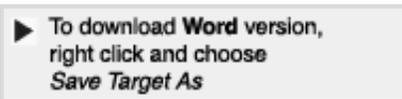
**A. Two-Class Share Structure.** This corporation is authorized to issue two classes of shares, to be designated \_\_ [name of first class, e.g., common, voting, Class A common] \_\_ and \_\_ [name of second class, e.g., preferred, nonvoting, Class B common] \_\_, respectively. The corporation is authorized to issue \_\_ [number] \_\_ shares of \_\_ [e.g., common] \_\_ stock and \_\_ [number] \_\_ shares of \_\_ [e.g., preferred] \_\_ stock.

*Comment:* The number of shares of the class or series may, in some circumstances, be increased or decreased by the board alone if the articles permit. Corp C §§203.5(b)-(c), 401(c)-(d). An article provision is required to authorize any division of the shares into classes, or of any class into one or more series. See Corp C §§202(e), 203. As to classes, the articles must designate each class and state its total number of shares. Corp C §202(e)(1)-(2). As to series within a class, the articles may either designate each series and state its total number of shares or authorize the board of directors to do so. Corp C §202(e)(1)-(2). The distinctions between classes created by the articles must be substantive and permanent. For example, a provision for one class to have preferential dividends until a future date, at which time the class will have the same rights as the common shares, may be rejected by the Secretary of State. See Counseling California Corporations (3d ed Cal CEB 2008). The solution is to provide for automatic conversion into the other class on the specified date or event.

**Source:** Business Law/Selecting and Forming Business Entities/8 S and C Corporations/§8.46 d. Form: Preferences, Privileges, and Restrictions on Shares

## §8.46 d. Form: Preferences, Privileges, and Restrictions on Shares

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §8.43 and ends in §8.57



8.46-1 Preferences, privileges, and restrictions

[Add one of the following alternatives]

[Alternative 1: Preferences, privileges, and restrictions on shares]

**B. Preferences, Privileges, and Restrictions on Shares.** The rights, preferences, privileges, and restrictions granted to or imposed on the respective classes or series of shares or on their holders are as follows: \_\_ [Insert a statement of the dividend rights, redemption provisions, conversion provisions (including antidilution protection), liquidation rights, voting rights, and the like, for the respective classes, and the protective provisions for rights of preferred shares]\_\_.

[Alternative 2: Board determines attributes of unissued shares]

**B. Preferences, Privileges, and Restrictions on Shares.** The \_\_ [name of preferred class]\_\_ shares may be issued in any number of series, as determined by the board of directors. The board may by resolution fix the designation and number of shares of any such series.

The board may determine, alter, or revoke the rights, preferences, privileges, and restrictions pertaining to any wholly unissued class or series of shares. The board may thereafter in the same manner increase or decrease the number of shares of any such series (but not below the number of shares of that series then outstanding).

*Comment:* The articles may either specify the rights, preferences, privileges, and restrictions of each class or series of shares or (if the class or series is wholly unissued) authorize the board of directors to do so. Corp C §202(e)(3). See Corp C §§400(a), 401. If the issuance of common and preferred shares is contemplated at the outset, it may be simpler to specify their respective rights, preferences, privileges, and restrictions in the articles, using form 8.45-1. See also Organizing Corporations in California, chap 2 (3d ed Cal CEB 2001).

The second alternative authorizes what is referred to as "blank stock," giving the board of directors power to establish the attributes of that stock. The advantage in permitting the board to set the characteristics of unissued shares is that the articles need not be amended and shareholder approval sought if the characteristics are changed; the change can be made by board resolution. The number of shares of any *class* to be issued must be fixed by the articles, but the number of shares of any *series* may be left to the discretion of the directors if the articles so provide. Corp C §202(e)(1). However, if the articles authorize a class of shares to be issued in series, they must also include either the designation and number of shares for at least one series within that class or an authorization of common shares. Corp C §203.5(c). See Corp C §183 on the definition of "series."

If the board is to fix the attributes of a class or series, it must require the officers to file a certificate of determination of preferences (Corp C §156) with the Secretary of State before any shares of the class or series are issued. See Corp C §§154, 401(a). See §8.58 for a form of certificate of determination.

The capitalization provisions of articles are regulated not only by the General Corporation Law (Corp C §§100-2319) but also indirectly by the Corporate Securities Law of 1968 (Corp C §§25000-25707) and the administrative rules, regulations, and interpretations under the securities law. In addition, corporations are subject to the federal securities laws and regulations and, depending on the intended distribution of the shares, may be subject to the securities laws of other states and the rules of a stock exchange or of the NASD (National Association of Securities Dealers).



**Source:** Business Law/Selecting and Forming Business Entities/8 S and C Corporations/§8.47 e. Form: Dividend Preferences (Two-Class Share Structure)

## §8.47 e. Form: Dividend Preferences (Two-Class Share Structure)

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8.47-1 Dividend preferences (two-class share structure)

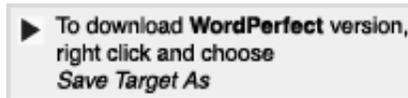
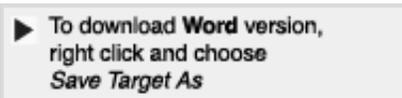
**C. Dividend Preferences.** The holders of \_\_ *[name of preferred class]* \_\_ shares shall be entitled to receive dividends, as declared by the board of directors, from any corporate assets at the time they are legally available for this purpose, at the rate of \$ \_\_ *[amount]* \_\_ per share per year, payable in cash quarterly or at such intervals as the board of directors may from time to time decide. Dividends on these \_\_ *[e.g., preferred]* \_\_ shares shall (a) accrue from the date of issuance of the shares, whether or not earned or declared, (b) be payable before any dividends on \_\_ *[name of nonpreferred class, e.g., common]* \_\_ shares are paid or declared and set apart, and (c) be cumulative, so that if dividends required to be paid under this clause on these outstanding \_\_ *[e.g., preferred]* \_\_ shares have not been paid or set apart for any year or years, the amount of the deficiency shall first be fully paid or declared and set apart for payment, but without interest, before any distribution, by dividend or otherwise, is declared, paid on, or set apart for the \_\_ *[e.g., common]* \_\_ shares. After all dividends on the \_\_ *[e.g., preferred]* \_\_ shares due to be paid under this clause have been declared and either paid or set apart for payment, dividends may then be declared and paid to the holders of \_\_ *[name(s) of class(es) to participate]* \_\_ shares, at the discretion of the board of directors, provided that they are declared equally among the \_\_ *[shares/classes of shares]* \_\_ entitled to participate.

*Comment:* For statutory restrictions on corporate distributions, including the payment of dividends, see Corp C §§500-507. No denial or limitation of dividend rights is effective unless at the time at least one class or series of outstanding shares is entitled to unlimited dividend rights. Corp C §400(a).

For a provision granting voting rights to holders of preferred shares when dividend payments are in default, see §8.49. See also 10 Cal Code Regs §260.140.3 (protective provisions required for preferred shares).

## §8.48 f. Form: Voting Rights

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §8.43 and ends in §8.57



8.48-1 Voting rights

**D. One Share/One Vote.** Each \_\_[name of class or series, e.g., common]\_\_ share shall have one vote on all matters on which shareholders are entitled to vote under the California Corporations Code and these Articles, with the following exceptions: \_\_[List and describe any exceptions]\_\_.

*[If applicable, add one or more of the following options]*

*[Option 1: Exceptions to voting rights]*

**[E.] Classes With No Voting Rights.** Each \_\_[name of class or series, e.g., preferred]\_\_ share shall have no voting rights, except as follows: \_\_[List and describe any exceptions]\_\_.

*[Option 2: Variations from statutory rules on voting]*

**[F.] Voting Rules.** The following rules shall apply with respect to shareholder voting: \_\_[List and describe any variations from the normal statutory rules on shareholder voting]\_\_.

*Comment:* Voting of shares is covered generally by Corp C §§700-709. Shareholder approval under the Corporations Code is either (1) "[a]pproved by (or approval of) the outstanding shares" (Corp C §152), which usually means the affirmative vote of a majority of the outstanding shares entitled to vote on the matter (regardless of how many shares actually vote), or (2) "[a]pproved by (or approval of) the shareholders" (Corp C §153), which usually means the affirmative vote of a majority of the shares actually voting.

**NOTE:** The term "shareholder" applies not only to a "holder of record of shares," but also to "any person who claims to have been denied the right to vote." Corp C §709(a); *Haah v Kim* (2009) 175 CA4th 45, 55, 95 CR3d 515 (investors had standing to bring action to invalidate election of directors, even though no shares had been issued).

The type of approval needed for a particular matter or situation is usually established by statute. As to either type of approval, a supermajority or unanimous vote instead of a simple majority may be required for any or all matters if so provided in the articles.

Variations in the standard voting rules may be made by an appropriate provision in the articles, as follows:

- The articles may provide that the shares of any class or series are entitled to more or less than one vote per share on any matter, subject to special rules for election of directors. Corp C §§112, 700(a), 708.
- The articles may provide for the election of one or more directors by the holders of one or more series or classes of shares, voting by class or series. Corp C §301(a).
- The articles may require shareholder approval or approval of the outstanding shares for any corporate action, even though not otherwise required by statute. Corp C §204(a)(9).
- The articles may require, for any or all corporate actions except as noted below, the vote of all of the shares of any class or series or of a larger proportion of those shares than is otherwise required by law. Corp C §204(a)(5). Supermajority or unanimous shareholder vote requirements are effective only if they are set forth in the articles or in a valid shareholders' agreement; they may not be imposed to dilute the shareholders' rights to vote on removing a director without cause (Corp C §303), to elect directors (Corp C §708(c)), or to vote on the voluntary dissolution of the corporation (Corp C §1900). Corp C §204(a)(5).
- The articles may prohibit action by written shareholder consent or require a supermajority or unanimous vote for actions by written shareholder consent. Without such a provision in the articles, any action that could be taken at

a shareholders' meeting may be taken without a meeting and without prior notice if a written consent (see Corp C §195) is signed by the holders of a majority (or supermajority, if applicable) of the outstanding shares. See Corp C §603(a). However, electing directors by written consent ordinarily requires the unanimous written consent of all shares entitled to vote to elect directors. However, shareholders may elect a director to fill a vacancy, other than a vacancy created by removal, by the written consent of a majority of the outstanding shares entitled to vote. Corp C §§305(a)-(b), 603(d).

- The articles may lower the normal quorum requirements for valid shareholders' meetings, but the quorum specified may not be less than one-third of the shares entitled to vote at the meeting. Without such a provision in the articles, there is a quorum if a majority of the shares entitled to vote are represented at the meeting in person or by proxy. This requirement cannot be raised, except for a statutory close corporation. Corp C §602(a).
- The articles may require that certain actions be approved by the shareholders. This requirement, which limits the authority of the board of directors, cannot be imposed by a bylaw or by a resolution of the board or the shareholders. Corp C §§204(a)(9), 300(a). Provisions of this nature should be carefully considered because many matters are required by statute to be within the authority of the board of directors.

In general, after shares are issued, any amendment to the articles requires approval of the outstanding shares. Corp C §902(a). If a provision in the articles requires a supermajority or unanimous vote of the shares not otherwise required by statute, that provision cannot be amended or repealed except by the specified vote, unless it expressly provides otherwise. Corp C §902(e).

Normally, if a disappearing corporation in a merger is a statutory close corporation and the surviving corporation is not, the merger must be approved by the affirmative vote of at least two-thirds of each class of the outstanding shares of the disappearing statutory close corporation. The articles may provide for a lesser vote, but not less than a majority of the outstanding shares of each class. Corp C §1111.

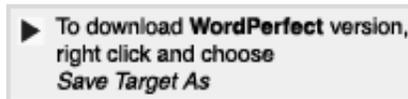
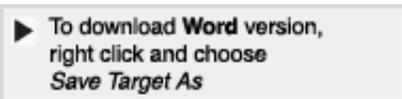
Notwithstanding Corp C §204(a)(5), a domestic corporation qualifying as a listed corporation under Corp C §301.5(a) that has eliminated cumulative voting pursuant to Corp C §301.5(a) may amend its articles or bylaws to provide that the approval of the shareholders (Corp C §153) is required to elect a director in an uncontested election. Corp C §708.5(b); see Corp C §708.5(a). Any board vacancy resulting from the failure of a candidate to be elected by the approval of the shareholders in an uncontested election of a listed corporation that has amended its articles or bylaws pursuant to Corp C §708.5(b) will be filled in accordance with Corp C §305.

Common shares should ordinarily have equal voting rights on all matters when this is permitted by law; the Commissioner of Corporations will not ordinarily approve the issuance of nonvoting common stock. See 10 Cal Code Regs §260.140.1. In electing directors, all voting shares generally have cumulative voting rights if certain procedures are followed. See Corp C §708.

**Source:** Business Law/Selecting and Forming Business Entities/8 S and C Corporations/§8.49 g. Form: Voting Rights (Failure to Pay Dividends on Preferred Shares)

## §8.49 g. Form: Voting Rights (Failure to Pay Dividends on Preferred Shares)

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §8.43 and ends in §8.57



8.49-1 Voting rights

**[G.] Failure to Pay Dividends on Preferred Shares.** Except as otherwise provided by these Articles or by law, the holders of \_\_[e.g., common]\_\_ shares shall have exclusive voting rights and powers, including the exclusive right to notice of shareholders' meetings. If, however, the dividend payments on \_\_[e.g., preferred]\_\_ shares are in default for \_\_[e.g., eight]\_\_ or more \_\_[e.g., quarterly]\_\_ periods, whether or not consecutive, then the holders of the \_\_[e.g., preferred]\_\_ shares shall become entitled to notice of shareholders' meetings and shall immediately become entitled as a class to elect the smallest number of directors constituting a majority of the board of directors, and the holders of the \_\_[e.g., common]\_\_ shares shall as a class retain the right to elect only the remaining directors. These rights of the respective classes to elect directors shall continue until all dividends accrued on the \_\_[e.g., preferred]\_\_ shares have been paid or set apart, at which time the right of the holders of \_\_[e.g., preferred]\_\_ shares to participate in the election of directors shall cease, and exclusive voting rights and powers, including the right to notice of shareholders' meetings, shall revert to the holders of the \_\_[e.g., common]\_\_ shares until such time as a further default in payment of dividends on the \_\_[e.g., preferred]\_\_ shares occurs.

*[If applicable, add the following option]*

*[Option: Right to call special meeting after default]*

**[H.] Call of Special Meeting After Default.** If the holders of the \_\_[e.g., preferred]\_\_ shares become entitled to elect members of the board of directors under this Article, then any officer or any holder of \_\_[e.g., preferred]\_\_ shares shall, on demand, be granted access to the corporate stock books and shareholder lists, and the secretary, on the written request of any holder of \_\_[e.g., preferred]\_\_ shares, shall call a special meeting of the holders of \_\_[e.g., preferred]\_\_ and \_\_[e.g., common]\_\_ shares in accordance with the Bylaws. At any meeting so called, and at any annual meeting held while the holders of the \_\_[e.g., preferred]\_\_ shares are entitled to elect directors under this Article, the holders of a majority of the then outstanding \_\_[e.g., preferred]\_\_ shares, present in person or by proxy, shall be sufficient to constitute a quorum for the election of directors. The term of office of all persons who are directors at the time such a meeting is convened shall terminate immediately on the election, at the meeting, by the holders of the \_\_[e.g., preferred]\_\_ shares of the number of directors they are entitled to elect under this Article. The directors elected by the holders of the \_\_[e.g., preferred]\_\_ shares, together with the directors, if any, elected by the holders of the \_\_[e.g., common]\_\_ shares at such a meeting, shall then constitute the duly elected board of directors of the corporation. If the holders of the \_\_[e.g., common]\_\_ shares fail to elect the number of directors that they are entitled to elect at such a meeting, additional directors may be appointed by the directors elected by the holders of the \_\_[e.g., preferred]\_\_ shares. When the holders of the \_\_[e.g., preferred]\_\_ shares are no longer entitled to voting rights under this Article, the terms of office of all directors shall terminate immediately on the election of their successors at a valid meeting of the holders of the \_\_[e.g., common]\_\_ shares called in accordance with the Bylaws.

*Comment:* It is advisable for the articles to establish the procedure for electing directors if preferred shareholders become entitled to representation on the board due to nonpayment of dividends. This form grants preferred shareholders the right to elect a majority of the board at the next shareholders' meeting following the specified default, which would presumably be called by the preferred shareholders promptly after the default.

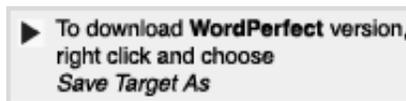
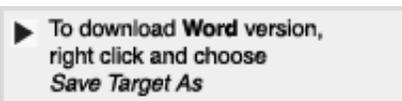
If there are nonconvertible preferred shares without full voting rights, the articles should give the holders of those shares the right to reasonable representation on the board of directors on a serious default in their dividend payments. This right should continue until all arrears in dividends on the preferred shares have been fully paid. The right to elect a majority of the board is presumed to be reasonable representation. 10 Cal Code Regs §260.140.2.



**Source:** Business Law/Selecting and Forming Business Entities/8 S and C Corporations/§8.50 h. Form: Liquidation Preferences

**§8.50 h. Form: Liquidation Preferences**

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §8.43 and ends in §8.57



8.50-1 Liquidation preferences

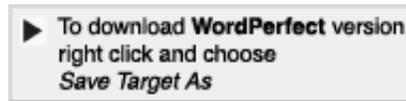
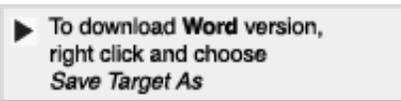
**[1.] Liquidation Preferences.** On any liquidation, dissolution, or winding up of the corporation, whether voluntary or involuntary, before any distribution of cash or other assets is made to the holders of \_\_ *[name of nonpreferred class, e.g., common]* \_\_ shares, the holders of \_\_ *[name of preferred class]* \_\_ shares shall be paid an amount equal to \$ \_\_ *[amount]* \_\_ per share plus all accrued and unpaid dividends. After these amounts have been paid or distributed to the holders of the \_\_ *[e.g., preferred]* \_\_ shares, the remaining assets and funds of the corporation shall be divided and distributed ratably among the holders of the \_\_ *[e.g., common]* \_\_ shares.

*Comment:* No denial or limitation of liquidation rights is effective unless at the time at least one class or series of outstanding shares, singly or in the aggregate, is entitled to unlimited liquidation rights. Corp C §400(a).

**Source:** Business Law/Selecting and Forming Business Entities/8 S and C Corporations/§8.51 i. Form: Preemptive Rights

## §8.51 i. Form: Preemptive Rights

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §8.43 and ends in §8.57



8.51-1 Preemptive rights

**[J.] Preemptive Rights.** Each holder of \_\_ *[name of class of shares to have preemptive rights]* \_\_ shares shall have full preemptive or preferential rights, as these rights are defined by law, to subscribe for or purchase that holder's proportional part of any \_\_ *[if desired, name classes of shares to which shareholders have right to subscribe]* \_\_ shares that may be issued at any time by this corporation.

*[If applicable, add the following option]*

*[Option: Restriction on amending article]*

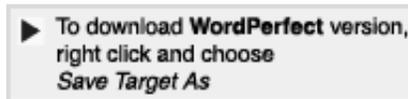
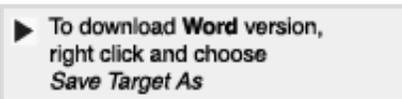
**[K.] Limitation on Amendment.** This Article may be amended only by the vote or written consent of the holders of \_\_ *[percentage or fraction]* \_\_ of the outstanding \_\_ *[name of class having preemptive rights]* \_\_ shares.

*Comment:* Absent a provision in the articles establishing preemptive rights, the board of directors may issue shares, option rights, or securities with conversion or option rights without first offering them to the corporation's existing shareholders. Corp C §§204(a)(2), 406. Preemptive rights entitle shareholders to subscribe to new stock issues in proportion to their interests in the corporation, thus offering some protection against dilution of minority interests. However, preemptive rights may create a barrier to wide distribution of shares and new public financing. For discussion, see Counseling California Corporations (3d ed Cal CEB 2008).

If the preemptive right is not to be illusory, it should provide that it can be amended only by a percentage or fraction of the shareholders that is large enough to allow the protected minority to block the amendment, as in the "Restriction on amending option" in form 8.51. An amendment altering preemptive rights, if adopted, will likely require qualification under the securities laws. See Corp C §25120.

## §8.52 j. Form: Redeemable Shares

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §8.43 and ends in §8.57



8.52-1 Redeemable shares

[Add one of the following alternatives]

[Alternative 1: Shares redeemable at corporation's option]

**[L.] Shares Redeemable at Corporation's Option.** The corporation may from time to time redeem all or any of the outstanding \_\_ [name of class, e.g., preferred] \_\_ shares by paying in cash \$ \_\_ [amount] \_\_ per share plus all accrued and unpaid dividends on each redeemed share to and including the date of redemption, the sum of which is called the redemption price. At least \_\_ [number] \_\_ days before the date of redemption, a written redemption notice shall be given to each \_\_ [e.g., preferred] \_\_ shareholder by first-class mail, postage prepaid, at the shareholder's address as shown in the corporation's records, stating (1) the class to be redeemed and whether all or fewer than all outstanding shares of the class are to be redeemed, (2) the date fixed for redemption, (3) the redemption price, and (4) the place of payment of the redemption price. If fewer than all outstanding \_\_ [e.g., preferred] \_\_ shares are to be redeemed, the redemption shall be on a prorata basis, as designated by the board of directors.

[If applicable, add one or more of the following options to Alternative 1]

[Option 1: Restriction on redemption]

**[1.] Restriction on Redemption.** No shares may be redeemed, however, unless all accrued dividends for all periods to and including the current period on all outstanding \_\_ [e.g., preferred] \_\_ shares shall have been paid, except that dividends for the current period shall not be paid for the shares being redeemed.

[Option 2: Surrender of certificates]

**[2.] Surrender of Certificates.** On or before the date fixed for redemption, each holder of shares to be redeemed shall surrender the certificates representing these shares to the corporation at the place designated for payment in the redemption notice and shall then be entitled to receive payment of the redemption price. If fewer than all the shares represented by any of the surrendered certificates are redeemed, new certificates representing the unredeemed shares shall be issued.

[Option 3: Termination of rights]

**[3.] Termination of Rights.** If the redemption notice is given in the manner provided in this Article, and if on the redemption date the redemption price is available for payment, whether or not the certificates covering these shares are surrendered, all rights with respect to the redeemable shares shall terminate except the right of the holders to receive the redemption price without interest on the surrender of the certificates.

[Alternative 2: Shares redeemable at holder's option]

**[L.] Shares Redeemable at Holder's Option.** At any time after \_\_ [identify triggering event, if any, e.g., the corporation reports annual revenue of \$1 million] \_\_, any holder of any of the outstanding \_\_ [name of class and/or series, e.g., preferred] \_\_ shares may from time to time require the corporation to redeem all or any of said shares for cash at \$ \_\_ [amount] \_\_ per share plus all accrued and unpaid dividends on each redeemed share to and including the date of redemption, the sum of which is called the redemption price. A holder wishing to require the corporation to redeem such shares shall give the corporation written notice by first-class mail, postage prepaid, stating

1. The occurrence of the event triggering the redemption right;

2. The class and/or series to be redeemed, the number of shares to be redeemed, and whether all or fewer than all shares of the class and/or series held by the holder are to be redeemed;

3. The date fixed for redemption;

4. The redemption price; and

5. The name and address for payment of the redemption price.

No shares may be redeemed unless all accrued dividends for all periods to and including the current period on all outstanding \_\_[e.g., preferred]\_\_ shares shall have been paid, except that dividends for the current period shall not be paid for the shares being redeemed.

*[Alternative 3: Shares redeemable on vote of class of shares]*

**[L.] Shares Redeemable on Vote of Class of Shares.** At any time after \_\_[identify triggering event, if any, e.g., the corporation reports annual revenues of \$1 million]\_\_, a majority of the outstanding \_\_[name of class and/or series, e.g., preferred]\_\_ shares may from time to time require the corporation to redeem all or any of the outstanding \_\_[name of classes and/or series, e.g., preferred]\_\_ shares by paying in cash \$ \_\_[amount]\_\_ per share plus all accrued and unpaid dividends on each redeemed share to and including the date of redemption, the sum of which is called the redemption price. At least \_\_[number]\_\_ days before the redemption, the holders of such shares shall give the corporation notice by first-class mail, postage prepaid, stating (1) the occurrence of the event triggering the redemption right; (2) the class and/or series to be redeemed and whether all or fewer than all of the outstanding shares of the class and/or series are to be redeemed; (3) the method of selecting the shares to be redeemed, if fewer than all of the outstanding shares of the class and/or series are to be redeemed; (4) the date fixed for redemption; (5) the redemption price; (6) the place of payment of the redemption price; and (7) the number of shares of the class and/or series outstanding and the number of shares voting in favor of such redemption.

*[Continue]*

**[M.] Redemption Notice.** Within \_\_[number]\_\_ days after such notice, the corporation shall give a written redemption notice to each \_\_[e.g., preferred]\_\_ shareholder by first-class mail, postage prepaid, at the shareholder's address as shown in the corporation's records, stating:

1. That redemption has been approved by a majority of the outstanding shares of the class and/or series to be redeemed;

2. The class and/or series to be redeemed, and whether all or fewer than all of the outstanding shares of the class and/or series are to be redeemed;

3. The date fixed for redemption;

4. The redemption price;

5. The place of payment of the redemption price; and

6. The number of shares of the class and/or series outstanding, and the number of shares voting in favor of such redemption.

*Comment:* The articles may provide that one or more classes or series of shares are redeemable, in whole or in part, at the option of the corporation or the holder, or on the vote of the shareholders. Corp C §402. Further, the articles may provide that one or more classes or series of preferred shares are redeemable, in whole or in part, on the occurrence of one or more specified events, at the option of the holder or the corporation, or on a majority vote of the outstanding shares of the class or series to be redeemed. Corp C §402(a).

The triggering events must be specified in the articles and should also be recited in the shareholder's notice of redemption. Whether shares are redeemable at the option of the corporation, the holders, or a vote of the shareholders, the articles (or certificate of determination of preferences) must set forth the price(s), time limits, terms, and conditions applicable to the redemption. In addition, if the articles permit partial redemption of a class or a series of shares, they

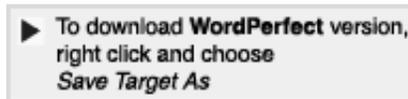
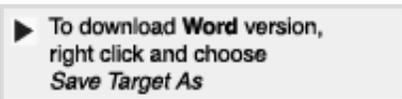
must prescribe the method of selecting the shares to be redeemed, whether pro rata, by lot, at the discretion of or in a manner approved by the board, or on other terms specified in the articles. Corp C §402(b). Any redemption, whether at the option of the corporation or the shareholder, is subject to the financial tests of Corp C §§500-503.1. Corp C §402(d).

Ordinarily, the articles must provide for at least one class of common shares that is not subject to redemption, and no redeemable common shares may be either issued or redeemed unless a class of nonredeemable shares remains outstanding. For the rule and three limited exceptions, see Corp C §402(c). The articles may specify the procedure for giving notice of redemption. Corp C §509(b).

When a corporation reacquires its own shares, those shares are restored to the status of authorized but unissued shares unless the articles prohibit their reissuance. Thus, shares redeemed or otherwise reacquired by the corporation may be reissued unless the articles provide to the contrary. Corp C §510(a). If the articles prohibit reissuance, then the articles must be amended after the reacquisition to reduce the number of authorized shares. Corp C §510(b), (f); see Corp C §510(c) (amendment required when articles bar reissuance of shares as shares of same series).

## §8.53 k. Form: Conversion Rights

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §8.43 and ends in §8.57



8.53-1 Conversion rights

[Add one of the following alternatives]

[Alternative 1: Preferred shareholders may convert to common shares at any time or under specified conditions]

**[N.] Conversion Rights.** The holders of    [e.g., preferred]    shares shall be entitled to convert those shares to    [e.g., common]    shares    [at any time/under the following circumstances:    [Specify]      ].

[Alternative 2: Preferred shareholders may convert in response to notice of redemption]

**[N.] Conversion Rights.** At any time up to and including    [number]    days before the date fixed for redemption of redeemable shares in a notice of redemption as provided in    [specify paragraph by number or letter]    of these Articles, holders of    [redeemable class, e.g., preferred]    shares being redeemed who endorse the certificates representing redeemable shares and deliver them, together with a written notice of their intention to convert, to the corporation at its principal office, shall be entitled to receive    [number]    share(s) of    [class, e.g., common]    stock for each share being converted, subject to the following adjustments, terms, and conditions:

1. If the number of outstanding shares of    [e.g., common]    stock has been increased or reduced since the first issuance of the    [e.g., preferred]    shares having conversion rights, because of a split, share dividend, merger, consolidation, or other capital change or reorganization affecting the number of outstanding    [e.g., common]    shares, this Article shall be amended to adjust the number of    [e.g., common]    shares to be issued for each share of    [e.g., preferred]    stock being converted, to preserve fairly and equitably as far as reasonably possible the original conversion rights of the shares being converted. No redemption notice pursuant to    [specify paragraph by number or letter]    shall be given until any amendment to the Articles required for this adjustment has been made.

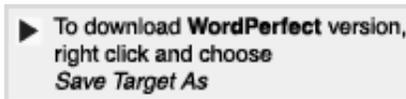
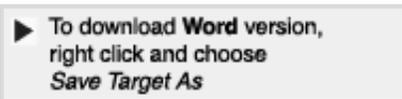
2. Shares converted under this Article shall not be reissued. The corporation shall at all times reserve and keep available a sufficient number of its authorized but unissued    [e.g., common]    shares, and shall further obtain and keep in force any permits required, to enable it to issue and deliver all    [e.g., common]    shares required to cover the conversion rights granted under this Article.

3. No fractional shares shall be issued on conversion, but the corporation shall pay cash for any fractional shares of    [e.g., common]    stock to which shareholders may be entitled, at the fair value of these shares at the time of conversion. The fair value of these shares shall be determined by the board of directors.

*Comment:* The articles may provide that any class or series of shares is convertible into another class or series of shares. See Corp C §403(a). The Commissioner of Corporations requires that any conversion procedure be fair to the holders of convertible securities. See Counseling California Corporations (3d ed Cal CEB 2008). If preferred stock or other securities are to have conversion rights, the articles should also include an antidilution provision (as provided in this form), requiring that the conversion ratio be adjusted in the case of stock splits, stock dividends, or other changes in the capitalization of the issuer. 10 Cal Code Regs §260.140.6. Neither the exercise of conversion rights nor the issuance of shares in connection with such a conversion is an offer or sale of securities requiring qualification. See Corp C §25017(e). See Corp C §407 with regard to the handling of fractional shares.

## §8.54 I. Form: Transfer Restrictions; Right of First Refusal

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §8.43 and ends in §8.57



8.54-1 Transfer restrictions; right of first refusal

**[O.] Right of First Refusal.** Every shareholder, before selling or transferring any shares of the corporation, must first offer the shares to the corporation and then to the holders of \_\_ *[class of shares having first refusal rights]* \_\_ shares, in the following manner:

1. The offering shareholder shall mail or personally deliver a written offer to the secretary of the corporation, stating the number and class of shares and the price, terms, and conditions of the proposed sale or transfer \_\_ *[including the name of any proposed outside buyer]* \_\_. The corporation shall then have the right to purchase any or all of those shares at the price and on the terms and conditions stated in the offer, by giving written notice to the offering shareholder of its election to purchase a specified number of shares. This notice shall be given by mail or personal delivery within \_\_ *[number, e.g., ten]* \_\_ days after the date of the shareholder's written offer, as that date is defined in subparagraph 8 of this section.

2. If the corporation fails to give notice of its election to purchase within the prescribed period, or if it elects to purchase fewer than all of the shares being offered, the secretary of the corporation, as soon as possible and in no event more than \_\_ *[number, e.g., 15]* \_\_ days after the date of the written offer, shall mail or personally deliver a copy of the offer together with a statement of the number of shares not being purchased by the corporation, to each holder of \_\_ *[class of shares having first refusal rights]* \_\_ shares. Each of these shareholders shall then have the right to purchase part or all of the available number of shares at the price and on the terms and conditions stated in the offering shareholder's written offer, by giving the secretary of the corporation a written notice of intent to purchase. This notice of intent to purchase shall state the number of shares that the shareholder wishes to purchase, and shall be given by mail or personal delivery to the secretary of the corporation within \_\_ *[number, e.g., 30]* \_\_ days after the offering shareholder's written offer was given to the corporation, as defined in subparagraph 8 of this section.

3. If the total number of shares specified by the several shareholders in their respective notices of intent to purchase exceeds the number of available shares specified in the secretary's statement, each purchasing shareholder shall be entitled to purchase that fraction of the number of shares specified in the shareholder's notice of intent to purchase that is equal to the number of the shareholder's shares with purchase rights under this Article, divided by the total number of shares with purchase rights held by all shareholders who gave notice of intent to purchase.

4. If fewer than all the shares offered for sale by the offering shareholder are subscribed to under subparagraphs 1 and 2 of this section, each shareholder who desires additional shares shall be entitled to purchase that fraction of the shares not subscribed to that is equal to the number of the shareholder's shares with purchase rights under this Article, divided by the total number of shares with purchase rights held by all shareholders who desire to purchase the remaining shares.

5. Unless otherwise specifically stated in the shareholder's notice of intent to purchase shares given under subparagraph 2 of this section, that notice shall also be considered an offer to purchase the number of shares to which the shareholder is entitled under subparagraph 3 or subparagraph 4 of this section.

6. If fewer than all the shares specified by the selling shareholder in the offer are subscribed to under subparagraphs 1, 2, 3, or 4 of this section within the time periods specified for exercising the respective rights to purchase shares granted by this Article, the offering shareholder shall not be required to sell the specified shares to the corporation or to any of the shareholders pursuant to their respective notices of intent to purchase, but may dispose of all of the specified shares to \_\_ *[any person or persons/the proposed buyer]*

specified in the offering shareholder's written offer to the secretary of the corporation]\_\_ within \_\_[number, e.g., 45]\_\_ days after the date of the written offer to sell, provided that such shareholder shall not sell or transfer these shares at a lower price or on terms less favorable to the seller than those specified in the offer to the secretary.

7. Unless otherwise prohibited by law or by these Articles of Incorporation, the corporation may purchase its own shares from any offering shareholder; provided, however, that the corporation shall not purchase all of its outstanding voting shares. Any sale or transfer, or purported sale or transfer, of the corporation's shares by any shareholder shall be null and void unless the terms, conditions, and provisions of this Article are strictly followed.

8. Each offer, notice, or statement provided for in this Article shall be considered given when it is personally delivered to the person to whom it is to be given, or when it is deposited in the United States mail, by first-class mail properly addressed to such person and with all postage or other charges fully prepaid.

*[If applicable, add the following option]*

*[Option: Legend on share certificates]*

9. Each share certificate of the corporation's \_\_[e.g., common]\_\_ stock shall bear the following legend:

**This certificate and the shares evidenced by this certificate may be sold, assigned, transferred, pledged, or otherwise disposed of subject only to the provisions of \_\_[specify paragraph by number or letter]\_\_.**

*Comment:* The articles or the bylaws may reasonably restrict the right to transfer or hypothecate any or all classes or series of shares. However, no restriction is binding on shares issued before the adoption of the restriction unless the holders of those shares voted in favor of the restriction. Corp C §§204(b), 212(b)(1).

It may be preferable to create first-offer restrictions by a separate contract between the corporation and its shareholders. This contract can also deal with related problems, such as transfers on the shareholder's death, disability, marital dissolution, or termination of employment.

The corporation may wish to vary subparagraph 6 of this form by allowing the corporation or other shareholders to purchase less than all the offered shares, or allowing the corporation or other shareholders to purchase less than all the offered shares if another proposed buyer will purchase the remainder.

The fact that shares are subject to transfer restrictions must be stated on the share certificates. Corp C §418(a)(1). Subparagraph 9 of this form specifies language for the legend on the certificate when transferability is restricted by the articles or bylaws. When securities are uncertificated, any transfer restrictions must appear on the initial transaction statement. Com C §8202; Corp C §§174, 418(a).

## §8.55 m. Form: Limit on Directors' Liability

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §8.43 and ends in §8.57

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8.55-1 Limit on directors' liability

### ARTICLE [VI]

#### LIMITATIONS ON DIRECTOR LIABILITY

**The liability of the directors of the corporation for monetary damages shall be eliminated to the fullest extent permissible under California law.**

*Comment:* This form contains the statutory language of Corp C §204.5(a). Although that language is not the exclusive form of article provision that may be adopted to limit the directors' personal liability (Corp C §204.5(b)), it is recommended in most instances. The statutory language insulates the directors to the fullest extent permissible from personal liability for monetary damages for breach of a director's duties to the corporation or its shareholders and for other acts or omissions. Corp C §204(a)(10). The provision does not operate to change the otherwise applicable standards or duties of disclosure to shareholders in connection with approval of such a provision in the articles. Corp C §204.5(c). See also Corp C §309 on duties of directors.

In addition to the limitations discussed above, liability for breach of duty to the corporation or its shareholders may not be limited or eliminated for any of the following:

- Acts or omissions involving intentional misconduct or knowing and culpable violations of the law (Corp C §204(a)(10)(A)(i));
- Acts or omissions that a director believes to be contrary to the best interests of the corporation or its shareholders (Corp C §204(a)(10)(A)(ii));
- Acts done without good faith on the part of a director (Corp C §204(a)(10)(A)(ii));
- Acts from which a director derives an improper personal benefit (Corp C §204(a)(10)(A)(iii));
- Acts or omissions that show a reckless disregard for a director's duty to the corporation or its shareholders when the director was or should have been aware, in the ordinary course of performing a director's duties, of a risk of serious injury to the corporation or its shareholders (Corp C §204(a)(10)(A)(iv));
- Acts or omissions that make up a pattern of inattention that amounts to abdication of a director's duty to the corporation or its shareholders (Corp C §204(a)(10)(A)(v));
- Violations of Corp C §310, which requires the disclosure of material facts in transactions between a corporation and its director or a corporation and an entity in which one or more of its directors has a material financial interest (Corp C §204(a)(10)(A)(vi)); or
- Violations of Corp C §316, which subjects a director to liability for improper distributions, loans, or guaranties (Corp C §204(a)(10)(A)(vii)).

**Source:** Business Law/Selecting and Forming Business Entities/8 S and C Corporations/§8.56 n. Form: Indemnification of Officers and Directors

## **§8.56 n. Form: Indemnification of Officers and Directors**

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §8.43 and ends in §8.57

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8.56-1 Indemnification of officers and directors

### **ARTICLE [VII]**

#### **DIRECTOR AND OFFICER INDEMNIFICATION**

*[Add one of the following alternatives]*

*[Alternative 1: Indemnification: short form]*

**The corporation is authorized to indemnify the directors and officers of the corporation to the fullest extent permissible under California law.**

*[Alternative 2: Indemnification: long form]*

**The corporation is authorized to provide indemnification of agents (as defined in Corporations Code §317) for breach of duty to the corporation and its shareholders through Bylaw provisions or through agreements with the agents, or both, in excess of the indemnification otherwise permitted by Corporations Code §317, subject to the limits on such excess indemnification set forth in Corporations Code §204.**

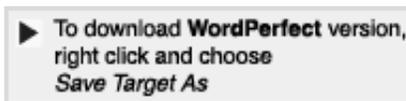
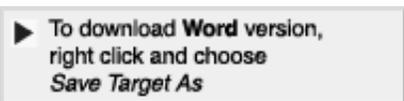
*Comment:* The language of the short form is drawn from Corp C §317(g) and has been suggested by the office of the Secretary of State. Note that agents may not be indemnified for acts for which a director may not be relieved of liability or in circumstances in which indemnity is expressly prohibited by Corp C §317.

The articles may authorize the corporation, by bylaw, agreement, or other means, to permit indemnification of corporate agents in excess of the express limits of Corp C §317 for breach of duty to the corporation or its shareholders. Corp C §204(a)(11).

**Source:** Business Law/Selecting and Forming Business Entities/8 S and C Corporations/§8.57 o. Form: Election to Be Statutory Close Corporation

**§8.57 o. Form: Election to Be Statutory Close Corporation**

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §8.43 and ends in §8.57



8.57-1 Election to be statutory close corporation

**ARTICLE [VIII]**

**CLOSE CORPORATION ELECTION**

**This corporation is a close corporation. The issued shares of this corporation of all classes shall be held of record by not more than \_ \_ [maximum number of persons, not greater than 35, who may hold shares]\_ \_ persons.**

*Comment:* For the statements required in the articles of incorporation to form a statutory close corporation, see §9.6.

§8.58 3. Form: Certificate of Determination of Preferences

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8.58-1 Certificate of determination of preferences

**Certificate of Determination of Preferences of**

\_\_ [e.g., Preferred] \_\_ Shares of

\_\_ [name of corporation] \_\_

The undersigned, \_\_ [name] \_\_ and \_\_ [name] \_\_, certify that:

1. They are the duly elected and acting \_\_ [e.g., president and secretary] \_\_, respectively, of the corporation.

2. Under authority given by the corporation's articles of incorporation, the Board of Directors has duly adopted the following recitals:

**WHEREAS**, the Articles of Incorporation of the corporation provide for a class of shares known as \_\_ [e.g., preferred stock] \_\_, issuable from time to time in one or more series; and

**WHEREAS**, the Board of Directors of the corporation is authorized \_\_ [within the limitations and restrictions stated in the articles of incorporation] \_\_ to determine or alter the rights, preferences, privileges, and restrictions granted to or imposed on any wholly unissued series of \_\_ [e.g., preferred stock] \_\_, to fix the number of shares constituting any such series, and to determine the designation of any of them; and

Whereas, the corporation has not issued any shares of such \_\_ [series of] \_\_ \_\_ [e.g., preferred stock] \_\_ and the Board of Directors of this corporation desires to determine the rights, preferences, privileges, and restrictions relating to this \_\_ [initial] \_\_ series of \_\_ [e.g., preferred stock] \_\_, the number of shares constituting such series, and its designation.

Resolved, that the Board of Directors determines the designation of, the number of shares constituting, and the rights, preferences, privileges, and restrictions relating to this \_\_ [initial] \_\_ series of \_\_ [e.g., preferred stock] \_\_ as follows:

1. The \_\_ [initial] \_\_ series of \_\_ [e.g., preferred stock] \_\_ is designated \_\_ [e.g., "Preferred Shares, \_\_ [Series A] \_\_ ]."

2. The number of shares constituting the \_\_ [e.g., Preferred Shares \_\_ [Series A] \_\_ ], is \_\_ [number] \_\_.

3. The dividend rate on the \_\_ [e.g., Preferred Shares, \_\_ [Series A] \_\_ ], is \$ \_\_ [amount] \_\_ per share per year.

The undersigned, \_\_ [names] \_\_, the \_\_ [e.g., president and secretary] \_\_, respectively, of \_\_ [name of corporation] \_\_, each declare under penalty of perjury under the laws of the State of California that the matters set out in this certificate are true and correct to \_\_ [his/her] \_\_ own knowledge.

Executed at \_\_ [city] \_\_, \_\_ [state] \_\_, on \_\_ [date] \_\_.

\_\_ [Signature] \_\_  
\_\_ [Typed name] \_\_  
President

\_\_ [Signature] \_\_  
\_ \_ [Typed name] \_ \_  
**Secretary**

*Comment:* Corporations Code §173 requires that two officers sign and verify the certificate. Typically, the signers are the president and the secretary, although the statute permits other officers to sign.

For more detailed discussion of certificates of determination of preferences, see §8.19.

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**Source:** Business Law/Selecting and Forming Business Entities/8 S and C Corporations/ B. Bylaws/§8.59 1. Form: Heading; Location of Offices

## B. Bylaws

### §8.59 1. Form: Heading; Location of Offices

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §8.59 and ends in §8.104

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8.59-1 Bylaw heading; location of offices

**Bylaws of** \_\_ *[name of corporation]* \_\_ ,  
\_\_ *[a California Corporation]* \_\_

#### ARTICLE I

#### OFFICES OF CORPORATION

**A. Location of Principal Office.** The board of directors shall fix the location of the principal executive office of the corporation at any place within or outside California. If the principal executive office is located outside California and the corporation has one or more business offices in California, the board shall fix and designate a principal business office in California.

**B. Other Offices.** Branch or subordinate offices may be established at any time and at any place by the \_\_ *[board of directors/following officers: \_\_ *[List]* \_\_]* \_\_.

*Comment:* There is no requirement that a California corporation have its principal executive office, or any office, in California. However, every corporation must designate its principal executive office in the information statement filed with the Secretary of State annually under Corp C §1502(a). If this office is outside California, the statement must identify its principal business office in California, if any. Corp C §1502(a).

A corporation must keep a copy of its bylaws at its principal executive or business office in California. If the corporation has neither, the corporation must furnish a copy of the current bylaws to any shareholder that requests a copy in writing. Corp C §213.

The authority to establish branch offices is ordinarily given to the board. However, counsel should discuss with the client whether that authority should also be given to principal officers of the corporation, such as the president and the chief financial officer.

**Source:** Business Law/Selecting and Forming Business Entities/8 S and C Corporations/ 2. Shareholders' Meetings/  
§8.60 a. Form: Place of Meetings

## 2. Shareholders' Meetings

### §8.60 a. Form: Place of Meetings

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §8.59 and ends in §8.104

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8.60-1 Place of meetings

## ARTICLE II

### SHAREHOLDERS' MEETINGS

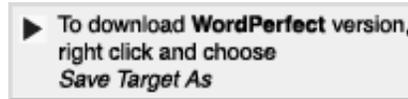
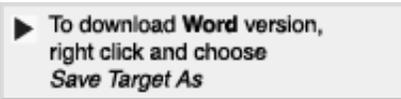
**A. *Location of Shareholders' Meetings.*** Meetings of shareholders shall be held at any place within or outside California that the board of directors may designate. Absent a designation by the board, shareholders' meetings shall be held at the corporation's principal executive office.

*Comment:* Meetings of shareholders may be held at any place stated in or fixed in accordance with the bylaws. Corp C §600(a).

**Source:** Business Law/Selecting and Forming Business Entities/8 S and C Corporations/§8.61 b. Form: Conducting Meetings by Electronic Transmission

## **§8.61 b. Form: Conducting Meetings by Electronic Transmission**

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §8.59 and ends in §8.104



8.61-1 Conducting meetings by electronic transmission

**B. Meetings by Electronic Transmission.** Meetings of shareholders may be conducted, in whole or in part, by electronic transmission by and to the corporation, as provided in Corporations Code §§20 and 21, or by electronic video screen communication if:

**1. The corporation implements measures to provide shareholders, in person or by proxy, a reasonable opportunity to participate in the meeting and to vote on matters submitted to them, including an opportunity to read or hear the proceedings of the meeting concurrently with the proceedings; and**

**2. The corporation maintains a record of any shareholder votes or other shareholder action at the meetings by means of electronic transmission or electronic video screen communication.**

**Any request by a corporation for consent to conduct a meeting of shareholders by electronic transmission by and to the corporation must include a notice that, absent consent of the shareholder, the meeting shall be held at a physical location.**

*Comment:* Meetings of shareholders may be conducted by electronic transmission by or to the corporation, or by electronic video screen communication, under the following conditions:

- The board of directors authorizes such a means of conducting the meeting (Corp C §600(a));
- The corporation requests shareholder consent to conduct the meeting by electronic transmission (Corp C §20), and the request for consent includes a notice that, absent a shareholder's consent, the meeting must be held at a physical location (Corp C §600(e));
- The corporation implements reasonable measures to permit shareholders to participate in the electronic meeting and to vote on matters, and the shareholders can read or hear the proceedings of the meeting concurrently with the meeting (Corp C §600(e)); and
- The corporation maintains a record of any shareholder's vote or other action taken at the electronic meeting. Corp C §600(e).

Corporations Code §20 defines "electronic transmission by the corporation." This means a communication (Corp C §20):

- Delivered by
  - Fax communications or e-mail to the recipient's fax number or e-mail address on file with the corporation;
  - Posting on an electronic message board or network that the corporation has designated for the purpose, together with a separate notice of the posting; or
  - Other forms of electronic communication.
- That creates a record capable of retention and retrieval.
- To a person who has provided an unrevoked consent.
- That, when directed to an individual shareholder or corporate member who is a natural person (and, if an officer or director, only if communicated to that person in his or her capacity as shareholder or member) is preceded by or includes a clear written statement as to
  - Any right to have the record provided or made available on paper;
  - Whether the consent applies to that transmission, to categories of communications, or to all communications

from the corporation; and

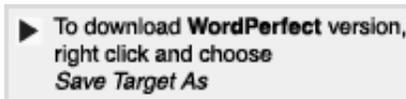
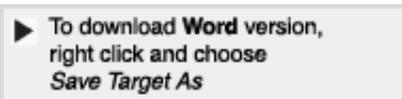
- The procedures the recipient must use to withdraw consent.

Corporations Code §21 defines "electronic communication *to* the corporation." Under that section, the corporation must have reasonable measures in place to verify that the sender is the shareholder, member, or director purporting to send the transmission. Further, the electronic transmission must create a record capable of retention and retrieval. Corp C §21.

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## §8.62 c. Form: Annual Meeting of Shareholders

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8.62-1 Annual meeting of shareholders

[Add one of the following alternatives]

[Alternative 1: Annual meeting date to be set by directors]

**C. Annual Meeting Set by Board.** The annual meeting of shareholders shall be held each year on a date and at a time designated by the board of directors. At each annual meeting, directors shall be elected and any other proper business within the power of the shareholders may be transacted.

[Alternative 2: Annual meeting date set by end of fiscal year]

**C. Annual Meeting Set by Year's End.** The annual meeting of shareholders shall be held each year on a date and at a time designated by the board of directors. The date so designated shall be within \_\_ [e.g., five] \_\_ months after the end of the corporation's fiscal year, and within 15 months after the last annual meeting. At each annual meeting, directors shall be elected and any other proper business within the power of the shareholders may be transacted.

[Alternative 3: Annual meeting held on fixed date]

**C. Annual Meeting Held on Fixed Date.** The annual meeting of the shareholders shall be held on the \_\_ [e.g., tenth day, or third Monday] \_\_ of the month of \_\_ [month] \_\_ in each year at \_\_ [time] \_\_. If, however, this day falls on a legal holiday, then the meeting shall be held at the same time and place on the next succeeding full business day. At each annual meeting, directors shall be elected and any other proper business within the power of the shareholders may be transacted.

*Comment:* Neither the bylaws nor the articles may dispense with the requirement for an annual shareholders' meeting. See Corp C §600. The bylaws may either designate a date for the meeting, or specify a procedure for fixing the date. Corp C §600(b). Typically, the annual meeting is held 3 to 4 months after the end of each fiscal year so that the financial statements for the past year can be considered by the shareholders in electing directors for the coming year and taking other actions.

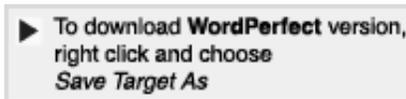
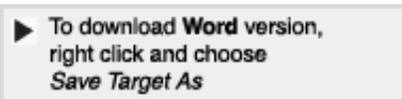
If no date is designated in the bylaws, the initial annual meeting must be held within 15 months after the corporation was organized (*i.e.*, the date the Secretary of State filed the articles), and each succeeding annual meeting must be held within 15 months after the preceding annual meeting. Corp C §600(c).

The second alternative specifies time limits within which the board must set the meeting date. If a date is specified in the bylaws, the annual meeting must be held within 60 days after that date. Corp C §600(c). In either case, if the meeting is not held within the required time period, the superior court, on the application of any shareholder, may summarily order that a meeting be held. Corp C §600(c).

**Source:** Business Law/Selecting and Forming Business Entities/8 S and C Corporations/§8.63 d. Form: Special Meetings

## §8.63 d. Form: Special Meetings

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §8.59 and ends in §8.104



8.63-1 Special meetings; timing

**D. Special Meetings.** A special meeting of the shareholders may be called at any time by the board of directors, by the chair of the board, by the president or vice president, \_\_[title or description of other person(s) entitled to call meeting, e.g., the chief financial officer]\_\_, or by one or more shareholders holding shares that in the aggregate are entitled to cast 10 percent or more of the votes at that meeting.

If a special meeting is called by anyone other than the board of directors, the person(s) calling the meeting shall make a request in writing, delivered personally or sent by registered mail or by telegraphic or other facsimile transmission, to the chair of the board or the president, vice president, or secretary, specifying the time and date of the meeting (which is not less than 35 nor more than 60 days after receipt of the request) and the general nature of the business proposed to be transacted. Within 20 days after receipt, the officer receiving the request shall give notice to the shareholders entitled to vote, in accordance with \_\_[specify paragraph by number or letter; see forms 8.64-1, 8.65-1]\_\_, stating that a meeting will be held at the time requested by the person(s) calling the meeting, and stating the general nature of the business proposed to be transacted. If notice is not given within 20 days after receipt of the request, the person(s) requesting the meeting may give the notice. Nothing in this paragraph shall be construed as limiting, fixing, or affecting the time when a meeting of shareholders called by action of the board may be held.

*Comment:* The board, the chair, the president or a vice president, and shareholders with 10 percent or more of the voting power may call a special meeting of the shareholders. Corp C §600(d). In addition, the bylaws may name any other person, such as the secretary or chief financial officer of the corporation, as a person entitled to call a special shareholders' meeting. Corp C §600(d).

The procedures and time periods for calling special meetings are set forth in Corp C §601. If the officer requested to call the meeting does not give the requisite notice, the person or persons making the request may give the notice themselves, or apply to the superior court for a summary order requiring the notice to be given. Corp C §601(c).

Note that the bylaws may vary the manner of calling and giving notice of shareholders' meetings if the bylaw provision does not conflict with law or the articles. Corp C §212(b)(2).

## **§8.64 e. Form: Notice of Shareholders' Meetings**

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8.64-1 Notice of shareholders' meetings; timing; contents

**E. Notice of Shareholders' Meetings.** All notices of meetings of shareholders shall be sent or otherwise given in accordance with \_\_ *[specify paragraph by number or letter]* \_\_ not fewer than 10 nor more than 60 days before the date of the meeting. Shareholders entitled to notice shall be determined in accordance with \_\_ *[specify paragraph by number or letter]* \_\_. The notice shall specify the place, date, and hour of the meeting, the means of electronic transmission by and to the corporation, as defined in Corporations Code §§20 and 21, or electronic video screen communication, if any, by which shareholders may participate in the meeting. For a special meeting, the notice shall specify the general nature of the business to be transacted. For the annual meeting, the notice shall specify the matters that the board of directors, at the time of giving the notice, intends to present for action by the shareholders. If directors are to be elected, the notice shall include the names of all nominees whom the board intends, at the time of the notice, to present for election.

*[If applicable, add the following option]*

*[Option: Proposed approval of certain matters]*

The notice shall also state the general nature of any proposed action to be taken at the meeting to approve any of the following matters:

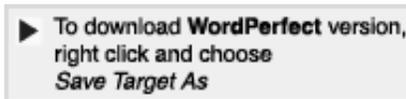
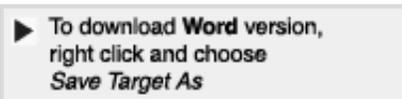
1. A transaction in which a director has a financial interest, within the meaning of Corporations Code §310;
2. An amendment of the Articles of Incorporation under Corporations Code §902;
3. A reorganization under Corporations Code §1201;
4. A voluntary dissolution under Corporations Code §1900; or
5. A distribution in dissolution that requires approval of the outstanding shares under Corporations Code §2007.

*Comment:* This form is based on Corp C §601, which sets forth the notice requirements for annual and special shareholders' meetings. Notice of the annual meeting cannot be dispensed with. See Corp C §601. The manner of giving notice may be varied in the bylaws if the bylaw provision does not conflict with the law or the articles. On the definition of "electronic transmission by and to the corporation," see the Comment in §8.61.

**Source:** Business Law/Selecting and Forming Business Entities/8 S and C Corporations/§8.65 f. Form: Manner of Giving Notice of Shareholders' Meetings

## §8.65 f. Form: Manner of Giving Notice of Shareholders' Meetings

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §8.59 and ends in §8.104



8.65-1 Manner of giving notice of shareholders' meetings

**F. Manner of Giving Notice of Meetings.** Notice of any shareholders' meeting shall be given either personally, or by first-class mail or other written communication, including facsimile, telegraphic, and other electronic transmission, by the corporation, charges prepaid, addressed to the shareholder at the address appearing on the corporation's books or given by the shareholder to the corporation for purposes of notice. If no address appears on the corporation's books or has been given as specified above, notice shall be either sent by first-class mail addressed to the shareholder at the corporation's principal executive office or published at least once in a newspaper of general circulation in the county where the corporation's principal executive office is located. Notice is deemed to have been given at the time when delivered personally or sent by electronic transmission by the corporation, deposited in the mail, or sent by other means of written communication.

Notice given by electronic transmission by the corporation shall be valid only if it complies with Corporations Code §20. Notice shall not be given by electronic transmission by the corporation if

1. The corporation is unable to deliver two consecutive notices to the shareholder by that means, or
2. The inability to deliver the notice by electronic transmission becomes known to the secretary or other person responsible for giving the notice.

*[If applicable, add one or more of the following options]*

*[Option 1: Undeliverable mail]*

If any notice or report mailed to a shareholder at the address appearing in the corporation's books is returned marked to indicate that the United States Postal Service is unable to deliver the document to the shareholder at that address, all future notices or reports shall be deemed to have been duly given without further mailing if the corporation holds the document available for the shareholder on written demand at the corporation's principal executive office for a period of one (1) year after the date the notice or report was given to all other shareholders.

*[Option 2: Affidavit of mailing or electronic transmission]*

An affidavit of the mailing, electronic transmission by the corporation, or other authorized means of giving notice or delivering a document, of any notice of shareholders' meeting, report, or other document sent to shareholders, may be executed by the corporation's secretary, assistant secretary, or transfer agent and, if executed, shall be filed and maintained in the minute book of the corporation.

*Comment:* This form is based on the procedure for giving notice in Corp C §601(b). See also Corp C §118 (time notice is given or sent) and Corp C §195 (facsimile, telegraphic, and electronic communication).

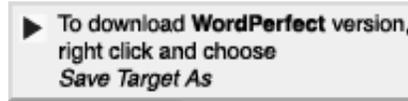
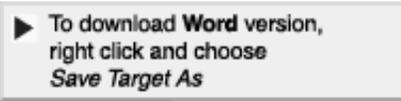
A corporation with 500 or more shareholders may use third-class mail, in which event the minimum required notice period is 30 days. Corp C §601(b). If flexibility in this matter is desired, this form should be modified accordingly.

The affidavit specified in the second option constitutes prima facie evidence that the notice was actually given. See Corp C §601(b). Although the affidavit of mailing of notice is not required by statute, it is good practice for the corporation to use an affidavit of mailing as to all notices and reports sent to shareholders.

On the definition of "electronic transmission by and to the corporation," see the Comment in §8.61.

**§8.66 g. Form: Quorum**

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §8.59 and ends in §8.104



8.66-1 Quorum

**G. Quorum.** The presence in person or by proxy of the holders of a majority of the shares entitled to vote at any meeting of the shareholders shall constitute a quorum for the transaction of business. The shareholders present at a duly called or held meeting at which a quorum is present may continue to do business until adjournment, notwithstanding the withdrawal of enough shareholders to leave less than a quorum, if any action taken (other than adjournment) is approved by at least a majority of the shares required to constitute a quorum unless the General Corporation Law (Corporations Code §§100-2319) requires the vote of a greater number of shareholders or a vote by classes.

*Comment:* Ordinarily, a quorum at a shareholders' meeting is a majority of the shares entitled to vote, represented at the meeting in person or by proxy. Corp C §602(a). Although this requirement cannot be increased, the articles may reduce the quorum requirement, but not to less than one-third of the shares entitled to vote. Corp C §602(a). If this provision is included in the articles, this bylaw provision should be altered to conform with the articles.

At a meeting where a quorum was originally present, if shareholders withdraw in such numbers as to leave less than a quorum, the remaining shareholders may continue to do business, but no action (other than adjournment) may be taken unless it is approved by a majority of the shares necessary to constitute a quorum or, if required by the Corporations Code, the vote of a greater number or voting by class. Corp C §602(b).

## §8.67 h. Form: Adjournment of Meeting

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §8.59 and ends in §8.104

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8.67-1 Adjournment of meeting

**H. Adjournment.** Any shareholders' meeting, whether or not a quorum is present, may be adjourned from time to time by the vote of the majority of the shares represented at that meeting, either in person or by proxy, but in the absence of a quorum, no other business may be transacted at that meeting, except as provided in \_\_[specify paragraph by number or letter]\_\_.

*[If applicable, add the following option]*

*[Option: Notice of adjourned meeting]*

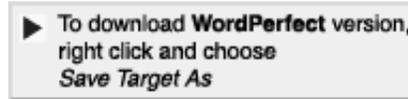
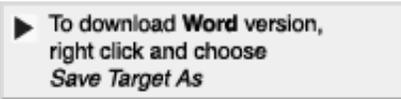
When any meeting of shareholders is adjourned to another time or place, notice of the adjourned meeting need not be given if the time and place or the means of electronic transmission by and to the corporation or electronic video screen communication, if any, by which the shareholders may participate are announced at the meeting at which the adjournment is taken, unless a new record date for the adjourned meeting is fixed, or unless the adjournment is for more than 45 days after the date set for the original meeting, in which case the board of directors shall set a new record date. Notice of any such adjourned meeting, if required, shall be given to each shareholder of record entitled to vote at the adjourned meeting, in accordance with \_\_[specify paragraph by number or letter]\_\_. At any adjourned meeting, the corporation may transact any business that might have been transacted at the original meeting.

*Comment:* Absent an initial quorum, any shareholders' meeting may be adjourned from time to time by the vote of a majority of the shares represented in person or by proxy, but no other business may be transacted. Corp C §602(c). If the adjournment is for more than 45 days after the original meeting date, or if a new record date is fixed for the adjourned meeting, a notice of the adjourned meeting must be given to each shareholder of record entitled to vote at the meeting. Corp C §601(d).

On the definition of "electronic transmission by and to the corporation," see the Comment in §8.61.

## §8.68 i. Form: Voting

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §8.59 and ends in §8.104



8.68-1 Voting; determining who may vote; manner of voting

**I. Voting.** The shareholders entitled to vote at any meeting of shareholders shall be determined in accordance with \_\_ *[specify paragraph by number or letter]* \_\_, subject to Corporations Code §§702-704 relating to voting shares held by a fiduciary, in the name of a corporation, or in joint ownership. The shareholders' vote may be by voice vote or by ballot, provided, however, that any election for directors must be by ballot if demanded by any shareholder before the voting has begun. On any matter other than the election of directors, any shareholder may vote part of the shares the shareholder is to vote in favor of the proposal and refrain from voting the remaining shares or vote them against the proposal. If the shareholder fails to specify the number of shares that the shareholder is voting affirmatively, it will be conclusively presumed that the shareholder's approving vote is with respect to all shares that the shareholder is entitled to vote. If a quorum is present (or if a quorum has been present earlier at the meeting but some shareholders have withdrawn), the affirmative vote of a majority of the shares represented and voting, provided such shares voting affirmatively also constitute a majority of the number of shares required for a quorum, shall be the act of the shareholders unless the vote of a greater number or voting by classes is required by law or by the Articles of Incorporation.

*[If applicable, add the following option]*

*[Option: Cumulative voting]*

At a shareholders' meeting at which directors are to be elected, no shareholder shall be entitled to cumulate votes (*i.e.*, cast for any candidate a number of votes greater than the number of votes which that shareholder normally would be entitled to cast), unless the candidates' names have been placed in nomination before commencement of the voting and a shareholder has given notice at the meeting, before the voting has begun, of the shareholder's intention to cumulate votes. If any shareholder has given such a notice, then all shareholders entitled to vote may cumulate their votes for candidates in nomination, and may give one candidate a number of votes equal to the number of directors to be elected multiplied by the number of votes to which that shareholder's shares are normally entitled, or distribute the shareholder's votes on the same principle among any or all of the candidates, as the shareholder thinks fit. The candidates receiving the highest number of votes, up to the number of directors to be elected, shall be elected.

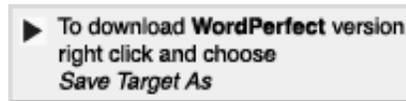
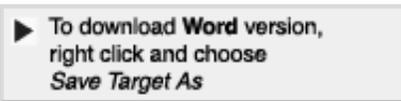
*Comment:* Unless otherwise provided in the articles, each share is entitled to one vote on all matters, and the affirmative vote of a majority of the shares represented and voting at a meeting at which a quorum is present is the act of the shareholders (unless the articles or the Corporations Code impose a higher requirement). Corp C §§602, 700.

For most corporations, cumulative voting for directors must be allowed if requested, but it is not automatic. Corp C §708(a); but see Corp C §§301.5, 708.5. A domestic corporation qualifying as a listed corporation (see Corp C §301.5(d)) that eliminated cumulative voting (see Corp C §301.5(a)) may amend its articles or bylaws to provide that the approval of the shareholders (see Corp C §153) is required to elect a director in an uncontested election. Corp C §708.5(a)(1), (b).

To trigger cumulative voting, one or more shareholders must give notice at the meeting, before the voting begins, of an intention to cumulate votes. If any shareholder gives such a notice, all shareholders may cumulate their votes, but only for candidates whose names have been placed in nomination. Corp C §708(b).

**§8.69 j. Form: Waiver of Notice or Consent by Absent Shareholders**

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §8.59 and ends in §8.104



8.69-1 Waiver of notice or consent by absent shareholders

**J. Waiver of Notice or Consent by Absent Shareholders.** The transactions of any meeting of shareholders, however called and noticed and wherever held, shall be as valid as though they were had at a meeting duly held after regular call and notice, if a quorum is present either in person or by proxy, and if each person entitled to vote who was not present in person or by proxy, either before or after the meeting, provides a written waiver of notice or a consent to holding the meeting or an approval of the minutes of the meeting. The waiver of notice or consent need not specify either the business to be transacted or the purpose of any annual or special meeting of the shareholders, except that, if action is taken or proposed to be taken for approval of any of the following matters, as specified in Corporations Code §601(f), the waiver of notice or consent must state the general nature of the action or proposed action:

1. A transaction in which a director has a financial interest, within the meaning of Corporations Code §310;
2. An amendment of the Articles of Incorporation under Corporations Code §902;
3. A reorganization under Corporations Code §1201;
4. A voluntary dissolution under Corporations Code §1900; or
5. A distribution in dissolution that requires approval of the outstanding shares under Corporations Code §2007.

All waivers, consents, and approvals must be filed with the corporate records or made a part of the minutes of the meeting.

*[If applicable, add the following option]*

*[Option: Waiver of notice or consent by attending shareholders]*

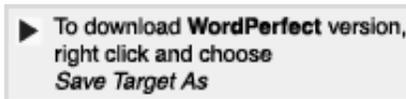
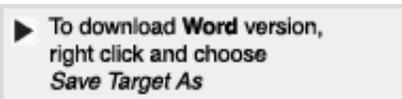
A shareholder's attendance at a meeting also constitutes a waiver of notice of that meeting, unless the shareholder at the beginning of the meeting objects to the transaction of any business on the ground that the meeting was not lawfully called or convened. In addition, attendance at a meeting does not constitute a waiver of any right to object to consideration of matters required by law to be included in the notice of the meeting which were not so included, if that objection is expressly made at the meeting.

*Comment:* This provision is based on Corp C §601(e). Subject to the statutes on voting by representatives, fiduciaries, receivers, pledgees, and corporate shareholders; and voting by shares standing in joint names (Corp C §§702-704), consents, or waivers of notice may be given by the shareholder entitled to vote or by the shareholder's proxy. Waiver of the corporation's noncompliance with notice requirements also occurs if the shareholder attends the meeting in question and fails to object to the faulty notice or lack of notice at the beginning of the meeting. Corp C §601(e).

**Source:** Business Law/Selecting and Forming Business Entities/8 S and C Corporations/§8.70 k. Form: Shareholder Action by Written Consent Without a Meeting

## §8.70 k. Form: Shareholder Action by Written Consent Without a Meeting

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §8.59 and ends in §8.104



8.70-1 Shareholder action by written consent without a meeting

**K. Action by Written Consent.** Any action that could be taken at an annual or special meeting of shareholders may be taken without a meeting and without prior notice, if a consent in writing, setting forth the action so taken, is signed by the holders of outstanding shares having not less than the minimum number of votes that would be necessary to authorize or take that action at a meeting at which all shares entitled to vote on that action were present and voted.

*[If applicable, add one or more of the following options]*

*[Option 1: Election of directors by written consent]*

Directors may be elected by written consent of the shareholders without a meeting only if the written consents of all outstanding shares entitled to vote are obtained, except that vacancies on the board (other than vacancies created by removal) not filled by the board may be filled by the written consent of the holders of a majority of the outstanding shares entitled to vote.

*[Option 2: Revocation of written consent]*

All consents shall be filed with the secretary of the corporation and shall be maintained in the corporate records. Any shareholder or other authorized person who has given a written consent may revoke it by a writing received by the secretary of the corporation before written consents of the number of shares required to authorize the proposed action have been filed with the secretary.

*[Option 3: Notice of corporate action]*

Unless the consents of all shareholders entitled to vote have been solicited in writing, prompt notice shall be given of any corporate action approved by shareholders without a meeting by less than unanimous consent, to those shareholders entitled to vote who have not consented in writing. As to approvals required by Corporations Code §310 (transactions in which a director has a financial interest), §317 (indemnification of corporate agents), §1201 (corporate reorganization), or §2007 (certain distributions on dissolution), notice of the approval shall be given at least 10 days before the consummation of any action authorized by the approval. Notice shall be given in the manner specified in \_\_ *[specify paragraph by number or letter]* \_\_.

*Comment:* Shareholder action by written consent without prior notice is authorized by Corp C §603, but it may be eliminated or restricted by the articles of incorporation. See Corp C §603(a).

There is no requirement that all shareholders entitled to vote must be solicited when written consents are sought. However, unless all shareholders entitled to vote were solicited in writing for consents, the statute requires the corporation to give all nonconsenting shareholders entitled to vote prompt notice of any corporate action approved by written consent of the shareholders without a meeting. Corp C §603(b).

As to the special matters requiring shareholder approval set forth in the third optional paragraph, the notice must be given at least ten days before consummation of the approved action (presumably to give nonconsenting shareholders an opportunity to seek judicial relief). Corp C §603(b)(1).

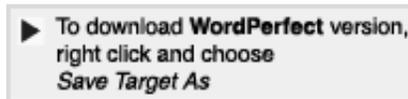
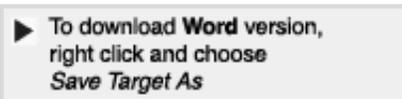
Election of directors by written consent of the shareholders requires unanimous consent of all outstanding shares entitled to vote. Corp C §603(d). This requirement is intended to protect the right of cumulative voting in the election of the entire board. However, vacancies on the board, other than those caused by removal, can be filled by the written consent of a majority of the outstanding shares entitled to vote. In the case of removal, filling a vacancy requires unanimous consent. Corp C §305(b).



**Source:** Business Law/Selecting and Forming Business Entities/8 S and C Corporations/§8.71 I. Form: Record Date for Notice and Voting

## §8.71 I. Form: Record Date for Notice and Voting

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §8.59 and ends in §8.104



8.71-1 Record date for notice and voting

**L. Record Date for Shareholder Notice and Voting.** For purposes of determining the shareholders entitled to receive notice of and vote at a shareholders' meeting or give written consent to corporate action without a meeting, the board may fix in advance a record date that is not more than 60 nor less than 10 days before the date of a shareholders' meeting, or not more than 60 days before any other action.

If no record date is fixed by the board:

1. The record date for determining shareholders entitled to receive notice of and vote at a shareholders' meeting shall be the business day preceding the day on which notice is given, or, if notice is waived as provided in \_\_ *[specify paragraph by number or letter]* \_\_, the business day preceding the day on which the meeting is held.

2. The record date for ascertaining shareholders entitled to give consent to corporate action in writing without a meeting, if no prior action has been taken by the board, shall be the day on which the first written consent is given.

3. The record date for determining shareholders for any other purpose shall be as set forth in \_\_ *[specify paragraph by number or letter]* \_\_ of these Bylaws.

A determination of shareholders of record entitled to receive notice of and vote at a shareholders' meeting shall apply to any adjournment of the meeting unless the board fixes a new record date for the adjourned meeting. However, the board must fix a new record date if the adjournment is to a date more than 45 days after the date set for the original meeting.

Only shareholders of record in the corporation's books at the close of business on the record date shall be entitled to these notice and voting rights notwithstanding any transfer of shares on the corporation's books after the record date, except as otherwise required by law.

*Comment:* A record date is necessary to identify which shareholders are entitled to various rights, including the right to receive notice of and vote at a shareholders' meeting and the right to give consent in writing to corporate actions without a shareholders' meeting. The board is authorized to fix a record date for shareholders' meetings and other purposes in advance, within the time limits specified in this form. Corp C §701(a). If the corporation is subject to stock exchange rules, restrictions on certificates of determination, or other instruments or agreements that further narrow the permissible range of record dates or specifically require the board to fix record dates for distributions, the form should be modified accordingly.

If no record date is fixed by the board of directors, Corp C §701(b) provides detailed rules for determining the record date, which are substantially followed in this form.

If a shareholders' meeting is adjourned, the same determination of shareholders applicable to the original meeting applies to the adjourned meeting unless the board of directors fixes a new record date, which it must do if the meeting is adjourned for more than 45 days. Corp C §701(c). Shareholders of record are those persons whose names appeared on the corporation's books at the close of business on the record date, whether or not there are later transfers of shares on the corporation's books. Corp C §701(d).

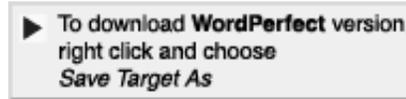
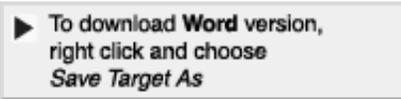
The statutory rules for determining record dates may be varied by agreement or by the articles of incorporation. Corp

C §701(d). If substantial changes from the above form are desired, an appropriate provision should be included in the articles of incorporation, and the bylaw provision should conform to the provision in the articles.

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## §8.72 m. Form: Proxies

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §8.59 and ends in §8.104



8.72-1 Proxies

**M. Proxies.** Every shareholder entitled to vote for directors or on any other matter shall have the right to do so either in person or by one or more agents authorized by a written proxy signed \_\_ \_\_*[or an electronic transmission authorized]*\_\_ by the shareholder or the shareholder's attorney-in-fact and filed with the secretary of the corporation. A proxy shall be deemed signed if the shareholder's name is placed on the proxy (whether by manual signature, typewriting, telegraphic or electronic transmission, or otherwise) by the shareholder or the shareholder's attorney-in-fact.

*[If applicable, add the following option]*

*[Option: Oral transmission of proxy permitted]*

A proxy may be transmitted by an oral telephonic transmission if it is submitted with information from which it may be established that the proxy was authorized by the shareholder or the shareholder's attorney-in-fact.

*[Continue]*

A validly executed proxy that does not state that it is irrevocable shall continue in full force and effect unless

1. It is revoked by the person executing it, before the vote pursuant to that proxy, by a writing delivered to the corporation stating that the proxy is revoked, or by attendance at the meeting and voting in person by the person executing the proxy or by a subsequent proxy executed by the same person and presented at the meeting; or

2. Written notice of the death or incapacity of the maker of that proxy is received by the corporation before the vote pursuant to that proxy is counted. However, no proxy shall be valid after the expiration of 11 months from the date of the proxy, unless otherwise provided in the proxy. The revocability of a proxy that states on its face that it is irrevocable shall be governed by Corporations Code §705(e) and (f).

*Comment:* Proxies are governed by Corp C §§604 and 705. A proxy need not be signed manually if the shareholder or the shareholder's attorney-in-fact places the shareholder's name on the proxy by any of the means indicated in this form. Corp C §178. The corporation is entitled to rely on the authenticity of the signature, because a proxy purporting to be duly executed is presumptively valid. Corp C §705(a). The same rules appear to apply to revocation of a proxy by a written instrument. See Corp C §195.

If the corporation has 100 or more shareholders but is not subject to the reporting requirements of the Securities Exchange Act of 1934 (15 USC §§78a-78oo), a proxy or a written consent form distributed to ten or more shareholders must afford the person voting an opportunity to specify a choice between approval or disapproval of each matter or group of related matters, other than election of directors or officers. Corp C §604.

Irrevocable proxies are permitted in certain limited situations, e.g., if they are held by a pledgee, a person with an option to purchase the shares, a creditor of the corporation or its shareholders, an employee under an employment contract, or a voting trustee or trust beneficiary. See Corp C §705(e). However, even a proxy purporting to be irrevocable may become revocable under some circumstances, e.g., if the pledge is redeemed (Corp C §705(e)) or if the shares are purchased by a person who has no knowledge of the proxy's irrevocability and the share certificate does not indicate both the proxy and its irrevocability. Corp C §705(f); see Counseling California Corporations (3d ed Cal CEB 2008).



**Source:** Business Law/Selecting and Forming Business Entities/8 S and C Corporations/§8.73 n. Form: Inspectors of Election

## §8.73 n. Form: Inspectors of Election

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §8.59 and ends in §8.104

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### 8.73-1 Appointment and duties of inspectors of election

**N. Inspectors of Election.** Before any meeting of shareholders, the board of directors may appoint any persons other than nominees for office to act as inspectors of election at the meeting or its adjournment. If no inspectors of election are so appointed, the chair of the meeting may, and on the request of any shareholder or a shareholder's proxy must, appoint either one or three inspectors of election at the meeting. If inspectors are appointed at a meeting on the request of one or more shareholders or proxies, the holders of a majority of shares or their proxies present at the meeting shall determine whether one or three inspectors are to be appointed. If any person appointed as inspector fails to appear or fails or refuses to act, the chair of the meeting may, and on the request of any shareholder or a shareholder's proxy must, appoint a person to fill that vacancy.

The inspectors of election will:

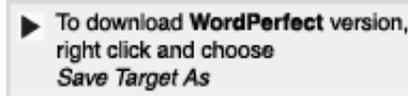
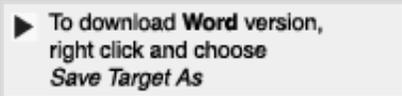
1. Determine the number of shares outstanding and the voting power of each, the shares represented at the meeting; the existence of a quorum; and the authenticity, validity, and effect of proxies;
2. Receive votes, ballots, or consents;
3. Hear and determine all challenges and questions in any way arising in connection with the right to vote;
4. Count and tabulate all votes or consents;
5. Decide when the polls shall close;
6. Determine the result; and
7. Do any other acts that may be proper to conduct the election or vote with fairness to all shareholders.

*Comment:* This form is based on Corp C §707.

### 3. Board of Directors

#### §8.74 a. Form: Powers of Directors

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §8.59 and ends in §8.104



8.74-1 Powers granted to directors

## ARTICLE III

### DIRECTORS

**A. Director Powers.** Subject to California's General Corporation Law and any limitations in the Articles of Incorporation and these Bylaws relating to action required to be approved by the shareholders or by the outstanding shares, the business and affairs of the corporation shall be managed and all corporate powers shall be exercised by or under the direction of the board of directors.

*[If applicable, add the following option]*

*[Option: Specification of powers of directors]*

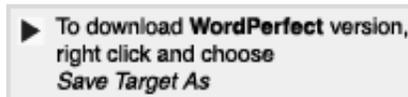
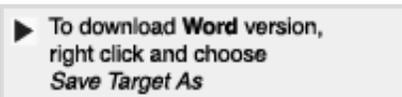
Without prejudice to these general powers, and subject to the same limitations, the board of directors has the power to:

1. Select and remove all officers, agents, and employees of the corporation; prescribe any powers and duties for them that are consistent with law, with the Articles of Incorporation, and with these Bylaws; fix their compensation; and require from them security for faithful service.
2. Change the principal executive office or the principal business office in California from one location to another; cause the corporation to be qualified to do business in any other state, territory, dependency, or country and conduct business within or outside California; and designate any place within or outside California for holding any shareholders' meeting or meetings, including annual meetings.
3. Adopt, make, and use a corporate seal; prescribe the forms of certificates of stock; and alter the form of the seal and certificates.
4. Authorize the issuance of shares of stock of the corporation on any lawful terms, in consideration of money paid, labor done, services actually rendered, debts or securities canceled, or tangible or intangible property actually received.
5. Borrow money and incur indebtedness on behalf of the corporation, and cause to be executed and delivered for the corporation's purposes, in the corporate name, promissory notes, bonds, debentures, deeds of trust, mortgages, pledges, hypothecations, and other evidences of debt and securities.

*Comment:* The first portion of this form is based on Corp C §300(a). The optional portion reflects the scope of the board of directors' powers. For statutory provisions on general powers of the corporation, who may exercise corporate powers, and limitations on these powers, see Corp C §§207-208. Note that, subject to the restrictions of Corp C §204(a), the articles or bylaws may restrict or eliminate the power of the board to adopt, amend, or repeal any or all bylaws. Corp C §211.

## §8.75 b. Form: Number of Directors

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §8.59 and ends in §8.104



8.75-1 Number of directors

[Add one of the following alternatives]

[Alternative 1: Number of directors is fixed]

**B. Fixed Number of Directors.** The authorized number of directors shall be \_\_ [number] \_\_ until changed by a duly adopted amendment to the Articles of Incorporation \_\_ [or by amendment to this bylaw adopted by the vote or written consent of a majority of the outstanding shares entitled to vote] \_\_. However, an amendment that would reduce the authorized number of directors to a number fewer than five cannot be adopted if the votes cast against its adoption at a shareholders' meeting, or the shares not consenting to an action by written consent, are equal to more than one-sixth (16 <sup>2</sup>/<sub>3</sub> percent) of the outstanding shares entitled to vote.

[Alternative 2: Number of directors is variable]

**B. Variable Number of Directors.** The authorized number of directors shall be no fewer than \_\_ [minimum number] \_\_ nor more than \_\_ [maximum number] \_\_. The exact number of authorized directors shall be \_\_ [number] \_\_ until changed, within the limits specified above, by a Bylaw amending this paragraph, duly adopted by the board of directors or by the shareholders. The maximum or minimum number of directors cannot be changed, nor can a fixed number be substituted for the maximum and minimum numbers, except by a duly adopted amendment to the Articles of Incorporation or by an amendment to this Bylaw duly approved by a majority of the outstanding shares entitled to vote. An amendment that would reduce the minimum number to fewer than five, however, cannot be adopted if the votes cast against its adoption at a shareholders' meeting or the shares not consenting to an action by written consent are equal to more than one-sixth (16 <sup>2</sup>/<sub>3</sub> percent) of the outstanding shares entitled to vote. No amendment may change the stated maximum number of authorized directors to a number greater than two times the stated minimum number minus one.

*Comment:* Alternative 1 of this form is for use if a fixed rather than a variable number of directors is desired. If a fixed number is specified in the articles, a change in the number requires an amendment to the articles of incorporation, in which case the remainder of the first sentence following "articles of incorporation" should not be used. Any special articles' provisions regarding the required vote should be reflected in this bylaw. If the number of directors on a fixed board is established by the bylaws (rather than the articles), the number can be changed by a bylaw amendment, but the amendment must be approved by a majority of the outstanding shares entitled to vote. Corp C §212.

If the articles of incorporation specify the maximum and minimum number of directors, a change in these numbers requires an amendment to the articles (Corp C §212(a)), but within the specified limits the exact number may be changed by a simple amendment to the bylaws adopted by the board or the shareholders. If the variable board and its maximum and minimum numbers are established by bylaw rather than the articles, a change in the range of numbers or a change to a fixed number of directors requires approval of the outstanding shares entitled to vote. Corp C §212(a). To reduce the minimum (or fixed) number of directors to fewer than five in any case requires approval of a supermajority of the shares as set forth in this form. The stated minimum number of directors on a variable board may not be fewer than three, and the stated maximum may not be greater than twice the stated minimum minus one (to protect minority shareholders' right to elect directors by cumulative voting). For example, if the stated minimum is five, the stated maximum cannot be more than nine. See Corp C §212.

**Source:** Business Law/Selecting and Forming Business Entities/8 S and C Corporations/§8.76 c. Form: Election and Term of Office of Directors

## §8.76 c. Form: Election and Term of Office of Directors

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8.76-1 Election and term of office of directors

**C. Election and Term of Office.** Directors shall be elected at each annual meeting of the shareholders to hold office until the next annual meeting. Each director, including a director elected to fill a vacancy, shall hold office until expiration of the term for which elected and until a successor is elected and qualified. No reduction of the authorized number of directors shall have the effect of removing any director before that director's term of office expires.

*Comment:* Directors may be elected to hold office until the next annual meeting. Corp C §301(a). However, Corp C §301(a) permits the articles to provide for a term of office for directors shorter than 1 year to effect a "voting shift," which is defined as a "change, pursuant to or by operation of a provision of the articles, in the relative rights of the holders of one or more classes or series of shares, voting as one or more separate classes or series, to elect one or more directors." Corp C §194.7

A "listed" corporation may adopt a provision in its articles or bylaws for either two or three classes of directors to be elected to serve for 2 or 3 years, respectively. A "listed" corporation is one that is listed on the New York Stock Exchange, the NYSE Amex, the NASDAQ Global Market, or the NASDAQ Capital Market. Corp C §301.5(d).

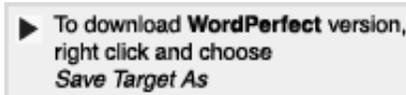
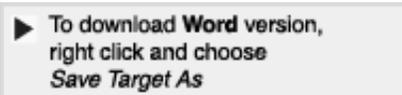
If a "listed" corporation ceases to be a listed corporation, there is provision for the elimination of classes of directors, unless the articles or bylaws contain a provision to the contrary. Corp C §301.5(e). See Corp C §303(a) for provisions on removal of directors from classified boards. The effect of such a provision is to stagger the directors' terms. A minimum of three directors must be elected at each election and the elections must be distributed so that, as nearly as possible, in the case of two classes of directors, half the directors are elected at each election and, in the case of three classes of directors, one-third of the directors are elected at each election. A listed corporation may also dispense with cumulative voting by amendment of its articles or bylaws. A corporation that is not listed may include these provisions in its bylaws, with the provisions to become effective if the corporation ever becomes a listed corporation.

The amendment of the articles or bylaws to split the directors into classes or abolish cumulative voting must be approved by the board and by the affirmative vote of a majority of the outstanding shares entitled to vote on the matter.

**Source:** Business Law/Selecting and Forming Business Entities/8 S and C Corporations/§8.77 d. Form: Vacancies on Board of Directors

## **§8.77 d. Form: Vacancies on Board of Directors**

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §8.59 and ends in §8.104



8.77-1 Vacancies on board of directors

### **D. Vacancies. A vacancy on the board of directors will be deemed to exist:**

**1. If a director dies, resigns, or is removed by the shareholders or an appropriate court, as provided in Corporations Code §303 or §304;**

**2. If the board of directors declares vacant the office of a director who has been convicted of a felony or declared of unsound mind by an order of court;**

**3. If the authorized number of directors is increased; or**

**4. If at any shareholders' meeting at which one or more directors are elected the shareholders fail to elect the full authorized number of directors to be voted for at that meeting.**

**E. Resignations. Any director may resign effective on giving written notice to the chair of the board, the president, the secretary, or the board of directors, unless the notice specifies a later effective date. If the resignation is effective at a future time, the board may elect a successor to take office when the resignation becomes effective.**

**F. Filling Vacancies. Except for a vacancy caused by the removal of a director, vacancies on the board may be filled by approval of the board or, if the number of directors then in office is less than a quorum, by**

**1. The unanimous written consent of the directors then in office,**

**2. The affirmative vote of a majority of the directors then in office at a board meeting held pursuant to notice or waivers of notice complying with Corporations Code §307, or**

**3. A sole remaining director.**

**A vacancy on the board caused by the removal of a director may be filled only by the shareholders, except that a vacancy created when the board declares the office of a director vacant may be filled by the board of directors.**

**The shareholders may elect a director at any time to fill a vacancy not filled by the board of directors.**

**The term of office of a director elected to fill a vacancy will run until the next annual meeting of the shareholders, and such a director shall hold office until a successor is elected and qualified.**

*Comment:* Vacancies (see Corp C §192) in the board of directors are covered in Corp C §§301-306. The board of directors may declare vacant the office of a director who has been declared of unsound mind by court order or convicted of a felony. Corp C §302. The shareholders may remove any or all directors without cause, subject to strict voting limitations (see Corp C §303), and the superior court in a shareholders' derivative suit may remove directors for abuses listed in Corp C §304.

Vacancies created by removal of a director are filled by the shareholders. The shareholders may fill a vacancy by a simple majority of those present and voting at a meeting, or without a meeting by unanimous written consent. A

vacancy other than one caused by removal may be filled with the written consent of a shareholder majority. See Corp C §§305(a)-(b), 603(a), (d). However, the articles or bylaws may expressly permit the board to fill vacancies. Corp C §305(a). (Note that under Corp C §305(a), the articles or bylaws may require shareholder approval of the filling of any board vacancy.) Any vacancies not filled by the directors may be filled by the shareholders. If written consent procedures are used, the consent of a majority of the outstanding shares entitled to vote is required. Corp C §305(b).

**NOTE:** Corporations Code §305 distinguishes between filling a vacancy when a quorum remains in office and doing so when less than a quorum remains. When less than a quorum of the board remains in office, a vacancy may be filled by the directors in one of two ways: by the unanimous written consent of the remaining directors, or a majority vote of the remaining directors at a meeting held under a notice or waiver of notice. A meeting is required when the unanimous consent of the remaining directors cannot be obtained.

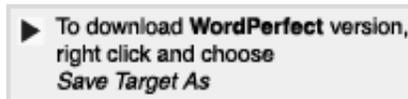
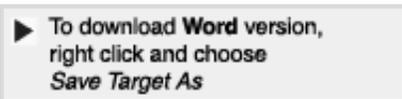
If after the board has filled a vacancy, the number of directors who were elected by the shareholders is less than a majority of the board, the holders of 5 percent or more of the outstanding shares with voting rights may call a special shareholders' meeting (Corp C §305(c)(1)) or may apply to the superior court for a summary order requiring a special meeting, at which the entire board will be elected (Corp C §305(c)(2)).

Corporations Code §305(a) permits shareholders to approve an article or a bylaw allowing directors to fill vacancies resulting from removal; the form assumes that no such bylaw or article has been adopted.

If a person is elected to the board but fails to participate in any meetings or to communicate with the other board members, it cannot be assumed that the position has become vacant. In the absence of death, resignation, or removal proceedings, the absent member must be carried on the board of directors until that member's term expires. See Corp C §192.

## §8.78 e. Form: Meetings of Board of Directors

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §8.59 and ends in §8.104



8.78-1 Meetings of the board

### G. Meetings of the Board.

**1. Location of Meetings.** Regular meetings of the board of directors may be held at any place within or outside California as designated from time to time by the board. In the absence of a designation, regular meetings shall be held at the principal executive office of the corporation. Special meetings of the board shall be held at any place in or outside California designated in the notice of the meeting, or if the notice does not state a place, or if there is no notice, at the principal executive office of the corporation. Any meeting, regular or special, may be held by conference telephone, electronic video screen communication, or electronic transmission by and to the corporation, as provided in Corporations Code §§20 and 21. Participation in a meeting through the use of conference telephone or electronic video screen communication constitutes presence in person at the meeting, provided that all directors participating in the meeting are able to hear one another. Participation through electronic transmission by and to the corporation (other than by conference telephone and electronic video screen communication) constitutes presence in person at the meeting, provided that (a) all directors participating can communicate with all of the other directors concurrently; (b) each director is provided the means of participating in all matters before the board, including, without limitation, proposing, or interposing an objection to, a specific action of the corporation; (c) the corporation adopts and implements some means of verifying that the person communicating is a director and that all statements, questions, actions, or votes were made by that director; and (d) the method of communication used creates a record that is capable of retention, retrieval, and review and that may be rendered into clearly legible tangible form.

**2. Annual Directors' Meeting.** Immediately after each annual shareholders' meeting, the board of directors shall hold a regular meeting at the same place, or at any other place that has been designated by the board of directors, to consider matters of organization, election of officers, and other business as desired. Notice of this meeting is not required unless some place other than the place of the annual shareholders' meeting has been designated.

**3. Other Regular Meetings.** Other regular meetings of the board of directors may be held without call at times to be fixed by the board of directors from time to time. These regular meetings may be held without notice.

**4. Special Meetings.** Special meetings of the board of directors may be called for any purpose or purposes at any time by the chair of the board, the president, any vice president, the secretary, or any two directors. Special meetings must be held on 4 days' notice by mail or 48 hours' notice delivered personally or by telephone, including a voice messaging system, or by electronic transmission by the corporation, as defined in Corporations Code §20. Oral notice given personally or by telephone may be transmitted either to the director or to a person at the director's office who can reasonably be expected to communicate it promptly to the director. Written notice, if used, shall be addressed to each director at the address shown on the corporation's records. The notice need not specify the purpose of the meeting, nor need it specify the place if the meeting is to be held at the principal executive office of the corporation.

*Comment:* Either the bylaws or the board of directors may fix the time and place for regular board meetings. See Corp C §307(a)(2); see also Corp C §307(a)(5)-(6). Many corporations find it difficult to determine in advance when the board of directors' meeting should be held. Allowing the board to decide this matter provides maximum flexibility. If the place and date of regular board meetings are set forth in the bylaws or fixed by the board, notice is not required. Although no statute requires the directors to meet after each annual shareholders' meeting, such a meeting, often

referred to as an organizational meeting because it is the first meeting after the annual elections of directors, is ordinarily advisable.

The board of directors may meet by conference telephone, electronic video screen communication, or "electronic transmission by and to the corporation." Corp C §307(a)(6). See Corp C §§20-21. On the definition of "electronic transmission by and to the corporation," see the Comment in §8.61. Whether such participation counts as presence depends on which medium of communications is used. If the medium is a conference phone call or electronic video screen, all members must be able to hear one another. See Corp C §307(a)(6). Participation in a meeting through electronic transmission by and to the corporation constitutes presence in person at that meeting if both of the following apply (Corp C §307(a)(6)(A)-(B)):

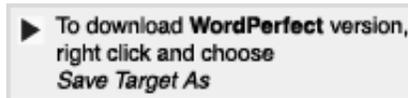
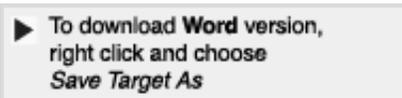
- Each member participating in the meeting can communicate with all of the other members concurrently; and
- Each member is provided the means of participating in all matters before the board, including the capacity to propose, or to interpose an objection to, a specific action to be taken by the corporation.

The procedures for giving notice of directors' meetings are outlined in Corp C §307. See also Corp C §118. The statutes provide considerable latitude for giving a director effective notice, even permitting notice by telephone, voice mail, electronic mail, fax, or other "electronic transmission by the corporation" to a person at the director's office other than the director, if the person giving the notice has reason to believe that the notice will be promptly communicated to the director. See Corp C §§118, 307(a)(2).

The bylaws are not required to include provisions for notice to be given by fax, voicemail, or e-mail. However, the consequences and effectiveness of such measures should be reviewed with the client before these notice procedures are used. See Corp C §§118, 212(b)(2), 307(a). Neither the articles nor the bylaws may dispense with notice of special board meetings. Corp C §307(a)(2).

## §8.79 f. Form: Quorum

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §8.59 and ends in §8.104



8.79-1 Quorum

**H. Quorum.** A majority of the authorized number of directors constitutes a quorum for the transaction of business, except to adjourn as provided in \_\_[specify paragraph by number or letter]\_\_. Every act or decision done or made by a majority of the directors present at a meeting duly held at which a quorum is present will be regarded as the act of the board of directors, subject to the provisions of Corporations Code §310 (as to approval of contracts or transactions in which a director has a direct or indirect material financial interest), §311 (as to appointment of committees), and §317(e) (as to indemnification of directors).

[Add one of the following alternatives]

[Alternative 1: Business may be transacted despite withdrawal of quorum]

**A meeting at which a quorum is initially present may continue to transact business, despite a withdrawal of directors, if any action taken is approved by at least a majority of the required quorum for that meeting.**

[Alternative 2: Business may not be transacted after withdrawal of quorum]

**Even though a quorum is initially present, if the number of directors present at a meeting is reduced to less than a quorum by withdrawal of directors, no further business except adjournment from time to time may be transacted at the meeting until a quorum is present.**

*Comment:* Absent special rules established in the articles or bylaws, a majority of the authorized number of directors is a quorum at a board of directors' meeting, and a majority of the directors present at a meeting at which a quorum is present may validly take board action (subject to special rules in situations involving an interested director; see Corp C §§310, 317(e)). Corp C §307(a)(7).

Directors are counted as present whether attending in person or by conference telephone or similar communications equipment (see Corp C §307(a)(6)); however, unlike shareholders, directors may not attend a meeting of the board by proxy. The theory is that—because the board is a deliberative body—only the directors participating in the discussion of an agenda item should take part in the vote on that item.

The bylaws may provide that less than a majority of the directors constitutes a quorum, but the quorum cannot be less than one-third of the authorized number of directors or two directors, whichever is larger (except for those corporations having only one director, who alone constitutes a quorum). Corp C §§212(b)(4), 307(a)(7).

Only the articles (or, for a statutory close corporation, a valid shareholders' agreement) may require a greater-than-majority quorum or vote for actions by the board (Corp C §204(a)(5)). However, the bylaws may require the affirmative vote of a majority of the authorized directors for any board action (rather than a majority of those present at the meeting). See Corp C §204(a). Neither the articles nor the bylaws may provide that a vote of less than a majority of the directors present at a meeting constitutes valid board action. Corp C §307(a)(8).

The first alternative in this form restates Corp C §307(a)(8) for continuing a meeting despite withdrawal of some directors. This provision is intended to prevent a small fraction from blocking board action by simply leaving the meeting. Some lawyers, fearing potential abuse under this rule, prefer to limit the application of the statutory rule by substituting the second alternative.

**Source:** Business Law/Selecting and Forming Business Entities/8 S and C Corporations/§8.80 g. Form: Waiver of Notice of Board of Directors' Meetings

## §8.80 g. Form: Waiver of Notice of Board of Directors' Meetings

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §8.59 and ends in §8.104

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8.80-1 Waiver of notice

**I. Waiver of Notice, Consent, or Approval of Minutes.** Notice of a meeting, although otherwise required, need not be given to any director who either before or after the meeting

1. Provides a waiver of notice or a consent to holding the meeting without being given notice,
2. Signs an approval of the minutes of the meeting, or
3. Attends the meeting without protesting the lack of notice before or at the beginning of the meeting.

**Waivers of notice or consents need not specify the purpose of the meeting. All waivers, consents, and approvals of the minutes will be filed with the corporate records or made a part of the minutes of the meeting.**

*Comment:* This clause substantially follows Corp C §307(a)(3). Mere attendance at a meeting does not constitute waiver of notice if the director objects to the lack of notice at or before the beginning of the meeting.

**Source:** Business Law/Selecting and Forming Business Entities/8 S and C Corporations/§8.81 h. Form: Adjournment of Board of Directors' Meetings

## **§8.81 h. Form: Adjournment of Board of Directors' Meetings**

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8.81-1 Adjournment of meeting to another time or place

### **J. Adjournment.**

**1. Adjournment to Another Time or Place.** Whether or not a quorum is present, a majority of the directors present may adjourn any meeting to another time or place.

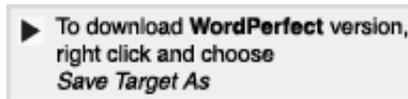
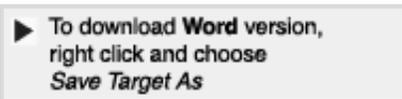
**2. Notice of Adjourned Meeting.** Notice of the time and place of resuming a meeting that has been adjourned need not be given unless the adjournment is for more than 24 hours, in which case notice shall be given, before the time set for resuming the adjourned meeting, to the directors who were not present at the time of the adjournment. Notice need not be given in any case to directors who were present at the time of adjournment.

*Comment:* This form is based on Corp C §307(a)(4). The directors present are authorized to adjourn a meeting to another time or place, even though they do not constitute a quorum for purposes of transacting any other business. Corp C §307(a)(4).

**Source:** Business Law/Selecting and Forming Business Entities/8 S and C Corporations/§8.82 i. Form: Action Without a Board of Directors' Meeting

## §8.82 i. Form: Action Without a Board of Directors' Meeting

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §8.59 and ends in §8.104



8.82-1 Action without meeting

**K. Action Without a Meeting.** Any action required or permitted to be taken by the board of directors may be taken without a meeting, if all members of the board of directors individually or collectively consent in writing to that action and if the number of members of the board serving at the time constitutes a quorum. Any action by written consent will have the same force and effect as a unanimous vote of the board of directors. All written consents will be filed with the minutes of the proceedings of the board of directors.

For purposes of this Bylaws paragraph only, "all members of the board" includes an "interested director," as described in Corporations Code §310(a), and a "common director," as described in Corporations Code §310(b), who abstains in writing from providing consent, when all of the following are true:

1. The disclosures required by §310 have been made to the noninterested or noncommon directors, as applicable, before execution of the written consents;
2. The specified disclosures are conspicuously included in the written consents; and
3. The noninterested or noncommon directors, as applicable, approve the action by a vote that is sufficient without counting the votes of the interested or common directors.

If written consent is provided by the directors in accordance with the preceding paragraph, and the disclosures made regarding the action that is the subject of the consent do not comply with the requirements of §310, the action that is the subject of the consent will be deemed approved. In any suit brought to challenge such an action, the party asserting the validity of the action shall have the burden of proof in establishing that the action was just and reasonable to the corporation at the time it was approved.

All of the foregoing applies also to committees of the board and incorporators and actions by those committees and incorporators.

*Comment:* The Corporations Code permits boards of directors to conduct business without a formal meeting. However, unlike action by the shareholders without a meeting, action taken by the board of directors without a meeting will only be valid if all board members unanimously consent in writing to the action and if the number of members of the board serving at the time constitutes a quorum. Corp C §307(b). For these purposes, all members of the board include an "interested director" or a "common director" (see Corp C §310), as specified in form above. For further discussion of these provisions, see Counseling California Corporations (3d ed Cal CEB 2008).

**Source:** Business Law/Selecting and Forming Business Entities/8 S and C Corporations/§8.83 j. Form: Compensation of Directors

## §8.83 j. Form: Compensation of Directors

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §8.59 and ends in §8.104

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### 8.83-1 Fees and compensation of directors

**L. Fees and Compensation of Directors.** Directors and members of committees of the board may be compensated for their services, and will be reimbursed for expenses, as fixed or determined by resolution of the board of directors. This paragraph shall not be construed to preclude any director from serving the corporation in any other capacity, as an officer, agent, employee, or otherwise, or from receiving compensation for those services.

*Comment:* This form empowers the corporation to compensate directors for their service as directors. It provides useful future flexibility even if directors are to serve initially without compensation. When directors are to be paid, the amount of that compensation typically is fixed annually by board resolution. However, some corporations may prefer to fix or limit directors' compensation in the bylaws, or require that the board adopt rules to be applied uniformly. Even when service on the board is uncompensated, it is customary to reimburse directors for their reasonable out-of-pocket expenses incurred in attending meetings and otherwise performing directorial duties.

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**Source:** Business Law/Selecting and Forming Business Entities/8 S and C Corporations/§8.84 k. Form: Committees of the Board of Directors

## **§8.84 k. Form: Committees of the Board of Directors**

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §8.59 and ends in §8.104

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8.84-1 Committees of the board of directors

### **ARTICLE IV**

#### **COMMITTEES**

**A. Establishment and Authority of Committees.** The board of directors may, by resolution adopted by a majority of the authorized number of directors, designate one or more committees, each consisting of two or more directors. The board may designate one or more directors as alternate members of any committee, to replace any absent member at a committee meeting. The appointment of committee members or alternate members requires the vote of a majority of the authorized number of directors. A committee may be granted any or all of the powers and authority of the board, to the extent provided in the resolution of the board of directors establishing the committee, except with respect to:

1. Approving any action for which the California Corporations Code also requires the approval of the shareholders or of the outstanding shares;
2. Filling vacancies on the board of directors or any committee of the board;
3. Fixing directors' compensation for serving on the board or a committee of the board;
4. Adopting, amending, or repealing Bylaws;
5. Amending or repealing any resolution of the board of directors that by its express terms is not so amendable or repealable;
6. Making distributions to shareholders, except at a rate or in a periodic amount or within a price range determined by the board of directors; or
7. Appointing other committees of the board or their members.

**B. Meetings and Actions of Committees.** Meetings and actions of committees are governed by, and held and taken in accordance with, Bylaw provisions applicable to meetings and actions of the board of directors, with such changes in the context of those Bylaws as are necessary to substitute the committee and its members for the board of directors and its members.

*[If applicable, add the following option]*

*[Option: Meetings and actions of committees]*

Despite the foregoing paragraph,

1. The time of regular meetings of committees may be determined either by resolution of the board of directors or by resolution of the committee;
2. Special meetings of committees may also be called by resolution of the board of directors; and
3. Notice of special meetings of committees must also be given to all alternative members who have the right to attend all meetings of the committee. The board of directors may adopt rules for the governance of any

**committee not inconsistent with these Bylaws.**

*Comment:* This form restates Corp C §311. The board of directors may delegate any of its powers, other than the enumerated exceptions, to an executive committee or other board committee composed of two or more directors. Establishing a committee, as well as appointing its members, requires a majority vote of the authorized number of directors, which means that any vacancies on the board and any directors absent from the meeting must be counted in determining the required number of votes for this purpose. Alternate committee members with the authority to vote in the absence of any regular member are appointed in the same manner as regular members and must have the same qualifications, *i.e.*, be elected directors. See Corp C §311.

**PRACTICE TIP:** When establishing a committee, the board of directors' resolution should carefully delineate the exact limits of the authority being delegated to that committee. Absent these limits, the committee will have the full authority of the board except as to the enumerated exceptions (Corp C §311(a)-(g)) set out in this form. Note that Corp C §311(e) (see item 5 of this form) apparently permits a committee to repeal or amend board resolutions that do not expressly provide that they cannot be so repealed or amended. If the board is establishing a committee with broad executive authority but does not want it to have the power to repeal or amend resolutions adopted by the full board, the resolution establishing the committee should clearly state this limitation; otherwise, each board resolution must contain the limitation.

The board of directors may also establish one or more committees made up of, or including, persons who are not directors. In general, these committees are merely advisory and may not be delegated the board's decision-making authority.

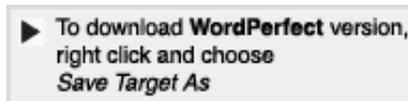
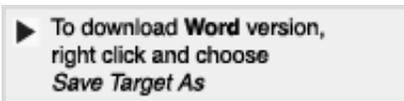
Although committees are typically established by board resolution, occasionally a corporation may wish to write one or more standing committees into the bylaws. The bylaw can also be amended by board action (unless shareholder approval of the amendment is specifically required), but including the committee in the bylaws is often felt to be an expression of greater permanence. This approach is often taken in response to a suggestion from a financier (*e.g.*, an investment banker) or a regulator to establish an audit or nominating committee. In some cases (such as an audit committee), the bylaw should also prescribe that all or a certain proportion of the members of the committee should be "outside" directors, who do not serve as officers or employees of the corporation.

Source: Business Law/Selecting and Forming Business Entities/8 S and C Corporations/ 4. Corporate Officers/§8.85 a.  
Form: Corporate Officers

#### 4. Corporate Officers

##### §8.85 a. Form: Corporate Officers

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §8.59 and ends in §8.104



8.85-1 Corporate officers

### ARTICLE V

#### CORPORATE OFFICERS

**A. Designation of Officers.** The officers of the corporation will be a president, a secretary, and a chief financial officer. The corporation may also have, at the discretion of the board of directors, a chair of the board, one or more vice presidents, one or more assistant secretaries, one or more assistant treasurers, and such other officers as may be appointed in accordance with paragraph C of this Article. Any number of offices may be held by the same person.

**B. Appointment of Officers.** The officers of the corporation, except for subordinate officers appointed in accordance with paragraph C of this Article, will be appointed \_\_ [specify period, e.g., annually] \_\_ by the board of directors, and will serve at the pleasure of the board of directors.

**C. Appointment of Subordinate Officers.** The board of directors may appoint, and may empower the \_\_ [president/specify other officer(s)] \_\_ to appoint other officers as required by the business of the corporation, whose duties shall be as provided in the Bylaws, or as assigned from time to time by the board of directors or the president.

**D. Removal and Resignation of Officers.** Any officer chosen by the board of directors may be removed at any time, with or without cause or notice, by the board of directors. Subordinate officers appointed by persons other than the board under paragraph C of this Article may be removed at any time, with or without cause or notice, by the board of directors or by the officer by whom appointed. Officers may be employed for a specified term under a contract of employment if authorized by the board of directors; these officers may be removed from office at any time under this paragraph and shall have no claim against the corporation or individual officers or board members because of the removal except any right to monetary compensation to which the officer may be entitled under the contract of employment.

Any officer may resign at any time by giving written notice to the corporation. Resignations shall take effect on the date of receipt of the notice, unless a later time is specified in the notice. Unless otherwise specified in the notice, acceptance of the resignation is not necessary to make it effective. Any resignation is without prejudice to the rights, if any, of the corporation to monetary damages under any contract of employment to which the officer is a party.

**E. Filling Vacancies in Offices.** A vacancy in any office resulting from an officer's death, resignation, removal, disqualification, or from any other cause shall be filled in the manner prescribed in these Bylaws for regular election or appointment to that office.

*Comment:* Every corporation must have a chair of the board or a president or both, a secretary, and a chief financial officer. Corp C §312(a). The names and addresses of these principal officers must be filed annually with the Secretary of State. Corp C §1502(a).

This form continues the usual practice of requiring a president but not a chair of the board. If the principal executive officer intends to use the title "chair of the board" and there is to be no other president, the board should also elect that

person president. This procedure will make it easier to complete the many documents that request the corporation to indicate its "president," and will permit the later election of a president without the need to amend the bylaws.

The president, or if there is none, the chair, is the corporation's general manager and chief executive officer, unless the articles or bylaws provide otherwise. Many corporations today prefer to use the title chief executive officer, rather than chair or president. However, because of the many occasions when a corporation will be called on to indicate its president, the board may wish to elect an individual as "president (or chair) and chief executive officer" or indicate in the bylaws that the president (or chair) may have the additional title of chief executive officer.

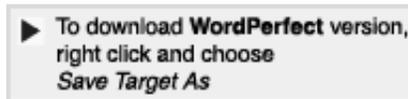
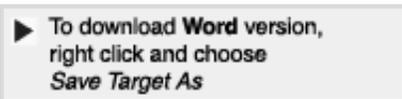
Although the statute requires a "chief financial officer," the person holding that office may also be designated "treasurer" for situations in which an officer with that title may be needed. See Corp C §2305 (treasurer is deemed chief financial officer of corporations existing on January 1, 1977). Some attorneys prefer to retain the title of treasurer in the bylaws and to provide in the bylaws that the treasurer (or, *e.g.*, the vice president—finance) shall be the chief financial officer.

Unless the articles or bylaws provide to the contrary, the same person may hold any number of offices, including those of both president and secretary. Corp C §312(a). However, as a practical matter, banks, brokers, and others needing documents signed on behalf of the corporation may object to having the same person sign twice, once as president and once as secretary. If at all possible, the corporation should have at least two people acting as officers, even if one is president, secretary, and chief financial officer and the other merely a vice president or assistant secretary.

Officers serve at the pleasure of the board of directors except as otherwise provided by the articles or bylaws. Corp C §312(b). This form does not require that officers be appointed or reappointed annually; such a provision is unnecessary, because officers serve at the pleasure of the board and may be replaced at any time. However, if it is considered desirable to set up a framework of yearly selection, the word "annually" can be included after "appointed" in this form.

## §8.86 b. Form: Duties of Particular Officers

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §8.59 and ends in §8.104



8.86-1 Duties of particular officers

### F. Duties of Particular Officers.

**1. Chair of the Board.** The board of directors \_\_ *[shall/may]* \_\_ elect a chair, who will preside, if present, at board meetings and exercise and perform such other powers and duties as may be assigned from time to time by the board of directors. If there is no president, the chair of the board will also serve as the chief executive officer of the corporation and will have the powers and duties as set forth in subparagraph 2 of this section.

*[Add one of the following alternatives]*

*[Alternative 1: President is chief executive officer]*

**2. President.** Except to the extent that the Bylaws or the board of directors assign specific powers and duties to the chair of the board (if any), the president is the corporation's general manager and chief executive officer and, subject to the control of the board of directors, has general supervision, direction, and control over the corporation's business and its officers. The managerial powers and duties of the president include, but are not limited to, all the general powers and duties of management usually vested in the office of president of a corporation, and the president will have other powers and duties as prescribed by the board of directors or the Bylaws. The president presides at all meetings of the shareholders and, in the absence of the chair of the board or if there is no chair of the board, also presides at meetings of the board of directors.

*[Alternative 2: Board chair is chief executive officer]*

**2. Chief Executive Officer.** The chair of the board of directors is the corporation's general manager and chief executive officer and, subject to the control of the board of directors, has general supervision, direction, and control over the corporation's business and its officers. These managerial powers and duties include, but are not limited to, all the general powers and duties of management usually vested in the office of president of a corporation, and the chair of the board will have other powers and duties as prescribed by the board of directors or the Bylaws. The chair of the board presides at all meetings of the shareholders, as well as all meetings of the board of directors.

*[Continue]*

**3. Vice Presidents.** If desired, one or more vice presidents may be chosen by the board of directors in accordance with the provisions for selecting officers set forth in Paragraph B. In the absence or disability of the president, the president's duties and responsibilities will be carried out by the highest ranking available vice president if vice presidents are ranked or, if not, by a vice president designated by the board of directors. When so acting, a vice president has all the powers of and is subject to all the restrictions on the president. Vice presidents of the corporation will have such other powers and perform such other duties as prescribed from time to time by the board of directors, the Bylaws, or the president (or chair of the board if there is no president).

**4. Secretary.** The secretary's duties shall consist of the following:

(a) **Minutes.** The secretary will keep, or cause to be kept, minutes of all shareholders' meetings and all other board meetings. If the secretary is unable to be present, the secretary or the presiding officer of the meeting must designate another person to take the minutes of the meeting.

The secretary will keep, or cause to be kept, at the principal executive office or such other place as

designated by the board of directors, a book of minutes of all meetings and actions of the shareholders, of the board of directors, and of committees of the board.

The minutes of each meeting must state the time and place the meeting was held; whether it was regular or special; if special, how it was called or authorized; the names of directors present at board or committee meetings; the number of shares present or represented at shareholders' meetings; an accurate account of the proceedings; and when it was adjourned.

(b) *Record of Shareholders.* The secretary will keep, or cause to be kept, at the principal executive office or at the office of the transfer agent or registrar, a record or duplicate record of shareholders. This record shall show the names of all shareholders and their addresses, the number and classes of shares held by each, the number and date of share certificates issued to each shareholder, and the number and date of cancellation of any certificates surrendered for cancellation.

(c) *Notice of Meetings.* The secretary will give notice, or cause notice to be given, of all shareholders' meetings, board meetings, and meetings of committees of the board for which notice is required by statute or by the Bylaws. If the secretary or other person authorized by the secretary to give notice fails to act, notice of any meeting may be given by any other officer of the corporation.

(d) *Other Duties.* The secretary will keep the seal of the corporation, if any, in safe custody. The secretary will have such other powers and perform other duties as prescribed by the board of directors or by the Bylaws.

**5. Chief Financial Officer.** The chief financial officer will keep, or cause to be kept, adequate and correct books and records of accounts of the properties and business transactions of the corporation, including accounts of its assets, liabilities, receipts, disbursements, gains, losses, capital, retained earnings, and shares. The books of account must be open to inspection by any director at all reasonable times.

The chief financial officer will

(a) Deposit corporate funds and other valuables in the corporation's name and to its credit with depositaries designated by the board of directors;

(b) Make disbursements of corporate funds as authorized by the board;

(c) Render a statement of the corporation's financial condition and an account of all transactions conducted as chief financial officer whenever requested by the president or the board of directors; and

(d) Have other powers and perform other duties as prescribed by the board of directors or the Bylaws.

*[If applicable, add the following option]*

*[Option: Chief financial officer deemed treasurer]*

**Unless the board of directors has elected a separate treasurer, the chief financial officer will be deemed to be the treasurer for purposes of giving any reports or executing any certificates or other documents.**

*Comment:* A corporation must have either a chair of the board or a president or both. The president, or if there is none, the chair of the board, is the corporation's general manager and chief executive officer unless the articles or bylaws provide otherwise. Corp C §312(a). The first alternative is for use if the corporation has a president; the second alternative may be used if the chair of the board will serve as chief executive officer.

A corporation is not required to have any vice presidents. See Corp C §312(a). Paragraph 3 of this form is appropriate even though no vice presidents have yet been chosen, and it provides for future flexibility. If there are to be no vice presidents, a statement to that effect can be substituted for this form with a provision that the board will designate a person to serve in the absence or disability of the president.

A corporation must keep written minutes of the proceedings of its shareholders, board, and committees of the board, and must keep, either at its principal executive office or at the office of its transfer agent or registrar, a record of its shareholders, their addresses, and their holdings. The minutes may be kept in written form, in another form capable of being converted into clearly legible tangible form, or in any combination of the two. When kept in a form capable of

being converted into clearly legible tangible form, the tangible form is admissible into evidence and must be accepted to the same extent as an original paper record, provided that it accurately portrays the record. Corp C §1500. It is usually the secretary's responsibility to see that these records are kept. The corporation must also keep adequate and correct books and records of accounts, a responsibility of the chief financial officer. For discussion of rights to inspect these records, see *Organizing Corporations in California*, chap 2 (3d ed Cal CEB 2001).

A corporation must have a chief financial officer. Corp C §312(a). Although the statute does not use the term "treasurer," a corporation is not prohibited from doing so. The treasurer of a corporation in existence on January 1, 1977, is deemed to be its chief financial officer. Corp C §2305. Some documents may still require execution by the corporation's "treasurer." The final paragraph of the form addresses this concern.

**Source:** Business Law/Selecting and Forming Business Entities/8 S and C Corporations/ 5. Indemnification of Directors, Officers, Employees, and Other Agents/§8.87 a. Form: Indemnification of Agents (Short Form)

## 5. Indemnification of Directors, Officers, Employees, and Other Agents

### §8.87 a. Form: Indemnification of Agents (Short Form)

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §8.59 and ends in §8.104

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8.87-1 Indemnification of agents (short form)

## ARTICLE VI

### INDEMNIFICATION

The corporation is, to the maximum extent permitted by California's General Corporation Law, empowered to indemnify its agents against expenses, judgments, fines, settlements, and other amounts actually and reasonably incurred in connection with any proceeding arising by reason of the fact that any such person is or was an agent of the corporation. The corporation is empowered to advance to each such agent expenses incurred in defending any such proceeding to the maximum extent permitted by that law. For purposes of this article, an "agent" of the corporation includes any person who is or was a director, officer, employee, or other agent of the corporation, or is or was serving at the request of the corporation as a director, officer, employee, or agent of another corporation, partnership, joint venture, trust, or other enterprise, or was a director, officer, employee, or agent of a corporation that was a predecessor corporation of the corporation or of another enterprise serving at the request of such predecessor corporation.

*Comment:* Corporations Code §317(g) provides that if the articles authorize indemnification to the maximum extent permitted by law (as this form does), the article will be construed to be both a provision for indemnification for breach of duty to the corporation and its shareholders under Corp C §204(a)(11) and a provision for additional indemnification for acts not involving breach of duty allowed under any bylaw, agreement, vote of shareholders or disinterested directors, or otherwise, to the extent authorized by the articles.

The inclusion of a bylaw providing for expanded indemnification is not effective for acts done before the adoption of the bylaw. Corp C §204(a)(10)(B), (a)(11). Corporations Code §204(a)(10)(A) lists matters for which the liability of directors may not be limited.

A more comprehensive indemnification bylaw provision is set forth in §8.88.

**Source:** Business Law/Selecting and Forming Business Entities/8 S and C Corporations/§8.88 b. Form: Indemnification of Directors, Officers, Employees, and Other Agents (Long Form)

## §8.88 b. Form: Indemnification of Directors, Officers, Employees, and Other Agents (Long Form)

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §8.59 and ends in §8.104

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8.88-1 Indemnification of directors, officers, employees, and other agents

### ARTICLE VII

#### INDEMNIFICATION

**A. *Indemnification; Definitions.*** For purposes of this article, "agent" means any person who is or was a director, officer, employee, or other agent of this corporation, or who is or was serving at the request of this corporation as a director, officer, employee, or agent of another foreign or domestic corporation, partnership, joint venture, trust or other enterprise, or who was a director, officer, employee, or agent of a foreign or domestic corporation that was a predecessor corporation of this corporation or of another enterprise at the request of such predecessor corporation; "proceeding" means any threatened, pending, or completed action or proceeding, whether civil, criminal, administrative, or investigative; and "expenses" includes, without limitation, attorney fees and any expenses of establishing a right to indemnification under \_\_[specify paragraph by number or letter]\_\_.

**B. *Actions Other Than by Corporation.*** This corporation is empowered to indemnify any person who was or is a party, or is threatened to be made a party, to any proceeding (other than an action by or in the right of this corporation to procure a judgment in its favor) by reason of the fact that such person is or was an agent of this corporation, against expenses, judgments, fines, settlements, and other amounts actually and reasonably incurred in connection with such proceeding if that person acted in good faith and in a manner that the person reasonably believed to be in the best interests of this corporation and, in the case of a criminal proceeding, had no reasonable cause to believe the conduct of that person was unlawful. The termination of any proceeding by judgment, order, settlement, conviction, or on a plea of nolo contendere or its equivalent does not, of itself, create a presumption that the person did not act in good faith and in a manner that the person reasonably believed to be in the best interests of this corporation or that the person had reasonable cause to believe that the person's conduct was unlawful.

**C. *Actions by or in Right of Corporation.*** This corporation is empowered to indemnify any person who was or is a party, or is threatened to be made a party, to any threatened, pending, or completed action by or in the right of this corporation to procure a judgment in its favor by reason of the fact that such person is or was an agent of this corporation, against expenses actually and reasonably incurred by such person in connection with the defense or settlement of that action, if such person acted in good faith, in a manner such person believed to be in the best interests of this corporation and its shareholders. No indemnification will be made under this paragraph for the following matters:

1. Any claim, issue, or matter on which such person has been adjudged to be liable to this corporation in the performance of such person's duty to the corporation and its shareholders, unless and only to the extent that the court in which such proceeding is or was pending shall determine on application that, in view of all the circumstances of the case, such person is fairly and reasonably entitled to indemnity for expenses but only to the extent that the court determines;

2. Amounts paid in settling or otherwise disposing of a pending action without court approval; or

3. Expenses incurred in defending a pending action that is settled or otherwise disposed of without court approval.

**D. *Successful Defense by Agent.*** To the extent that an agent of this corporation has been successful on the

merits in defense of any proceeding referred to in paragraphs \_\_ *[specify paragraphs by number or letter]* \_\_ of this Article, or in defense of any claim, issue, or matter in, the agent will be indemnified against expenses actually and reasonably incurred by the agent in connection with that proceeding.

**E. *Required Approval.*** Except as provided in paragraph D of this Article, any indemnification under this paragraph will be made by the corporation only if authorized in the specific case, after a determination that indemnification of the agent is proper in the circumstances because the agent has met the applicable standard of conduct set forth in paragraph B or C by any of the following:

1. A majority vote of a quorum consisting of directors who are not parties to such proceeding;
2. Independent legal counsel in a written opinion if a quorum of directors who are not parties to such a proceeding is not available;
3. Approval of the shareholders, with the shares owned by the person to be indemnified not being entitled to vote thereon; or
4. The court in which the proceeding is or was pending, on application made by this corporation or the agent or the attorney or other person rendering services in connection with the defense, whether or not such application by the agent, attorney, or other person is opposed by this corporation.

**F. *Advance of Expenses.*** Expenses incurred in defending any proceeding may be advanced by the corporation before the final disposition of such proceeding on receipt of an undertaking by or on behalf of the agent to repay such amounts if it shall be determined ultimately that the agent is not entitled to be indemnified as authorized in this article.

**G. *Other Contractual Rights.*** The indemnification provided by this article will not be deemed exclusive of any other rights to which those seeking indemnification may be entitled under any Bylaw, agreement, vote of shareholders or disinterested directors, or otherwise, both as to action in an official capacity and as to action in another capacity while holding such office, to the extent such additional rights to indemnification are authorized in the Articles of the corporation. Nothing in this paragraph affects any right to indemnification to which persons other than such directors and officers may be entitled by contract or otherwise.

**H. *Limitations.*** No indemnification or advance may be made under this Article, except as provided in paragraphs D or E(4), in any of the following circumstances:

1. It would be inconsistent with a provision of the Articles, Bylaws, a resolution of the shareholders, or an agreement in effect at the time of the accrual of the alleged cause of action asserted in the proceeding in which expenses were incurred or other amounts were paid, which prohibits or otherwise limits indemnification; or
2. It would be inconsistent with any condition expressly imposed by a court in approving settlement.

**I. *Insurance.*** This corporation may purchase and maintain insurance on behalf of any agent of the corporation insuring against any liability asserted against or incurred by the agent in that capacity or arising out of the agent's status as such, whether or not this corporation would have the power to indemnify the agent against that liability under the provisions of this Article. Notwithstanding the foregoing, if this corporation owns all or a portion of the shares of the company issuing the policy of insurance, the insuring company and/or the policy must meet the conditions set forth in Corporations Code §317(i).

**J. *Fiduciaries of Corporate Employee Benefit Plan.*** This Article does not apply to any proceeding against any trustee, investment manager, or other fiduciary of an employee benefit plan in that person's capacity as such, even though that person may also be an agent of the corporation. The corporation is empowered to indemnify, and to purchase and maintain insurance on behalf of any such trustee, investment manager, or other fiduciary of any benefit plan for any or all of the directors, officers, and employees of the corporation or any of its subsidiary or affiliated corporations.

*[If applicable, add one or more of the following options]*

*[Option 1: Survival of rights]*

**[K.] *Survival of Rights.*** The rights provided by this Article will continue for a person who has ceased to be

an agent and inure to the benefit of the heirs, executors, and administrators of that person.

[Option 2: Effect of amendment]

**[L.] Effect of Amendment.** Any amendment, repeal, or modification of this Article shall not adversely affect an agent's right or protection existing at the time of such amendment, repeal, or modification.

[Option 3: Settlement of claims]

**[M.] Settlement of Claims.** The corporation will not be liable to indemnify any agent under this Article for (1) any amounts paid in settlement of any action or claim effected without the corporation's written consent, which consent shall not be unreasonably withheld, or (2) any judicial award, if the corporation was not given a reasonable and timely opportunity to participate, at its expense, in the defense of that action.

[Option 4: Subrogation]

**[N.] Subrogation.** In the event of payment under this Article, the corporation will be subrogated, to the extent of that payment, to all of the rights of recovery of the agent, who will execute all papers required and do everything that may be necessary to secure those rights, including the execution of any documents as may be necessary to enable the corporation effectively to bring suit to enforce such rights.

[Option 5: No duplication of payments]

**[O.] No Duplication of Payments.** The corporation will not be liable under this Article to make any payment in connection with any claim made against the agent to the extent the agent has otherwise actually received payment, whether under a policy of insurance, agreement, vote, or otherwise, of the amounts otherwise indemnifiable under this Article.

*Comment:* This form tracks the provisions of Corp C §317. In many cases, an indemnification agreement may be preferable to a bylaw provision because of its greater flexibility. For example, a corporation might want to enter into agreements for mandatory indemnity for directors (and perhaps officers), yet reserve the right to decide indemnity claims on a case-by-case basis for other agents.

In certain circumstances, a corporation may be obligated to indemnify a California employee regardless of Corp C §317. See, e.g., Lab C §2802. Conversely, in some circumstances, an independent contractor might not be an agent for purposes of Corp C §317. See *APSB Bancorp v Thornton Grant* (1994) 26 CA4th 926, 31 CR2d 736 (independent accounting firm held not an agent within meaning of Corp C §317).

The potential conflict between the bylaw indemnification provisions and Lab C §2802 should not pose a problem unless indemnification required in a specific instance by Lab C §2802 would violate California public policy or the express prohibitions against indemnification found in Corp C §317. The interaction between Corp C §317 and Lab C §2802 apparently has not been settled judicially. The Labor Code provision is important to remember if a corporation is considering adopting an exclusive indemnification policy more restrictive than Lab C §2802. Also, if the board has been given discretion to indemnify employees and agents, it should be aware of the limits placed on its discretion by Lab C §2802.

**NOTE:** Although indemnification in excess of that permitted by Corp C §317 is possible, the standards for permitting that excess indemnification are uncertain. At a minimum, counsel should establish some standards for determining whether indemnification should be made. One possibility might be to make indemnification mandatory unless the party opposing indemnification establishes that the agent did not meet the specified applicable standards.

**Source:** Business Law/Selecting and Forming Business Entities/8 S and C Corporations/ 6. Records and Reports/§8.89  
a. Form: Maintenance of Records of Shareholders

## 6. Records and Reports

### §8.89 a. Form: Maintenance of Records of Shareholders

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §8.59 and ends in §8.104

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8.89-1 Records

## ARTICLE VIII

### RECORDS AND REPORTS

**A. Maintenance of Shareholder Records and Inspection by Shareholders.** The corporation must keep at its principal executive office or at the office of its transfer agent or registrar, as determined by resolution of the board of directors, a record of the names and addresses of all shareholders and the number and class of shares held by each shareholder.

A shareholder or shareholders holding at least 5 percent in the aggregate of the outstanding voting shares of the corporation have the right to do either or both of the following:

1. Inspect and copy the record of shareholders' names and addresses and shareholdings during usual business hours, on 5 days' prior written demand on the corporation; or

2. Obtain from the corporation's transfer agent, on written demand and tender of the transfer agent's usual charges for this service, a list of the names and addresses of shareholders who are entitled to vote for the election of directors, and their shareholdings, as of the most recent record date for which a list has been compiled or as of a specified date later than the date of demand. This list will be made available within 5 days after the date of demand or the specified later date as of which the list is to be compiled.

The record of shareholders will also be open to inspection on the written demand of any shareholder or holder of a voting trust certificate, at any time during usual business hours, for a purpose reasonably related to the holder's interests as a shareholder or holder of a voting trust certificate. Any inspection and copying under this paragraph may be made in person or by an agent or attorney of the shareholder or holder of a voting trust certificate making the demand.

*Comment:* The corporation must maintain a record of its shareholders, either at its principal executive office or at the office of its transfer agent or registrar. Corp C §1500. The records may be in written form, in another form capable of being converted into clearly legible tangible form, or in any combination of the two. Corp C §1500.

Holders of 5 percent or more of the outstanding voting shares have an absolute right to inspect and copy the record of shareholders and to obtain a list of the shareholders' names and addresses and their shareholdings from the corporation's transfer agent. Corp C §1600(a). If the corporation is subject to the Securities Exchange Act of 1934 (15 USC §§78a-78oo), holders of at least 1 percent of the voting shares who have filed a Schedule 14B (relating to the election of directors) with the SEC also have this absolute right. Corp C §1600(a). If the corporation or its transfer agent fails to comply promptly with the shareholder's inspection or copying demand, the shareholder has the right to relief, which includes a court order postponing any previously noticed shareholders' meeting (Corp C §1600(b)) and may include attorney fees. Corp C §1604.

Shareholders with less than 5 percent holdings also have the right to inspect and copy the share records but only for a purpose reasonably related to their interests as shareholders. Corp C §1600(c). The rights of shareholders to inspect and copy these records cannot be limited by the articles or bylaws. Corp C §1600(d). See Counseling

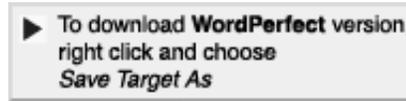
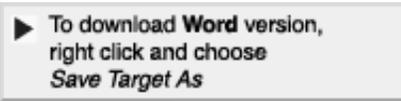
California Corporations (3d ed Cal CEB 2008).

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**Source:** Business Law/Selecting and Forming Business Entities/8 S and C Corporations/§8.90 b. Form: Maintenance and Inspection of Bylaws

## §8.90            b. Form: Maintenance and Inspection of Bylaws

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §8.59 and ends in §8.104



8.90-1            Maintenance and inspection of bylaws

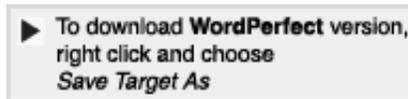
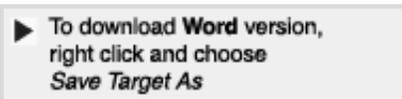
**B. *Maintenance and Inspection of Bylaws.*** The corporation will keep at its principal executive office, or if its principal executive office is not in California, at its principal business office in this state, the original or a copy of the Bylaws as amended to date, which shall be open to inspection by the shareholders at all reasonable times during office hours. If the principal executive office of the corporation is outside California and the corporation has no principal business office in this state, the secretary must, on the written request of any shareholder, furnish to that shareholder a copy of the Bylaws as amended to date.

*Comment:* This clause substantially follows Corp C §213 on maintaining the corporate bylaws and protecting the shareholders' right of inspection.

**Source:** Business Law/Selecting and Forming Business Entities/8 S and C Corporations/§8.91 c. Form: Maintenance and Inspection of Minutes and Accounting Records

## §8.91 c. Form: Maintenance and Inspection of Minutes and Accounting Records

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §8.59 and ends in §8.104



8.91-1 Maintenance and inspection of minutes and accounting records

**C. Maintenance and Inspection of Minutes and Accounting Records.** The minutes of proceedings of the shareholders, board of directors, and committees of the board, and the accounting books and records, will be kept at the principal executive office of the corporation, or at such other place or places as designated by the board of directors. The minutes and the accounting books and records may be kept in either written form or in another form capable of being converted into a clearly legible tangible form, or in any combination of the two. The minutes and accounting books and records will be open to inspection on the written demand of any shareholder or holder of a voting trust certificate at any reasonable time during usual business hours, for a purpose reasonably related to the holder's interests as a shareholder or holder of a voting trust certificate. The inspection may be made in person or by an agent or attorney, and shall include the right to copy and make extracts. These rights of inspection extend to the records of each subsidiary of the corporation.

*Comment:* A corporation is required to maintain accounting books and records, and minutes of the proceedings of its shareholders, board of directors, and committees of the board. Corp C §1500. However, because there is no requirement for the location of these records, they may be kept either in or outside California. This form provides that these records will be kept at the principal executive office of the corporation, unless the board makes another designation.

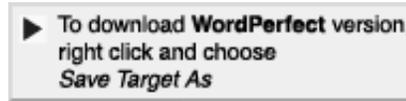
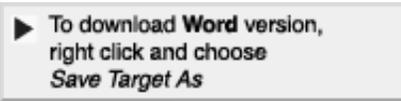
The minutes and records may be kept in written form, in another form capable of being converted into clearly legible tangible form, or in any combination of the two. When kept in a form capable of conversion into a legible tangible form, the tangible form is admissible into evidence and must be accepted for all purposes to the same extent as an original paper record, provided that the tangible form accurately portrays the record. Corp C §1500.

Shareholders or holders of voting trust certificates have a right to inspect these records, but only for a purpose reasonably related to their interests as shareholders or holders of voting trust certificates (Corp C §1601); the same right applies to inspecting the minutes and accounting records of subsidiaries of a California corporation. Corp C §1601(a). These rights cannot be limited by the articles or bylaws. Corp C §1601(b).

**Source:** Business Law/Selecting and Forming Business Entities/8 S and C Corporations/§8.92 d. Form: Inspection of Books and Records by Directors

**§8.92 d. Form: Inspection of Books and Records by Directors**

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §8.59 and ends in §8.104



8.92-1 Inspection of books and records by directors

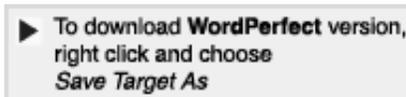
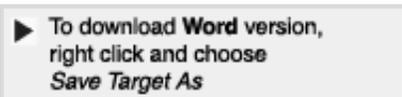
**D. Inspection by Directors.** Every director has the absolute right at any reasonable time to inspect all books, records, and documents of every kind and the physical properties of the corporation and each of its subsidiary corporations. This inspection by a director may be made in person or by an agent or attorney, and the right of inspection includes the right to copy and make extracts of documents.

*Comment:* This clause substantially follows Corp C §1602, which affords directors the absolute right to inspect and copy corporate records at any reasonable time. But see *Saline v Superior Court* (2002) 100 CA4th 909, 914, 122 CR2d 813 (restrictions on access to corporate documents appropriate when preponderance of evidence establishes director's clear intent to use documents to commit tort against corporation).

**Source:** Business Law/Selecting and Forming Business Entities/8 S and C Corporations/§8.93 e. Form: Annual Report to Shareholders

### §8.93 e. Form: Annual Report to Shareholders

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §8.59 and ends in §8.104



8.93-1 Annual report to shareholders

*[Add one of the following alternatives]*

*[Alternative 1: Annual report to be mailed]*

**E. Annual Report to Shareholders.** The board of directors will cause an annual report to be sent to the shareholders not later than 120 days after the close of the fiscal year adopted by the corporation. This report must be sent at least 15 days (if third-class mail is used, 35 days) before the annual meeting of shareholders to be held during the next fiscal year and in the manner specified for giving notice to shareholders in \_\_ *[specify paragraph by number or letter]* \_\_ of these Bylaws. The report and any accompanying material may be sent by electronic transmission by the corporation as defined in Corporations Code §20. The annual report will contain

1. A balance sheet as of the end of the fiscal year;

2. An income statement, and

3. A statement of cashflows for that fiscal year, prepared in accordance with generally accepted accounting principles applied on a consistent basis and accompanied by any report of independent accountants.

If no report of independent accountants exists, the income statement and statement of changes in financial position shall be accompanied by the certificate of an authorized officer of the corporation that the statements were prepared without audit from the corporation's books and records.

*[Alternative 2: Annual report not required]*

**E. No Annual Report Required.** Inasmuch as, and for as long as, there are fewer than 100 shareholders, the requirement of an annual report to shareholders referred to in Corporations Code §1501 is expressly waived. However, nothing in this provision shall be interpreted as prohibiting the board of directors from issuing annual or other periodic reports to the shareholders, as the board considers appropriate.

*[If applicable, add the following option to Alternative 2]*

*[Option: Annual report to shareholders becomes necessary]*

**If at any time the number of shareholders shall exceed 100, the preceding paragraph will be deemed repealed, and the following provisions substituted:** \_\_ *[Insert text of form 8.111-1 regarding contents of annual report]* \_\_.

*Comment:* A corporation must send an annual financial report to its shareholders. However, the bylaws of a corporation with fewer than 100 shareholders may expressly waive this requirement. Corp C §1501(a)(1). This report must contain a balance sheet as of the end of that fiscal year, an income statement, and a statement of cashflows for that fiscal year. The report must be accompanied by any report by independent accountants or, if there is no report, the certificate of an authorized officer of the corporation that the statements were prepared without an audit from the books and records of the corporation. Corp C §1501(a)(1).

If not waived, the annual financial report must be sent at least 15 days before the annual shareholders' meeting, and no later than 120 days after the close of the fiscal year. Corp C §1501(a)(1)-(2). Unless otherwise provided in the articles or bylaws, the report may be sent by electronic transmission. Corp C §1501(a)(1); see Corp C §20. For discussion of the definition of "electronic transmission by the corporation," see the Comment in §8.61.

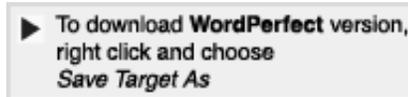
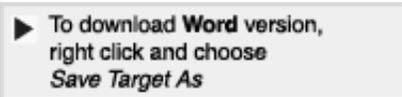
If the corporation has less than 100 shareholders of record (see Corp C §605) the requisite financial statements need not be prepared in conformity with generally accepted accounting principles, provided that they reasonably set forth the assets and liabilities and the income and expense of the corporation and disclose the accounting basis used in preparing the financial statements. Corp C §1501(a)(3).

If the corporation has 100 or more shareholders and is not subject to the reporting provisions of the Securities Exchange Act of 1934 (15 USC §§78a-78oo), the annual report must also contain significant additional information, including a description of transactions between the corporation and its officers or directors and indemnification or advances of more than \$10,000 to any officer or director. See Corp C §1501(b)(2). If the corporation has more than a few shareholders, counsel should discuss with the client the pros and cons of having the report audited.

Alternative 2 of this form may only be used when the corporation has fewer than 100 shareholders. Corp C §1501(a)(1). Even though the annual report is waived, the corporation must provide financial statements to shareholders on request. Corp C §1501(c). These financial statements are not required to be prepared in conformity with generally accepted accounting principles, provided that they reasonably set forth the assets and liabilities and the income and expense of the corporation and disclose the accounting basis used in preparing the financial statements. Corp C §1501(a)(3). If there are nearly 100 shareholders, or it is likely that number may be reached in the future, the attorney may wish to include the optional provision requiring annual reports once the number of shareholders exceeds 100.

## §8.94 f. Form: Financial Statements

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §8.59 and ends in §8.104



8.94-1 Financial statements

**F. Financial Statements.** The corporation will keep a copy of each annual financial statement, quarterly or other periodic income statement, and accompanying balance sheets prepared by the corporation on file in the corporation's principal executive office for 12 months; these documents shall be exhibited at all reasonable times, or copies provided, to any shareholder on demand.

If no annual report for the last fiscal year has been sent to shareholders, on written request of any shareholder made more than 120 days after the close of the fiscal year, the corporation will deliver or mail to the shareholder, within 30 days after receipt of the request, a balance sheet as of the end of that fiscal year and an income statement and statement of changes in financial position for that fiscal year.

A shareholder or shareholders holding 5 percent or more of the outstanding shares of any class of stock of the corporation may request in writing an income statement for the most recent 3-month, 6-month, or 9-month period (ending more than 30 days before the date of the request) of the current fiscal year, and a balance sheet of the corporation as of the end of that period. If such documents are not already prepared, the chief financial officer will cause them to be prepared and deliver the documents personally or mail them to the requesting shareholders within 30 days after receipt of the request. A balance sheet, income statement, and statement of changes in financial position for the last fiscal year will also be included, unless the corporation has sent the shareholders an annual report for the last fiscal year.

Quarterly income statements and balance sheets referred to in this paragraph will be accompanied by the report, if any, of independent accountants engaged by the corporation or the certificate of an authorized corporate officer stating that the financial statements were prepared without audit from the corporation's books and records.

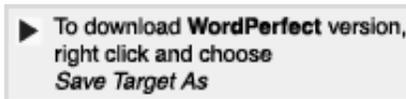
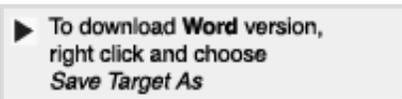
*Comment:* This clause substantially follows Corp C §1501(c)-(e). Shareholders holding at least 5 percent of the outstanding shares of any class have the right to obtain the corporation's last annual and last quarterly financial statements. Even if the corporation has not prepared these statements, it has the duty to prepare and provide the statements on request, although a superior court may extend the time of delivery. Corp C §1501(e). If a corporation withholds any of these statements without justification, the court may award the shareholder reasonable expenses, including attorney fees. Corp C §1501(f).

Financial statements required by Corp C §1501 must be "prepared or determined in conformity with generally accepted accounting principles then applicable, fairly presenting in conformity with generally accepted accounting principles the matters that they purport to present, subject to any specific accounting treatment required by a particular section of this division." Corp C §114. However, corporations with fewer than 100 shareholders of record need not prepare these financial statements in conformity with generally accepted accounting principles, provided that they reasonably set forth the assets and liabilities and the income and expense of the corporation and disclose the accounting basis used in preparing the financial statements. Corp C §1501(a)(3). The financial statements are to be prepared on a consolidated basis if the corporation has subsidiaries. "Financial statements other than annual statements may be condensed or otherwise presented as permitted by authoritative accounting pronouncements." Corp C §114.

**Source:** Business Law/Selecting and Forming Business Entities/8 S and C Corporations/§8.95 g. Form: Annual Information Statement

## §8.95 g. Form: Annual Information Statement

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §8.59 and ends in §8.104



8.95-1 Annual information statement

**G. Annual Information Statement.** Every year, during the calendar month in which the original Articles of Incorporation were filed with the Secretary of State, or during the preceding five (5) calendar months, the corporation shall file a statement with the Secretary of State on the prescribed form, setting forth the authorized number of directors; the names and complete business or residence addresses of all incumbent directors; the names and complete business or residence addresses of the chief executive officer, the secretary, and the chief financial officer; the street address of the corporation's principal executive office or principal business office in this state; the mailing address of the corporation if different from the street address of its principal executive office; a statement of the general type of business constituting the principal business activity of the corporation; and a designation of the agent of the corporation for the purpose of service of process, all in compliance with Corporations Code §1502.

However, if no change has been made in the information in the corporation's last annual statement on file in the Secretary of State's office, the corporation may, in lieu of filing the annual statement, advise the Secretary of State, on the appropriate form, that no changes in the required information have occurred during the applicable period.

*Comment:* Every California domestic stock corporation must file an annual Statement of Information with the Secretary of State (Form SI-200 C or Form SI-200 N/C). Corp C §1502(a). See form in §8.125. The initial statement must be filed within 90 days after filing the original articles of incorporation. Each succeeding statement must be filed during the 6-month calendar period including the calendar month of its incorporation and the preceding five (5) calendar months. Corp C §1502(d). If there has been no change in the required information since the last report was filed, the corporation may file a Statement of Information showing no change since the last form was filed. Corp C §1502(c). A corporation may file a new statement whenever any information changes, and the corporation must file a new statement to designate a new agent for service of process. Corp C §1502(e).

**Source:** Business Law/Selecting and Forming Business Entities/8 S and C Corporations/ 7. General Corporate Matters/  
§8.96 a. Form: Record Date for Dividends

## 7. General Corporate Matters

### §8.96 a. Form: Record Date for Dividends

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8.96-1 Fixed record date for dividends and other purposes

## ARTICLE IX

### GENERAL CORPORATE MATTERS

**A. Record Date for Purposes Other than Notice and Voting.** For purposes of ascertaining the shareholders entitled to receive payment of dividends or other distributions or allotment of rights, or entitled to exercise any rights in respect of any other lawful action (other than voting at and receiving notice of shareholders' meetings and giving written consent of the shareholders without a meeting), the board of directors may fix in advance a record date, which will be not more than 60 nor less than 10 days before the date of the dividend payment, distribution, allotment, or other action. If a record date is so fixed, only shareholders of record at the close of business on that date will be entitled to receive the dividend, distribution, or allotment of rights, or to exercise the other rights, as the case may be, notwithstanding any transfer of shares on the corporation's books after the record date, except as otherwise provided by statute.

If the board of directors does not so fix a record date in advance, the record date will be at the close of business on the later of the day on which the board of directors adopts the applicable resolution or the 60th day before the date of the dividend payment, distribution, allotment of rights, or other action.

*Comment:* This form substantially follows the portions of Corp C §701 as to record date for purposes other than shareholders' meetings and shareholders' action by written consent. Apparently the statutory rules can be varied only by a provision in the articles or by agreement. See Corp C §701(d).

**Source:** Business Law/Selecting and Forming Business Entities/8 S and C Corporations/§8.97 b. Form: Authorized Signatories

**§8.97            b. Form: Authorized Signatories**

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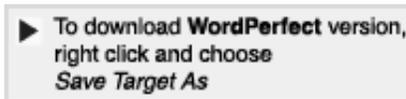
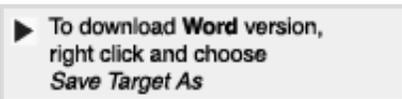
8.97-1            Authorized signatories

**B. Authorized Signatories for Checks.** All checks, drafts, other orders for payment of money, notes, or other evidences of indebtedness issued in the name of or payable to the corporation will be signed or endorsed by such person or persons and in the manner authorized from time to time by resolution of the board of directors.

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## **§8.98 c. Form: Executing Corporate Contracts**

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8.98-1 Executing corporate contracts

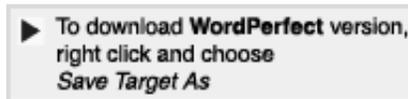
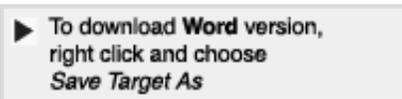
**C. Executing Corporate Contracts and Instruments.** Except as otherwise provided in the Articles or in these Bylaws, the board of directors by resolution may authorize any officer, officers, agent, or agents to enter into any contract or to execute any instrument in the name of and on behalf of the corporation. This authority may be general or it may be confined to one or more specific matters. No officer, agent, employee, or other person purporting to act on behalf of the corporation has any power or authority to bind the corporation in any way, to pledge the corporation's credit, or to render the corporation liable for any purpose or in any amount, unless that person was acting with authority duly granted by the board of directors as provided in these Bylaws, or unless an unauthorized act was later ratified by the corporation.

*Comment:* The general powers of a corporation to enter into contracts and execute instruments are set forth in Corp C §208. This form grants the board the power to authorize agents to act on the corporation's behalf and contains a disclaimer of all acts that were not so authorized. The bylaw provisions confer no authority on officers to enter into contracts or execute documents without specific board authorization. The recommended forms of initial board action (see forms in §§8.107-8.124) likewise include no blanket authorization. Although third parties may rely on the apparent authority of officers, whenever possible officers should obtain authorization from the board before executing documents on behalf of the corporation. When prior approval is not possible, officers should seek subsequent board ratification of the acts. These steps are important to protect the officers from claims that they exceeded their authority. Moreover, these steps are in the long-range interest of the corporation, because they permit it to establish (as it is asked to do in connection with financing and other circumstances) that its contracts have been duly authorized by all appropriate corporate action.

As to specific transactions, however, third parties under both the statute and general agency law may rely on the apparent authority of senior officers purporting to execute contracts or instruments on behalf of the corporation. Contracts, instruments, or share certificates signed by (1) either the chair of the board, the president, or a vice president, and also by (2) either the secretary, an assistant secretary, the chief financial officer, or an assistant treasurer, are not invalidated by any lack of authority of the signing officers, unless the other party had actual knowledge of the absence of authority. See Corp C §313. Apparent authority and the circumstances under which third parties may rely on corporate signatures, particularly the signature of a single officer, have been the subject of discussion in recent case law. Corporate officers and the third parties who rely on their signatures are prudent to insist on specific board or bylaw authority before entering into corporate agreements. See *Snukal v Flightways Mfg., Inc.* (2000) 23 C4th 754, 778, 98 CR2d 1.

## §8.99 d. Form: Issuing Shares Certificates

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §8.59 and ends in §8.104



8.99-1 Issuing shares certificates

**D. Certificates for Shares.** A certificate or certificates for shares of the capital stock of the corporation will be issued to each shareholder when any of the shares are fully paid.

*[If applicable, add the following option]*

*[Option: Certificates for partly paid shares]*

In addition to certificates for fully paid shares, the board of directors may authorize the issuance of certificates for shares that are partly paid and subject to call for the remainder of the purchase price, provided that the certificates representing partly paid shares states the total amount of the consideration to be paid for the shares and the amount actually paid.

*[Continue]*

All certificates must certify the number of shares and the class or series of shares represented by the certificate. All certificates will be signed in the name of the corporation by either the chair of the board of directors, the vice chair of the board of directors, the president, or any vice president, and either the chief financial officer, any assistant treasurer, the secretary, or any assistant secretary.

\_\_ *[Any or all/None]* \_\_ of the signatures on the certificate may be facsimile. If any officer, transfer agent, or registrar who has signed \_\_ *[or whose facsimile signature has been placed on]* \_\_ a certificate shall have ceased to be that officer, transfer agent, or registrar before that certificate is issued, the certificate may be issued by the corporation with the same effect as if that person were an officer, transfer agent, or registrar at the date of issue.

*Comment:* Shareholders are entitled to have signed certificates certifying the number of shares and the class or series of shares owned. The certificates must be signed by (1) the chair or a vice chair or the president or a vice president, and (2) the chief financial officer or an assistant treasurer or the secretary or an assistant secretary. Corp C §416(a). The provisions relating to the issuance of partly paid shares are in Corp C §§409-414. When shares are subject to particular rights, preferences, privileges, or restrictions, particular statements may be required to appear on the certificate. See Corp C §§417-418.

Facsimile signatures are particularly useful in a corporation with a large number of shareholders. If facsimile signatures are not to be used, it is good practice for security reasons to include in the bylaws a provision banning use of facsimile signatures.

If share certificates are lost, stolen, or destroyed, the corporation may issue new certificates. The corporation may require the shareholder to give a bond to indemnify the corporation against any claims based on the lost certificates. Corp C §419(a). If the corporation refuses to issue a new certificate, the shareholder may bring a superior court action for an order requiring the corporation to issue a replacement certificate. Corp C §419(b), (c).

A corporation may elect to eliminate share certificates and issue shares by electronic or other means not involving issuance of certificates. Corp C §416(b). The system that a corporation chooses for uncertificated securities must provide for a notice to purchasers instead of the statements on certificates required under Corp C §§417-418 and 1302, or required by the Corporate Securities Law of 1968 (Corp C §§25000-25707), and must be (1) approved by the Securities and Exchange Commission; (2) authorized by federal law; or (3) in accordance with the Commercial Code. Corp C §416(b).

All outstanding certificated securities must be surrendered before a system for issuing noncertificated securities can become legally effective. Corp C §416(b). Commercial Code §§8101-8603 regulate ownership, transfers, and security interests in uncertificated securities by requiring registration of these occurrences with the issuer. Transactions are evidenced by an initial transaction statement signed by or on behalf of the issuer. Com C §8408.

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**Source:** Business Law/Selecting and Forming Business Entities/8 S and C Corporations/§8.100 e. Form: Lost Certificates

## §8.100 e. Form: Lost Certificates

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8.100-1 Lost certificates

**E. Lost Certificates.** Except as provided in this paragraph, no new certificates for shares will be issued to replace old certificates unless the old certificate is surrendered to the corporation for cancellation at the same time. If share certificates or certificates for any other security have been lost, stolen, or destroyed, the board of directors may authorize the issuance of replacement certificates on terms and conditions as required by the board, which may include a requirement that the owner give the corporation a bond (or other adequate security) sufficient to indemnify the corporation against any claim that may be made against it (including any expense or liability) on account of the alleged loss, theft, or destruction of the old certificate or the issuance of the replacement certificate.

*Comment:* This form is based on Corp C §419(a). If the corporation refuses to issue a new certificate, the shareholder or the shareholder's legal representative may bring a superior court action for an order requiring the corporation to issue a replacement certificate. Corp C §419(b)-(c).

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**Source:** Business Law/Selecting and Forming Business Entities/8 S and C Corporations/§8.101 f. Form: Voting Shares of Other Corporations

## §8.101 f. Form: Voting Shares of Other Corporations

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8.101-1 Voting shares of other corporations

**F. Voting Shares of Other Corporations.** Shares of other corporations standing in the name of this corporation shall be voted by one of the following persons, listed in order of preference: \_\_ *[List persons who may vote shares, e.g., (1) chair of the board or person designated by the chair of the board; (2) president or person designated by the president; (3) first vice president or person designated by the first vice president; (4) other person designated by the board of directors]*\_\_.

**The authority to vote shares granted by this paragraph includes the authority to execute a proxy in the name of the corporation for purposes of voting the shares.**

*Comment:* This bylaw clause deals with the voting of shares owned by the corporation in another corporation. This share ownership may arise from corporate investments removed from the corporation's principal line of business. However, this clause also applies, and takes on particular importance, when a corporation establishes or acquires one or more operating subsidiaries.

A corporation's holdings in another corporation are voted in accordance with provisions in the shareholding corporation's bylaws. Corp C §703(a). If the bylaws are silent, the shares are voted in accordance with a determination by the board or, in the absence of such a determination, in accordance with rules supplied by the statute. See Corp C §703(a). However, the statutory rules are somewhat vague and if relied on could lead to confusion. Therefore, the bylaws should identify the officers who are empowered to exercise these rights and the order of preference among those specified. The persons named in the above form are merely illustrative; each corporation will wish to make its own designations for this purpose.

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**Source:** Business Law/Selecting and Forming Business Entities/8 S and C Corporations/§8.102 g. Form: Reimbursing Corporation for Disallowed Payments

## §8.102 g. Form: Reimbursing Corporation for Disallowed Payments

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8.102-1 Reimbursing corporation for disallowed payments

**G. Reimbursement of Corporation if Payment Not Tax Deductible.** If all or part of the compensation, including expenses, paid by the corporation to a director, officer, employee, or agent is finally determined not to be allowable to the corporation as a federal or state income tax deduction, the director, officer, employee, or agent to whom the payment was made must repay to the corporation the amount disallowed. The board of directors will enforce repayment of each such amount disallowed by the taxing authorities.

*Comment:* In small corporations, the taxing authorities may determine that payments by the corporation to a shareholder-employee as salary or expenses are unreasonable, and treat the excessive part as a dividend, disallowing the amount as a business deduction by the corporation. Treas Reg §1.162-8. See *Label/Graphics, Inc. v Commissioner* (9th Cir 2000) 221 F3d 1091 (huge increase in close corporation president's compensation not deductible as reasonable business expense). In this situation, the employee may be willing to repay the disallowed amount to the corporation, but the employee cannot deduct the repayment as a business expense on the employee's personal income tax return unless repayment is compulsory. See *Vincent E. Oswald* (1968) 49 TC 645, acq 1968-2 Cum Bull 2. However, reimbursement requirements adopted after the compensation arrangement in question may be taken as indicating the corporation's knowledge that the compensation was unreasonable. *Charles Schneider & Co. v Commissioner* (8th Cir 1974) 500 F2d 148, 155, cert denied (1975) 420 US 908. If a reimbursement provision in the bylaws is adopted, a corresponding provision should be included in any employment agreements with shareholder-employees. See *Advising California Employers and Employees*, chap 2 (Cal CEB 2005).

**Source:** Business Law/Selecting and Forming Business Entities/8 S and C Corporations/§8.103 8. Form: Construction and Definitions

## §8.103 8. Form: Construction and Definitions

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §8.59 and ends in §8.104

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8.103-1 Construction and definitions

**H. *Construction and Definitions.*** Unless the context requires otherwise, the general provisions, rules of construction, and definitions in Corporations Code §§100 through 195 govern the construction of these Bylaws. Without limiting the generality of this provision, the singular number includes the plural, the plural number includes the singular, and the term "person" includes both a corporation and a natural person.

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## §8.104 9. Form: Amending the Bylaws

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8.104-1 Amending the bylaws

### ARTICLE X AMENDMENTS

*[Add one of the following alternatives]*

*[Alternative 1: Statutory rule—amendment by board or shareholders]*

**A. Amendment by Board or Shareholders.** Except as otherwise required by law or by the Articles of Incorporation, these Bylaws may be amended or repealed, and new Bylaws may be adopted by the board of directors or by the holders of a majority of the outstanding shares entitled to vote.

*[If applicable, add the following option to Alternative 1]*

*[Option: Approval by majority of shares required]*

**B. Shareholder Approval Required.** Notwithstanding the first sentence of this \_\_ *[specify paragraph by number or letter]* \_\_, any amendment, repeal, or adoption of a Bylaw by action of the board of directors on any of the following matters shall be ineffective unless and until it is approved by a majority of the outstanding shares entitled to vote: \_\_ *[List matters for which bylaw change requires shareholder approval]* \_\_.

*[Alternative 2: Restriction on board's authority to amend]*

**A. Amendment of Bylaws.** No Bylaw may be amended or repealed, and no new Bylaw may be adopted, except by approval of a majority of the outstanding shares entitled to vote.

*[If applicable, add the following option to Alternative 2]*

*[Option: Approval by board required for specific matters]*

**B. Board Approval Required.** Notwithstanding the first sentence of this paragraph \_\_ *[specify paragraph by number or letter]* \_\_, Bylaws on the following matters may be adopted, amended, or repealed by the vote of a majority of a quorum of the board of directors: \_\_ *[List matters on which board may amend, repeal, or adopt bylaws without shareholder approval]* \_\_.

*Comment:* Corporations Code §211 gives the board of directors the power to make changes in the bylaws on most matters and allows bylaw changes by a majority of the shares entitled to vote. The first sentence of this form sets forth the normal statutory rule; the optional sentence is for use if there are any special matters on which shareholder approval is desired.

The articles of a corporation may provide for a supermajority vote of the outstanding shares entitled to vote, or a supermajority vote of the directors, or both, to amend or repeal bylaws or a particular bylaw or to adopt new bylaws. See Corp C §§204(a)(5), 211. In such a case, the bylaw provisions on amendments should be tailored to conform to the requirements of the articles.

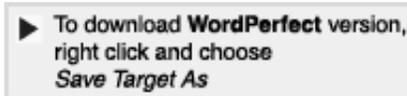
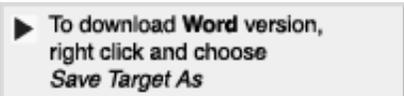
If the articles establish a fixed number of directors or the minimum and maximum number of directors, changing the fixed, minimum, or maximum number requires an amendment to the articles. If these matters are established by provisions in the bylaws rather than in the articles, a change can be effected by amending the bylaws, but the amendment must be approved by a majority of the outstanding shares entitled to vote. Corp C §212(a). The same rule

applies to changing from a fixed number of directors to a variable number, or vice versa. A bylaw amendment that would reduce the fixed or minimum number of directors to a number less than five cannot be adopted if more than one sixth of the outstanding shares entitled to vote fail to consent, in the case of action by written consent, or vote against the change at a meeting. Corp C §212(a).

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### C. Completing Corporate Organization

#### §8.105 1. Form: Adoption of Bylaws and Election of Directors by Incorporator



8.105-1 Incorporator's actions

**Action of Incorporator**  
of \_\_ *[name of corporation]* \_\_  
a California Corporation

The undersigned, sole incorporator of \_\_ *[name of corporation]* \_\_, a California corporation, hereby adopts the following resolutions under Corporations Code §210: \_\_ *[List resolutions]* \_\_.

**A. Adoption of Bylaws.** The Bylaws of the corporation as presented to the incorporator are adopted. The Secretary is hereby authorized and directed to execute a certification of the adoption of the Bylaws and to file the Bylaws as so certified in the minute book of the corporation, and to see that a copy of the Bylaws, similarly certified, is kept at the principal office of the corporation in accordance with Corporations Code §213.

**B. Election of Directors.** The following persons are elected directors of the corporation, to hold office until the next annual meeting and until their successors have been elected and qualified: \_\_ *[List names]* \_\_.

*[If applicable, add the following option]*

*[Option: Appointment of officers]*

**C. Appointment of Officers.** The following persons are hereby appointed to the indicated offices, to serve at the pleasure of the board of directors: \_\_ *[List names and offices]* \_\_.

*[Continue]*

Date: \_ \_ \_ \_ \_  
  \_\_ *[Signature of incorporator]* \_\_  
  \_ \_ *[Typed name]* \_ \_

*Comment:* Corporations Code §210 does not prescribe a form for incorporators' postfiling proceedings. This form represents one approach. If there is more than one incorporator, appropriate modifications should be made.

Before the directors are elected, incorporators may take whatever action is necessary and proper in connection with the organization of the corporation, including the adoption and amendment of the bylaws, the election of directors, and the appointment of officers. Corp C §210. Some experienced practitioners take the position that, except in urgent cases arising when no directors have been or can be elected, these three actions, the only ones specifically enumerated in the statute, are the only ones incorporators should take. In any event, just as the board approves the bylaws adopted by the incorporators when it meets, it is good practice for the directors to ratify any other actions taken by the incorporators.



**Source:** Business Law/Selecting and Forming Business Entities/8 S and C Corporations/ b. Minutes of First Meeting of Board of Directors/§8.107 (1) Form: Heading and Opening Sentence

## **b. Minutes of First Meeting of Board of Directors**

### **§8.107 (1) Form: Heading and Opening Sentence**

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8.107-1 Heading and opening sentence

*[Add one of the following alternatives]*

*[Alternative 1: Minutes of first meeting]*

**Minutes of First Meeting of Directors of**  
\_\_ *[name of corporation]* \_\_, a **California Corporation**

**The board of directors of** \_\_ *[name of corporation]* \_\_ **held its first meeting on** \_\_ *[date and time of meeting]* \_\_ **at** \_\_ *[street address and city]* \_\_, \_\_ *[name of state]* \_\_.

*[Alternative 2: Action by unanimous written consent without meeting]*

**Unanimous Written Consent of**  
\_\_ *[name of corporation]* \_\_, a **California Corporation**

**The undersigned, all the directors of** \_\_ *[name of corporation]* \_\_, a **California corporation, who constitute a quorum and who are acting by unanimous written consent without a meeting under Corporations Code §307(b) and** \_\_ *[specify paragraph by number or letter; see form 8.82-1]* \_\_ **of the Bylaws of the corporation, consent to their election as directors, accept the resignation of the incorporator(s), and adopt the following resolutions:** \_\_ *[List resolutions]* \_\_.

*Comment:* Action by written consent of the directors without a meeting requires unanimous consent and also requires that the number of members of the board serving at the time constitutes a quorum. Corp C §307(b). See §8.82. If this procedure, rather than an actual meeting, is used, the forms in §§8.106, 8.108, and 8.109 are unnecessary, and the introductory material preceding some of the resolutions set forth in §§8.110-8.124 should be modified to delete references to proceedings at a meeting (e.g., motions, seconds, votes).

**Source:** Business Law/Selecting and Forming Business Entities/8 S and C Corporations/§8.108 (2) Form: Directors Present; Officers of the Meeting

## §8.108 (2) Form: Directors Present; Officers of the Meeting

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §8.107 and ends in §8.124

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8.108-1 Directors present; officers of the meeting

**The following directors were present:** \_\_ *[List names]* \_\_. **The following directors were absent:** \_\_ *[List names, or state "None"]* \_\_. **Also present at the meeting were:** \_\_ *[List names and titles of other persons present]* \_\_. \_\_ *[Name]* \_\_ **acted as chair of the meeting, and** \_\_ *[name]* \_\_ **acted as secretary of the meeting.**

*Comment:* It is important to keep a record of who attended each meeting to facilitate proof of what took place should there be a challenge to the accuracy or completeness of the minutes. By separating the names of directors from those of other attendees, the process of demonstrating the presence of a quorum is simplified. Finally, a record of absences is useful if questions of directors' due diligence is raised. If directors participate by conference telephone equipment or other electronic communications equipment (see §8.78), the particular method of participation should be noted in the minutes, because when properly conducted this participation constitutes the presence of the director at the meeting.

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**Source:** Business Law/Selecting and Forming Business Entities/8 S and C Corporations/§8.109 (3) Form: Waiver of Notice Presented

### **§8.109 (3) Form: Waiver of Notice Presented**

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8.109-1 Waiver of notice presented

**The chair presented to the meeting the written waiver of notice and consent to the holding of the first meeting of directors signed by each director of the corporation. The chair instructed the secretary to make it a part of the records of the meeting and to insert it in the minute book immediately preceding these minutes.**

*Comment:* For a form of waiver of notice and consent to the holding of the first meeting, see §8.106.

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**Source:** Business Law/Selecting and Forming Business Entities/8 S and C Corporations/§8.110 (4) Form: Report of Articles Filed

### **§8.110 (4) Form: Report of Articles Filed**

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8.110-1 Report of articles filed

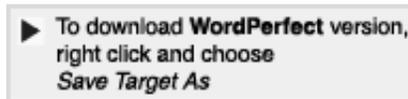
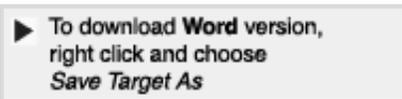
**The chair announced that the corporation was incorporated on \_\_[date]\_\_, the date on which the Articles of Incorporation were filed by the Secretary of State. The chair presented a certified copy of the Articles and directed the secretary to insert it in the corporation's minute book.**

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**Source:** Business Law/Selecting and Forming Business Entities/8 S and C Corporations/§8.111 (5) Form: Approval or Appointment of Agent for Service of Process

## §8.111 (5) Form: Approval or Appointment of Agent for Service of Process

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §8.107 and ends in §8.124



8.111-1 Approval or appointment of agent for service of process

**The chair informed the board that the corporation is required by statute to designate an agent for service of process in the State of California, and that \_\_[name of agent]\_\_ had been designated as that agent in the corporation's Articles filed with the Secretary of State. The board adopted the following resolutions:**

*[Add one of the following alternatives]*

*[Alternative 1: Individual designated as agent]*

**RESOLVED that \_\_[name]\_\_, a resident of California, whose \_\_[business/residence]\_\_ address is \_\_[address]\_\_, is \_\_[approved/appointed]\_\_ as this corporation's agent for service of process in California as required by Corporations Code §1502.**

*[Alternative 2: Corporation designated as agent]*

**RESOLVED that \_\_[name of corporate agent]\_\_, a corporation incorporated under the laws of \_\_[state]\_\_, which has complied with Corporations Code §1505, is \_\_[approved/appointed]\_\_ as this corporation's agent for service of process in California as required by Corporations Code §1502.**

*Comment:* Each California corporation must designate an individual or a qualified corporation to act as its agent for service of process. Corp C §1502(b). The name of the initial agent must be set forth in the articles (but may be deleted by amendment after the first annual statement required by Corp C §1502(a) has been filed with the Secretary of State). It is advisable that the board of directors ratify any designation made by the incorporator. If a different agent is designated, a statement designating the agent must be filed with the Secretary of State. Corp C §§1502(b), 1504.

If an officer of the corporation or other natural person is designated as agent for service of process, that person's business rather than residence address should ordinarily be given in order to protect the officer's privacy (this information is a matter of public record) and to guard against misplacement of papers served.

When drafting resolutions, some counsel routinely recite, "On motion duly made, seconded, and unanimously carried...." This is unnecessary. If the resolution is adopted, all those things can be presumed to have happened. Moreover, if the minutes indicate when approval is unanimous, must they also record when it is not? Does the precise vote need to be memorialized? It is better simply to record approval, unless one or more directors specifically requests that his or her dissent (or lack of participation in a particular vote) be recorded. A director might, for example, request that his or her lack of participation be recorded when he or she has an interest in the matter being considered.

**Source:** Business Law/Selecting and Forming Business Entities/8 S and C Corporations/§8.112 (6) Form: Approval of Bylaws

## §8.112 (6) Form: Approval of Bylaws

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §8.107 and ends in §8.124

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8.112-1 Approval of bylaws

The chair presented a copy of the corporation's Bylaws, as adopted by the incorporator. The board reviewed the general provisions of the Bylaws and adopted the following resolutions:

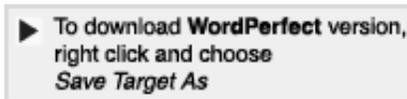
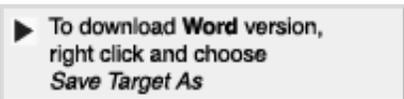
**RESOLVED that:**

1. The Bylaws adopted by the incorporator of this corporation are approved; and
2. The secretary of this corporation is authorized and directed to execute a certificate of the adoption of those Bylaws, to insert those Bylaws as so certified in the minute book of this corporation, and to cause a copy of those Bylaws, as they may be amended from time to time, to be kept and maintained at the principal executive office of this corporation, in accordance with Corporations Code §213.

*Comment:* Although the board is not required to approve the bylaws adopted by the incorporator, it is good practice to do so, particularly because going through the approval procedure serves to acquaint the directors with the bylaws and their contents. Either at this meeting or by correspondence, the attorney should review the bylaws with the directors.

### §8.113 (7) Form: Appointment of Officers

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §8.107 and ends in §8.124



8.113-1 Appointment of officers

The board appointed officers for the corporation. The following persons were appointed, to serve at the pleasure of the board, to the offices set forth opposite their names:

Name	Office
_____	__ <i>[President]</i> __
_____	__ <i>[Vice President]</i> __
_____	__ <i>[Secretary]</i> __
_____	__ <i>[Chief Financial Officer]</i> __

*[If applicable, add the following option]*

*[Option: Chief financial officer to act as treasurer]*

The board also adopted the following resolution authorizing the chief financial officer to act as the corporation's treasurer:

**RESOLVED** that, for purposes of giving any reports or executing any documents requiring the signature of the "treasurer," the chief financial officer is also deemed to be the treasurer of this corporation.

*Comment:* The statute requires each corporation to have a "chief financial officer," but it does not require a treasurer; no presumption of authority is created by the execution of a corporate document by the treasurer. See Corp C §313. However, because a treasurer's signature may be required (e.g., by financial institutions, regulatory authorities in other jurisdictions) on various documents and certificates, the chief financial officer should be given the authority to act as treasurer when necessary. This is done by including the optional paragraph of this form. This paragraph may be omitted if the subject is covered in the bylaws.

**Source:** Business Law/Selecting and Forming Business Entities/8 S and C Corporations/§8.114 (8) Form: Adoption of Corporate Seal

## **§8.114 (8) Form: Adoption of Corporate Seal**

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8.114-1 Adoption of corporate seal

**The chair presented to the board for its approval a proposed seal of the corporation, and the board adopted the following resolutions:**

**RESOLVED that:**

- 1. The corporate seal presented to this board of directors is adopted as the seal of this corporation; and**
- 2. The secretary is directed to affix an impression of the corporate seal of this corporation to the minutes of this meeting in the margin opposite this resolution.**

*Comment:* A corporation may adopt a corporate seal. Corp C §207(a). However, for more than a century, California law has made no distinction between documents that are under seal and those that are not. CC §1629 (adopted in 1872). A corporate seal no longer creates any presumption of authority or due execution of a document or instrument. It nevertheless is advisable to adopt a seal because some commercial landlords and many financial institutions, as well as governmental authorities in other jurisdictions, continue to request a corporate seal on certain documents.

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**Source:** Business Law/Selecting and Forming Business Entities/8 S and C Corporations/§8.115 (9) Form: Adoption of Share Certificate Form

### §8.115 (9) Form: Adoption of Share Certificate Form

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8.115-1 Adoption of share certificate form

**The chair presented to the board of directors for its approval a proposed form of share certificate for the corporation. The board adopted the following resolution:**

**RESOLVED that the form of share certificate presented to this board of directors is adopted for use by this corporation and that the secretary is directed to insert a copy of that form of share certificate in the corporation's minute book immediately following the minutes of the meeting.**

*Comment:* For discussion of share certificates, see Financing and Protecting California Businesses, chap 8 (Cal CEB 2006).

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**Source:** Business Law/Selecting and Forming Business Entities/8 S and C Corporations/§8.116 (10) Form: Selection of Annual Accounting Period

## §8.116 (10) Form: Selection of Annual Accounting Period

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8.116-1 Selection of annual accounting period

**The chair informed the board of directors that the accounting year should be fixed for the corporation, and the board adopted the following resolution:**

**RESOLVED** that the first fiscal year of this corporation shall commence on \_\_ \_\_ [date of filing of articles by Secretary of State]\_\_ \_\_ and shall end on the next succeeding \_\_ \_\_ [month and day]\_\_ \_\_, and thereafter the corporation's fiscal year shall end on \_\_ \_\_ [month and day]\_\_ \_\_ of each year.

*Comment:* Although the board is not required to adopt an accounting year at the start of the corporate existence, to avoid overlooking this important matter it is usually dealt with in the organizational minutes. In the alternative, the corporation's fiscal year may be set in the bylaws.

**PRACTICE TIP:** A fiscal year should not be chosen without consulting the corporation's tax advisor. The decision will affect the financial reporting cycle; the deadlines for filing federal, state, and local income tax returns; and the timing of the annual shareholders' meeting.

A corporation is no longer required to advise either the California or federal income tax agencies in advance of the close of its fiscal year, even if a tentative decision is reflected in the initial board minutes. It is possible to terminate the corporation's fiscal year at an earlier date or to extend it to a later and otherwise permissible date (*i.e.*, to the last day of a calendar month) not more than 1 year after the date of incorporation. However, generally accepted accounting principles and state and federal tax regulations may indicate the inappropriateness of certain choices of accounting years, primarily to avoid seasonal or other distortions in reporting income.

Any change in the fiscal year should be reflected in an appropriate board of director's resolution, as well as in the bylaws if they establish a fixed date for the annual shareholders' meeting. Once an initial year-end tax filing is made with the federal and California tax agencies, their permission must usually be sought and obtained before the corporation's fiscal year can be changed.

**Source:** Business Law/Selecting and Forming Business Entities/8 S and C Corporations/§8.117 (11) Form: Establishing Principal Executive Office

### §8.117 (11) Form: Establishing Principal Executive Office

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8.117-1 Establishing principal executive office

**The chair noted the desirability of designating a principal executive office for the corporation, and the board adopted the following resolution:**

**RESOLVED** that \_\_ *[address of principal executive office]* \_\_, **California, is designated as the principal executive office of this corporation.**

*Comment:* The provision in the bylaws requires the board of directors to designate the corporation's principal executive office (or principal California business office, if the principal executive office is outside California and the corporation has an office or offices in California). See Corp C §1502. If the location of the principal executive office or principal business office is set forth in the bylaws, this paragraph should not be included in the organizational minutes.

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**Source:** Business Law/Selecting and Forming Business Entities/8 S and C Corporations/§8.118 (12) Form: Filing of Annual Statement

## §8.118 (12) Form: Filing of Annual Statement

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8.118-1 Filing of annual statement

The chair advised the board that, within 90 days after its Articles were filed, the corporation must file a Statement of Information (Domestic Stock Corporation) (annual informational statement) with the California Secretary of State under Corporations Code §1502. The board adopted the following resolution:

**RESOLVED that:**

- 1. The secretary of this corporation is authorized and directed to prepare and to file or cause to be filed with the Secretary of State the necessary statement in compliance with Corporations Code §1502; and**
- 2. The secretary is directed to insert a copy of that statement in the minute book following the minutes of this meeting.**

*Comment:* These resolutions, although not required, may serve as a useful reminder of the informational statement due 90 days after incorporation under Corp C §1502(a). The person who filed the articles (usually the attorney) is sent a blank copy of the form by the Secretary of State at the time the requested certified copies of the articles are sent.

## §8.119 (13) Form: Establishing Bank Accounts

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### 8.119-1 Establishing bank accounts

The chief financial officer informed the board that it would be necessary to establish one or more bank checking and savings accounts and to select a depository for the corporation's employment taxes trust funds. The board was informed that an IRS Form SS-4 had been submitted to the Internal Revenue Service, applying for an employer identification number. The board adopted the following resolutions:

#### RESOLVED that:

1. This corporation establish in its name one or more deposit accounts with \_\_ *[name of bank]* \_\_, and that the \_\_ *[title, e.g., president]* \_\_ and \_\_ *[title, e.g., secretary]* \_\_ of this corporation are authorized to establish such an account or accounts, on terms and conditions as agreed on with the bank.

*[Repeat as necessary for additional banks or other financial institutions]*

2. The corporation's employment taxes trust funds will be deposited with \_\_ *[name, branch, and address of financial institution]* \_\_.

3. The \_\_ *[title, e.g., president]* \_\_ and \_\_ *[title, e.g., secretary]* \_\_, acting together, are authorized to designate as depositories of this corporation's funds one or more other banks, trust companies, or other financial institutions, and to open, keep, and close general and special accounts in those depositories.

4. Any officer of the corporation is authorized to endorse checks, drafts, or other evidences of indebtedness made payable to the corporation, but only for the purpose of deposit; and

*[Add one of the following alternatives]*

*[Alternative 1: Two officers to sign]*

5. All checks, drafts, and other instruments obligating the corporation to pay money, including instruments payable to officers or other persons authorized to sign them, shall be signed on the corporation's behalf by \_\_ *[any/any two]* \_\_ of the following officers: \_\_ *[titles of officers authorized to sign checks]* \_\_.

*[Alternative 2: Specified officers to sign]*

5. All checks, drafts, and other instruments obligating the corporation to pay money, including instruments payable to officers or other persons authorized to sign them, shall be signed on the corporation's behalf by any of the following officers: \_\_ *[titles of officers authorized to sign checks]* \_\_; provided, however, that if the amount of the check is in excess of \$ \_\_ *[amount]* \_\_, the signature of two of the following officers will be required: \_\_ *[titles]* \_\_.

*[Continue]*

6. The standard form of corporate resolution required by \_\_ *[name of financial institution]* \_\_ for opening a corporate account, as presented to this meeting, a copy of which is attached to these minutes, is adopted as the resolution of the board of directors; the secretary is directed to obtain the necessary signatures, execute the necessary certifications, and take such other steps as needed to open this account.

*Comment:* Before opening a corporate account, most banks and other financial institutions require a copy of the articles of incorporation, a certified copy of the board resolution authorizing the account, and a certified signature of

everyone authorized to sign on behalf of the corporation. In certain circumstances, a corporation may wish to require only one signature on smaller checks necessary in the day-to-day operation of the business but require two signatures on larger checks. Many banks will accommodate such an approach. Most banks furnish a printed signature card form containing the language they require a corporation opening an account to adopt as a resolution. For a form of bank resolution, see *Organizing Corporations in California*, chap 2 (3d ed Cal CEB 2001).

Before a corporate account can be used, the corporation may be required to furnish its employer identification number. An active corporation must obtain a federal and California employer identification number, make periodic deposits (called trust deposits) in an authorized bank or Federal Reserve Bank covering federal and state withholding taxes and federal social security taxes (both the portion withheld from employees and the portion contributed by the employer), and make deposits of its own estimated corporate income or franchise tax liability. On how to obtain federal and California employer identification numbers, see §§2.200-2.202.

**Source:** Business Law/Selecting and Forming Business Entities/8 S and C Corporations/§8.120 (14) Form: Payment of Incorporation Expenses

### **§8.120 (14) Form: Payment of Incorporation Expenses**

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8.120-1 Chief financial officer directed to pay expenses and reimburse advances

**The board then considered the payment of the expenses of incorporation and organization. The chair reported on the fees and expenses that had been incurred to date in this connection and the board approved the following resolution:**

**RESOLVED that the chief financial officer is authorized and directed to pay the expenses of incorporation and organization and to reimburse the persons advancing funds to the corporation for this purpose, as stated in the report presented to this meeting.**

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**Source:** Business Law/Selecting and Forming Business Entities/8 S and C Corporations/§8.121 (15) Form: Optional Qualification of Stock Under IRC §1244

## §8.121 (15) Form: Optional Qualification of Stock Under IRC §1244

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8.121-1 Optional qualification of stock under IRC §1244

The board considered the applicability of Internal Revenue Code §1244 to the corporation's \_\_[e.g., common]\_\_ stock. Section 1244 entitles shareholders to ordinary loss tax treatment of losses from stock that qualifies as "section 1244 stock." The board noted that the corporation is a small business corporation as defined in Internal Revenue Code §1244(c)(3)(A).

The board adopted the following resolutions:

**RESOLVED** that:

1. This corporation intends to qualify its \_\_[e.g., common]\_\_ stock for treatment under Internal Revenue Code §1244, under which the corporation plans that its total equity capital and paid-in surplus will in no event exceed \$1 million, that it will be largely an operating company, with less than 50 percent of its gross receipts coming from passive sources (royalties, rents, dividends, interest, annuities, and sales or exchanges of stocks or securities), and that it shall conform in all other respects to the requirements necessary to qualify its \_\_[e.g., common]\_\_ stock for treatment under Internal Revenue Code §1244.

2. The secretary of this corporation is authorized and directed to keep all records, prepare all reports and returns, and take all other steps as may be necessary to qualify this corporation's \_\_[e.g., common]\_\_ stock for treatment under Internal Revenue Code §1244.

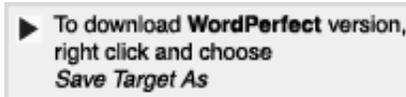
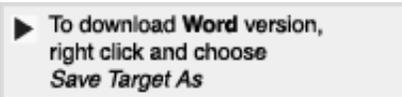
*Comment:* For shares to be considered "section 1244 stock," the corporation does not have to adopt a formal plan, but these resolutions may still be useful in reminding all concerned of the benefits and limitations of IRC §1244. In general, stock may be "section 1244 stock" if the corporation, at the time of issuance (and taking into account the proceeds from its issuance) has less than \$1 million in equity capital and paid-in surplus, disregarding retained earnings or losses. Each shareholder may claim up to \$50,000 (\$100,000 for husband and wife) as ordinary loss, for losses incurred on the sale or exchange of section 1244 stock. IRC §1244(b).

Careful attention should be given to the records that must be kept, and information that must be filed, by the corporation and the shareholders. The taxpayer must keep records to establish that the taxpayer is entitled to the loss and meets the requirements of IRC §1244. See Treas Reg §1.1244(e)-1.

**Source:** Business Law/Selecting and Forming Business Entities/8 S and C Corporations/§8.122 (16) Form: Authorization of Issuance of Shares

## §8.122 (16) Form: Authorization of Issuance of Shares

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8.122-1 Authorization of issuance of shares

**The board next discussed the issuance of shares. It noted that a total of \_\_[number]\_\_ shares of its \_\_[class, e.g., common]\_\_ stock are authorized by the Articles of Incorporation of which \_\_[number/no]\_\_ shares are currently issued and outstanding. It adopted the following resolutions:**

### **RESOLVED that:**

**1. The corporation issue and sell a total of \_\_[total number]\_\_ shares of its authorized \_\_[class, e.g., common]\_\_ stock to the following persons, in the number and for the consideration set forth opposite their names, respectively: \_\_[List name and number of shares; describe consideration]\_\_.**

**2. The officers of the corporation are authorized, empowered, and directed to take all actions that may be necessary and proper for this corporation to issue and sell the above-listed shares to the persons named, in accordance with applicable laws, and that those actions shall include, when necessary:**

**(a) Filing with the Commissioner of Corporations an appropriate notice under Corporations Code §25102(f) or §25102(h) or obtaining qualification of the offer and sale of such shares from the Commissioner of Corporations;**

**(b) Doing all acts that may be necessary under the federal securities laws and the applicable securities laws of any other state; and**

**(c) Doing all acts necessary to expedite these transactions or conform them to the requirements of any applicable law.**

**3. Each officer of this corporation is authorized and directed to execute all documents and to take any other action necessary or advisable to carry out the purposes of this resolution.**

*Comment:* This resolution is a general authorizing resolution designed to be adopted shortly after incorporation. It authorizes the issuance of the shares and the taking of any other action necessary to issue the shares in compliance with applicable laws, including state and federal securities laws.

Before adopting a resolution authorizing the issuance of shares, the board should ensure that the articles authorize a sufficient number of shares and that the issuance will not defeat or impede the corporation's or shareholders' intentions with respect to an S corporation election, the qualification of stock under IRC §1244, or an election to be a statutory close corporation. For statutory rules on issuance of shares, see Corp C §§400-423.

If the parties contemplate transferring a business to the new corporation in exchange for shares, careful investigation should be made of possible tax consequences. See Sales and Mergers of California Businesses, chap 3 (Cal CEB 2002). Other factors (e.g., assumption of liability, or representations or warranties of extent or value of property being transferred) may require a more elaborate transfer agreement.

**NOTE:** A corporation that is seeking a limited offering exemption under Corp C §25102(f) must file a notice prescribed by the Department of Corporations and available on the DOC website, listed in the Directory. The notice must be filed electronically, although there are certain hardship exceptions. 10 Cal Code Regs §260.102.14(a)(2), (c)-(f). See generally Organizing Corporations in California, chap 4 (3d ed Cal CEB 2001).



**Source:** Business Law/Selecting and Forming Business Entities/8 S and C Corporations/§8.123 (17) Form: Optional Election of S Corporation Status

## §8.123 (17) Form: Optional Election of S Corporation Status

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §8.107 and ends in §8.124

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8.123-1 S corporation status

The board considered the advantages of electing to be taxed as an S corporation under Internal Revenue Code Subchapter S (Internal Revenue Code §§1361-1379). It was noted that the corporation comes within the definition of an S corporation in Internal Revenue Code §1361(b) in that it is not a member of an affiliated group, it has no more than 100 shareholders, it has no shareholders who are not individuals, it has no shareholders who are nonresident aliens, and it has only one class of stock. After discussion, the following resolutions were adopted:

**RESOLVED that:**

1. This corporation elects, subject to the unanimous consent of all shareholders, to be an S corporation for federal income tax purposes as provided in Internal Revenue Code §1362(a). This election is made for the year ending on \_\_ *[date]* \_\_ and for each succeeding year until this election is revoked.

2. The officers of this corporation are authorized and directed to prepare the documents indicating this election, execute them on behalf of the corporation, obtain the necessary signatures or consents of all shareholders, file the documents with the appropriate authorities, and take any other actions necessary or desirable to effect the purposes of the foregoing resolution.

*Comment:* S corporations are governed by IRC §§1361-1379. See also Treas Reg §§1.1361-0—1.1368-4. On the availability and consequences of an S corporation election, see §8.5.

California law provides an equivalent to IRC Subchapter S in Rev & T C §§23800-23813. The maximum number of shareholders is 100 for federal income tax purposes, and California has conformed its income tax law to federal law. IRC §1361(b)(1)(A); Rev & T C §§17024.5, 23051.5.

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**§8.124 (18) Form: Adjournment**

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §8.107 and ends in §8.124

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8.124-1 Adjournment

**There being no further business to come before the board, the meeting was adjourned by the presiding officer at \_\_[time]\_\_.**

\_\_[Signature of secretary]\_\_

\_\_[Typed name]\_\_

**Secretary**

**Source:** Business Law/Selecting and Forming Business Entities/8 S and C Corporations/§8.125 3. Form: Statement of Information (Domestic Stock and Agricultural Cooperative Corporations) (Secretary of State Form SI-200 C)

**§8.125      3. Form: Statement of Information (Domestic Stock and Agricultural Cooperative Corporations) (Secretary of State Form SI-200 C)**





**State of California  
Secretary of State**



**STATEMENT OF INFORMATION**

**(Domestic Stock and Agricultural Cooperative Corporations)**

**FEES (Filing and Disclosure): \$25.00. If amendment, see instructions.**

**IMPORTANT — READ INSTRUCTIONS BEFORE COMPLETING THIS FORM**

This Space For Filing Use Only

1. **CORPORATE NAME** (Please do not alter if name is preprinted.)

**S**

**DUE DATE:**

**COMPLETE ADDRESSES FOR THE FOLLOWING** (Do not abbreviate the name of the city. Items 2 and 3 cannot be P.O. Boxes.)

2. **STREET ADDRESS OF PRINCIPAL EXECUTIVE OFFICE** CITY STATE ZIP CODE

3. **STREET ADDRESS OF PRINCIPAL BUSINESS OFFICE IN CALIFORNIA, IF ANY** CITY STATE ZIP CODE  
CA

4. **MAILING ADDRESS OF THE CORPORATION, IF DIFFERENT THAN ITEM 2** CITY STATE ZIP CODE

**NAMES AND COMPLETE ADDRESSES OF THE FOLLOWING OFFICERS** (The corporation must have these three officers. A comparable title for the specific officer may be added; however, the preprinted titles on this form must not be altered.)

5. **CHIEF EXECUTIVE OFFICER/** ADDRESS CITY STATE ZIP CODE

6. **SECRETARY/** ADDRESS CITY STATE ZIP CODE

7. **CHIEF FINANCIAL OFFICER/** ADDRESS CITY STATE ZIP CODE

**NAMES AND COMPLETE ADDRESSES OF ALL DIRECTORS, INCLUDING DIRECTORS WHO ARE ALSO OFFICERS** (The corporation must have at least one director. Attach additional pages, if necessary.)

8. **NAME** ADDRESS CITY STATE ZIP CODE

9. **NAME** ADDRESS CITY STATE ZIP CODE

10. **NAME** ADDRESS CITY STATE ZIP CODE

11. **NUMBER OF VACANCIES ON THE BOARD OF DIRECTORS, IF ANY:**

**AGENT FOR SERVICE OF PROCESS** (If the agent is an individual, the agent must reside in California and Item 13 must be completed with a California street address (a P.O. Box address is not acceptable). If the agent is another corporation, the agent must have on file with the California Secretary of State a certificate pursuant to Corporations Code section 1505 and Item 13 must be left blank.)

12. **NAME OF AGENT FOR SERVICE OF PROCESS**

13. **STREET ADDRESS OF AGENT FOR SERVICE OF PROCESS IN CALIFORNIA, IF AN INDIVIDUAL** CITY STATE ZIP CODE  
CA

**TYPE OF BUSINESS**

14. **DESCRIBE THE TYPE OF BUSINESS OF THE CORPORATION**

15. **BY SUBMITTING THIS STATEMENT OF INFORMATION TO THE CALIFORNIA SECRETARY OF STATE, THE CORPORATION CERTIFIES THE INFORMATION CONTAINED HEREIN, INCLUDING ANY ATTACHMENTS, IS TRUE AND CORRECT.**

DATE

TYPE/PRINT NAME OF PERSON COMPLETING FORM

TITLE

SIGNATURE

**INSTRUCTIONS FOR COMPLETING FORM SI-200 C**

For faster processing, the required statement for most corporations can be filed online at <https://businessfilings.sos.ca.gov/>. Alternatively, statement forms are available on the Secretary of State's website at <http://www.sos.ca.gov/business/> and can be viewed, filled in and printed from your computer. Completed forms along with the applicable fees can be mailed to Secretary of State, Statement of Information Unit, P.O. Box 944230, Sacramento, CA 94244-2300 or delivered in person to the Sacramento office, 1500 11<sup>th</sup> Street, 3<sup>rd</sup> Floor, Sacramento, CA 95814. If you are not completing this form online, please type or legibly print in black or blue ink. This form is filed only in the Sacramento office.

Every domestic stock and agricultural cooperative corporation shall file a Statement of Information with the California Secretary of State, within 90 days after filing of its original Articles of Incorporation, and annually thereafter during the applicable filing period. The applicable filing period for a corporation is the calendar month during which its original Articles of Incorporation were filed and the immediately preceding five calendar months. A corporation is required to file this statement even though it may not be actively engaged in business at the time this statement is due. Changes to information contained in a previously filed statement can be made by filing a new form, completed in its entirety.

**LEGAL AUTHORITY:** Statutory filing provisions are found in California Corporations Code section 1502 or Food and Agricultural Code section 54040, unless otherwise indicated. Failure to file this Statement of Information by the due date will result in the assessment of a \$250.00 penalty. (Corporations Code section 2204; Revenue and Taxation Code section 19141.)

**FEES:** The Statement of Information must be accompanied by a \$20.00 filing fee and \$5.00 disclosure fee. The filing fee and the disclosure fee may be included in a single check made payable to the Secretary of State. All domestic stock and agricultural cooperative corporations must pay a total of \$25.00 at the time of filing the statement. If this statement is being filed to amend any information on a previously filed statement and is being filed outside the applicable filing period, as defined above, no fee is required.

**COPIES:** The Secretary of State will endorse file one copy of the statement if an exact copy is submitted along with the statement to be filed. Copies submitted with the statement to be filed can be certified upon request and payment of the \$8.00 per copy certification fee.

**PUBLICLY TRADED CORPORATIONS:** Every publicly traded corporation must also file a Corporate Disclosure Statement (Form SI-PT) annually, within 150 days after the end of its fiscal year. A "publicly traded corporation" is a corporation, as defined in Corporations Code section 162, that is an issuer as defined in Section 3 of the Securities Exchange Act of 1934, as amended (15 U.S.C. Sec. 78c), and has at least one class of securities listed or admitted for trading on a national securities exchange, on the National or Small-Cap Markets of the NASDAQ Stock Market, on the OTC-Bulletin Board, or on the electronic service operated by Pink Sheets, LLC. Form SI-PT may be obtained from the Secretary of State's website at <http://www.sos.ca.gov/business/> or by calling the Statement of Information Unit at (916) 657-5448.

**Complete the Statement of Information (Form SI-200 C) as follows:**

- Item 1.** Please do not alter the preprinted name. If the corporate name is not correct, please attach a statement indicating the correct name and the date the name change amendment was filed with the California Secretary of State. If blank, enter the name of the corporation exactly as it is of record with the California Secretary of State.
- Item 2.** Enter the complete street address, city, state and zip code of the principal executive office. Please do not enter a P.O. Box or abbreviate the name of the city.
- Item 3.** Enter the complete street address, city and zip code of the corporation's principal office in California, if any. Please do not enter a P.O. Box or abbreviate the name of the city. Complete this item only if the address in Item 2 is outside of California.
- Item 4.** Enter the mailing address of the corporation, if different from the street address of the principal executive office.
- Items 5-7.** Enter the name and complete business or residential address of the corporation's chief executive officer (i.e., president), secretary and chief financial officer (i.e., treasurer). Please do not abbreviate the name of the city. The corporation must have these three officers (Corporations Code section 312(a).) Any number of offices may be held by the same person unless the articles or bylaws provide otherwise, except, in the case of an agricultural cooperative, neither the president nor the secretary may be the same person. (Food and Agricultural Code section 54149.) Please note, unless the articles or bylaws provide otherwise, the president, or if there is no president, the chairman of the board, is the chief executive officer of the corporation. A comparable title for the specific officer may be added; however, the preprinted titles on this form must not be altered.
- Items 8-10.** Enter the name and complete business or residential address of each incumbent director. If there are more than three directors, please attach additional pages. Please do not abbreviate the name of the city. The corporation must have at least one director. (Corporations Code section 212(a).)
- Item 11.** Enter the number of vacancies on the board of directors, if any.
- Item 12.** Enter the name of the agent for service of process in California. An agent is an individual (director, officer or any other person, whether or not affiliated with the corporation) who resides in California or another corporation designated to accept service of process if the corporation is sued. The agent must agree to accept service of process on behalf of the corporation prior to designation. If an individual is designated as agent, complete Items 12 and 13. If another corporation is designated as agent, complete Item 12 and proceed to Item 14 (do not complete Item 13).
- Note: Before another corporation may be designated as agent, that corporation must have previously filed with the California Secretary of State, a certificate pursuant to Corporations Code section 1505. A corporation cannot act as its own agent and no domestic or foreign corporation may file pursuant to section 1505 unless the corporation is currently authorized to engage in business in California and is in good standing on the records of the California Secretary of State.
- Item 13.** If an individual is designated as agent for service of process, enter a business or residential street address in California (a P.O. Box address is not acceptable). Please do not enter "in care of" (c/o) or abbreviate the name of the city. If another corporation is designated as agent, leave Item 13 blank and proceed to Item 14.
- Item 14.** Briefly describe the general type of business that constitutes the principal business activity of the corporation.
- Item 15.** Type or print the name and title of the person completing this form and enter the date this form was completed. By submitting this Statement of Information to the California Secretary of State, the corporation certifies the information contained herein, including any attachments, is true and correct.

*Comment:* Within 90 days after the articles of incorporation are filed and annually thereafter, the corporation must file

a Statement of Information (Domestic Stock Corporation) with the Secretary of State. Corp C §§1502-1505. The filing fee is \$25. See Govt C §12186(g). This form may be completed at the Secretary of State's website, [http://www.sos.ca.gov/business/corp/pdf/so/corp\\_so200c.pdf](http://www.sos.ca.gov/business/corp/pdf/so/corp_so200c.pdf), and then printed out.

The California Secretary of State has preclearance and expedited services for all business entity documents filed with the Secretary of State under the California Corporations Code. "Preclearance service" allows a customer to submit a business entity document in person at the Sacramento office before filing to determine if the document conforms to law and to receive a preclearance response within a guaranteed time frame. Only one copy of the document need be submitted. "Expedited filing" allows a customer to submit a business entity document in person in the Sacramento office and receive a filing response within a guaranteed time frame. For further information, consult the website at <http://www.sos.ca.gov/business/precexp.htm>.

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#### §8.126 4. Form: Corporate Operations Memorandum

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8.126-1 Corporate Operations Memorandum

\_\_ *[Name of client]* \_\_

\_\_ *[address]* \_\_

Re: \_\_ *[Name of new corporation]* \_\_

There are several postincorporation matters of which you should be aware concerning federal, state, and local laws affecting the legal status of your new corporation. We have outlined some of these in this memorandum. In addition to addressing these matters now, we suggest that you also review this memorandum each year before your annual shareholders' meeting so that you can confirm that these matters remain satisfied on a continuing basis.

#### FORMAL REQUIREMENTS

##### Bank Accounts

The corporation must maintain bank accounts separate from those of its owners. The corporation should establish which officers will be authorized to sign checks to disburse funds from the corporate bank accounts. The establishment of corporate bank accounts constitutes activity that the board of directors should approve. A copy of the account signature cards (and accompanying form of corporate resolutions) should be placed in the corporate minute book to confirm the actions taken.

##### Conducting Business as a Corporate Entity

The corporation should be sure to conduct all corporate business only in the corporate name and not in the individual name of any director, officer, or shareholder. To ensure that there is no confusion by outsiders dealing with the new corporation, the following steps should be taken:

1. All letterheads, bills, invoices, and other business forms used by the corporation should reflect its full legal name as well as its current address and telephone number.

2. The telephone numbers of the corporation should be listed under its name with the telephone company and in all telephone and trade directories.

3. The corporation's full legal name or fictitious business name should appear on all signs in its building. Business cards should indicate both the name of the corporation and that of the employee.

4. Any existing contracts or leases should be transferred to the corporate name, if permitted (future contracts or leases should be executed in the corporation's name, with the signature blocks clearly identifying the signing party as an officer signing on the corporation's behalf). The other party to any agreement should understand that the agreement is with the corporation and not with its owners individually. This includes correspondence with vendors and trade customers. An example of a corporate signature block is as follows:

\_\_ *[Name of Corporation]* \_\_

By: \_\_\_\_\_

Your Name, \_\_ *[Your Title]* \_\_

##### Receipt of Payments

Checks payable to the corporation should be made to the name of the corporation. If your individual name is used on a payment check, deposit the payment into the corporate account with an endorsement identifying the corporation as the entity receiving payment.

### **Never Commingle Assets**

Always observe the distinction between the corporation and its owners. Do not commingle corporate assets with personal assets.

### **Board Meetings**

The directors should decide how often the board of directors will meet. They may wish to meet periodically during the year to review business operations and establish corporate policy. It is generally best to have a formal meeting at least quarterly. Advance notice for each meeting is technically required, and your bylaws should specify when and how this should be given. If notice is not given, the directors must thereafter attend the meeting and sign a waiver (or the minutes) confirming the actions taken. When the directors act "without a meeting," minutes of the actions taken should be prepared, and each director must sign these minutes before the actions become official.

When regular meetings will be held, the minutes of the initial meeting should specify the regular day, place, and time of the subsequent meetings. When this is done, notices need not be sent to directors unless the time or location of a later meeting is changed or a "special" meeting is called. The bylaws we have prepared for you outline the procedures to follow in these matters.

The board of directors is charged with the management of the corporation and is held accountable for the ultimate direction of the corporation's business and affairs. Although day-to-day management of the corporation is ordinarily delegated to the officers, directors are responsible for approving major corporate action, setting goals and policy for the corporation, and monitoring the performance of management in achieving these goals. In performing these functions, directors are fiduciaries for the shareholders' benefit. Directors may be liable to the corporation's shareholders if they fail to exercise "reasonable care" or if they fail to act in the best interests of the corporation ("duty of loyalty").

Directors exercising a duty of care must act as prudent persons would act in similar circumstances. Although the directors may rely on the advice of independent experts, they must also make a reasonable inquiry into the facts on which such experts base their advice. The directors' duty of loyalty includes a prohibition against a director profiting from a transaction at the expense of the corporation and/or its shareholders. A corporate transaction in which a director has a material financial interest will be valid if the transaction is fair to the corporation and the material terms and the director's interests are disclosed to and ratified by the shareholders or by disinterested directors acting in good faith. Corporations Code §310 outlines specific procedures that may be followed in such cases.

### **Shareholders' Meetings**

The corporation should hold a meeting of its shareholders each year. Your bylaws indicate when this meeting will be held. If a different date or time is desired on a continuing basis, then the bylaws should be amended. The board of directors may establish a different meeting date or time if this is desired for a given year only. Shareholders must receive advance written notice of the meeting and the actions to be taken. The corporation's directors are elected by the shareholders annually, and this election should occur at the annual meeting. Whether other actions are taken is a matter for the board of directors to decide. In a closely held corporation, the waiver of some technical formalities may be appropriate. The bylaws describe the quorum that must be present to hold a shareholders' meeting. The shareholders' voting rights are also described in the bylaws.

### **Books, Records, and Reports**

California law requires that the accounting books and records, and the minutes of proceedings of shareholders and board of directors meetings, be open for inspection by any shareholder, director, or holder of a voting trust certificate. See Corporations Code §§1600-1601. Corporations are further required to send an annual report to shareholders within 120 days after the close of the fiscal year. This requirement can be waived in the bylaws by corporations with fewer than 100 shareholders. The annual report must otherwise contain a

balance sheet, an income statement, and a statement of cashflows for the fiscal year. The annual report must be accompanied by a report by the company's independent accountants; if there is no such report, the report must be accompanied by a declaration of an authorized officer of the corporation that the statements were prepared without audit from the books and records of the corporation. Corporations Code §1501 details these procedures.

Corporations with 100 or more shareholders that are not subject to federal securities reporting requirements must also comply with further disclosure requirements. These include describing any significant transactions between the corporation and any director, officer, or shareholder who owns at least 10 percent of the stock.

### **Approval of Important Matters**

All major business transactions of the corporation should be reviewed and authorized by the board of directors. Whether this is done at a meeting or accomplished "without meeting" involves decisions you must make in light of the applicable facts and circumstances. Minutes of the actions taken should be prepared and placed in the corporate minute book, which then becomes the repository of all minutes of the actions taken by the shareholders and directors of the corporation. The minute book is an important document that should be safeguarded.

### **Annual Information Filing With the Secretary of State**

Newly formed corporations must file a Statement of Information (Domestic Stock Corporation) within 90 days after the date of incorporation. This annual statement requires the disclosure of the names and addresses of the directors and principal officers, the address of the corporation's principal office, the name and address of its agent for service of process, and the number of authorized directors. Every year this form, or a form stating that there has been no change in the information contained in the last filed statement, must be filed by a specified deadline (the form may also be filed up to 5 months before the deadline). These procedures are required under Corporations Code §1502.

A \$25 filing fee must accompany the Statement of Information, which may be obtained from the Secretary of State's website at [http://www.sos.ca.gov/business/corp/corp\\_soinfo.htm](http://www.sos.ca.gov/business/corp/corp_soinfo.htm). The consequences of a failure to file, including penalties and suspension, are set forth in Corporations Code §§2204 and 2205 and Revenue and Taxation Code §19141.

## **FEDERAL AND STATE INCOME TAX MATTERS**

### **Employer Identification Number**

Each new corporation must obtain a Federal Employer Identification Number (FEIN) from the Internal Revenue Service. IRS Form SS-4 must be filed with the IRS to obtain a FEIN. This filing is normally done through the corporation's accountant and may be accomplished via a facsimile. We can assist with the filing if desired.

### **Election of Tax Year**

Generally, a new corporation may elect to be taxed using either a calendar tax year or a fiscal tax year; however, a personal service corporation and an S corporation must ordinarily use a calendar tax year. The period chosen must be the same as that used by the corporation to compute its book income. The initial adoption of a taxable year does not require the consent of either the IRS or the California Franchise Tax Board (FTB). To initiate the filing process, the corporation simply files its initial federal and state income tax returns on the basis of the taxable period that was selected. A subsequent change in the accounting period ordinarily requires prior approval from the IRS and the FTB. Internal Revenue Code §442 and Revenue and Taxation Code §24633 describe these procedures.

### **Election of Accounting Method**

Subject to certain exceptions, a new corporate taxpayer may elect to report its income and expenses for both federal and California income tax purposes on a cash basis, accrual basis, or any other method of accounting clearly reflecting income that is acceptable to the IRS. Internal Revenue Code §446 and Revenue and Taxation Code §24651(b) describe these procedures. This election does not require approval by the IRS or

the FTB. The initial federal and California income tax returns are simply filed in accordance with the accounting method chosen. Once an accounting method is used on an income tax return, prior approval of a subsequent change to another method must be obtained. Internal Revenue Code §446(e) and Revenue and Taxation Code §24651(e) describe these procedures. We suggest that you discuss these matters with the corporation's accountant.

## **S Corporation Election**

It is sometimes advantageous to elect S corporation tax treatment for federal tax purposes so that the corporation's profits or losses are passed directly to the shareholders. This election avoids double taxation of dividend income and allows shareholders to deduct the corporation's losses against their income. Because of a statutory deadline, this election should be filed with the IRS within 2 1/2 months after the date of incorporation. Internal Revenue Code §1362(b) and Revenue and Taxation Code §§23800-23813 describe these procedures. The form used to elect S Corporation status is IRS Form 2553, which also serves to make the election under California law.

## **Filing Federal and State Tax Returns and Installments of Estimated Tax**

Federal income tax returns and California franchise tax returns are due on or before the 15th day of the third month following the close of the corporation's tax year. See Internal Revenue Code §6072(b); Revenue and Taxation Code 18601(a). See also Internal Revenue Code §6072(c) (foreign corporations). In addition, most corporations are required to make periodic estimated federal tax payments by depositing such payments at either a Federal Reserve Bank or an authorized commercial bank. See Internal Revenue Code §6655. The corporation's accountant can handle these arrangements, or you may obtain additional information from IRS Form 1120-W, which can be obtained from any office of the IRS. California also requires payment of estimated franchise tax on FTB Form 100-ES. For further information, see FTB Publication 1060, "Guide for Corporations Starting Business in California" and FTB Publication 1063, "California Corporation Tax Law—A Guide for Corporations." Both publications may be obtained from any Franchise Tax Board office or downloaded from the Franchise Tax Board's website at <http://www.ftb.ca.gov>. You should consult with the corporation's accountant on the timely filing of these returns.

## **EMPLOYER TAX AND WITHHOLDING RESPONSIBILITIES**

If you are an employer, you will be responsible for certain employer taxes. In some cases, you will have to pay the tax directly; in other cases, your employees pay the tax, but you are responsible for withholding the tax payment from their wages and periodically depositing these funds in an authorized bank. See Publication 15, "(Circular E), Employer's Tax Guide" and Publication 334, "Tax Guide for Small Business," both of which are available from the IRS. See also Publication DE 44, "California Employer's Guide" and Publication DE 195, "Employer's Bill of Rights"; both are available from the California Employment Development Department.

## **General Considerations**

The corporation's responsibilities to pay employment taxes, to withhold taxes imposed on its employees, to file tax returns, and to make periodic tax deposits are substantial. Penalties for noncompliance can be severe. Corporate officials charged with tax-withholding responsibilities may be personally liable for 100 percent of the unpaid taxes and also for any tax penalties if they neglect their responsibilities. See Internal Revenue Code §6672. If you have not already done so, we suggest that you consult the corporation's accountant promptly to develop proper tax accounting procedures so that timely tax payments are made.

## **PROPERTY, SALES, AND OTHER TAXES**

### **California Sales and Use Taxes**

All parties engaged in the business of selling tangible personal property at retail in California must obtain a seller's permit from the California State Board of Equalization. As a practical matter, a permit is usually required even if the corporation sells tangible personal property at wholesale. A separate permit must be obtained for each retail business location and must be conspicuously displayed. A substantial security deposit of up to \$10,000 may be required. A business having a seller's permit can purchase tangible personal property for resale without having to pay sales tax to the seller as long as it gives the seller a signed resale certificate in a form prescribed by the State Board of Equalization.

## **Tax Payment Requirements**

If a corporation sells tangible personal property at retail in California, it will be subject to the California sales tax unless the property sold is specifically exempted. California also imposes a "use tax" on most retail purchases that occur outside of California but are intended for use within California. Revenue and Taxation Code §§6201-6207 describe this tax. Any retailer engaged in business in California must collect the sales and use taxes and remit them to the state. A retailer is deemed to be "engaged in the business" in California if it has any kind of an establishment in the state or if it has representatives operating in any kind of sales activity in the state. This law applies whether the retailer is involved directly or through a subsidiary or agent. See Revenue and Taxation Code §6203.

The holder of a seller's permit must file sales and use tax returns and pay or prepay the taxes collected, usually on a quarterly basis. Revenue and Taxation Code §6452 describes these procedures. You should promptly consult the corporation's accountant for the dates on which these returns must be filed.

## **Personal and Real Property Taxes**

The corporation must pay annual property taxes based on the value of the taxable real and personal property it owns or possesses on the requisite lien date. The tax rates, due dates, and delinquency dates differ for real and personal property taxes. Usually, this tax is paid to the county assessor of the county in which the property is located. The county has a priority tax lien on the property as of the lien date, which is removed by the payment of this tax.

If the corporation owns taxable personal property with an aggregate cost of at least \$100,000 in any assessment year, it must file a signed, written property statement each year between the lien date designated by the County Assessor and April 1. Personal property taxes must be paid by the due date specified in the County Assessor's notice. Intangible property is exempt. See Revenue and Taxation Code §441. When the cities do their own assessing, a separate written property statement should be filed with the city. If the corporation owns taxable personal property costing less than \$100,000, it must file a written property statement only when asked to do so by the County Assessor.

Taxable real property includes ownership and possessory interests (such as a leasehold). Real property taxes are payable in two installments: the first installment is due before December 10, and the second installment is due before the following April 10.

You should consult the corporation's accountant for advice on filing property tax statements because there are substantial penalties for late payment and there are numerous special provisions (e.g., an exemption for "intangibles"). This is a complex area, and competent accounting advice is essential to ensure full compliance.

## **Other Taxes**

Depending on the nature of your business, special taxes may be imposed by federal, state, or local governments, such as taxes on alcohol, tobacco, gross receipts, and real estate transactions. Your accountant should be able to assist you in preparing the proper tax forms and making the necessary payments.

## **PERSONNEL PRACTICES**

Nearly every business is subject to a variety of federal and state regulations that govern the personnel practices the business must follow. Although a full discussion of the corporation's obligations under these various laws is beyond the scope of this letter, the following information should provide a useful overview of some of the rules that apply to an employer. Because of the complexity of personnel practice law, and the great expense required to defend against legal actions in this area, we recommend that you contact us for further advice on this subject matter if you have any questions.

### **Hiring Practices and Employee Termination**

Many federal and state laws regulate employment practices and prohibit discrimination on the basis of race, religion, color, national origin, ancestry, mental or physical disabilities, medical condition, marital status, sex, age, or sexual orientation. See, e.g., Government Code §12940(a). These antidiscrimination laws apply to almost

every aspect of the employer-employee relationship, including hiring, compensation, promotions, work assignments, and working conditions. In addition, if you will be contracting with the federal government, you will be required to establish an affirmative action program.

The United States Department of Labor and the United States Equal Employment Opportunity Commission are the principal federal agencies that have jurisdiction in this area of the law. The California Department of Fair Employment and Housing also regulates employment practices to protect people from employment discrimination. California's antidiscrimination laws and regulations are more stringent in many areas than the federal requirements. When those requirements overlap, the more stringent standards are usually applied.

### **Wages, Hours, and Working Conditions**

Through the Wage and Hour Division of the United States Department of Labor, the federal government sets minimum wages and also regulates overtime and other aspects of working conditions for nearly all employees of firms engaged in interstate commerce. Notable exceptions to these rules include executives, administrators, professional personnel, and outside salespeople.

Through the Division of Labor Standards Enforcement of the Department of Industrial Relations, California enforces laws on the payment of wages, the minimum wage, hours of work, overtime, conditions of employment, equal pay for equal work, and compliance with compulsory Workers' Compensation laws. The Industrial Welfare Commission of the Division of Labor Standards Enforcement has the authority to eliminate working conditions that are detrimental to the welfare of California workers. The Commission issues special orders setting minimum wages, hours of employment, and overtime, and standards for working conditions, both in general and for specific industries. Note that the California minimum wage is higher than that prescribed by the United States Department of Labor.

The California Division of Industrial Safety of the Department of Industrial Relations conducts safety inspections to ensure that standards of safety and health are enforced and that unsafe conditions and practices are corrected. The Federal Occupational Safety and Health Act of 1970 (OSHA) (29 United States Code §§651-678) is implemented through the Division. The California Occupational Safety and Health Standards Board also promulgates safety and health standards for California businesses. There is a substantial overlap between federal and California requirements in this area. Again, the state requirements are generally more stringent, and the corporation must usually adhere to the more stringent standards.

### **Workers' Compensation**

California law requires nearly every employer to obtain Workers' Compensation insurance for its employees, and it imposes penalties for noncompliance. The Workers' Compensation laws impose liability on the employer for any work-related accident, regardless of the employee's negligence. Workers' Compensation insurance provides a schedule of benefits to the insured employee or his or her heirs if the employee is killed. Workers' Compensation liability insurance can be obtained either from the local office of the State Compensation Insurance Fund or from state-licensed Workers' Compensation private carriers. Alternatively, a business can obtain a certificate of consent to self-insure from the Director of Industrial Relations. See generally Labor Code §3700.

### **Employee Benefits**

If the corporation decides to provide other benefits to its employees, such as group insurance, or if the corporation adopts a pension or profit-sharing plan, the corporation may be subject to the Employee Retirement Income Security Act of 1974 (ERISA) (29 USC §§1001-1461). ERISA requires an employer to meet specified requirements and provide certain information to employees if an employee welfare plan is instituted. Welfare plans can include benefits such as health insurance, long-term disability insurance, group term life insurance, and accidental death insurance. The ERISA requirements for a pension or profit-sharing plan, even for a very small business, are complex and expensive. Because of the complexity of these reporting requirements, and because of the potential for fines and other civil and criminal penalties, we recommend that you contact us for further advice if you have any questions on this matter.

### **Labor-Management Relations**

Nearly all corporate employers are governed in their labor relations by the National Labor Relations Act

(NLRA) (29 USC §§151-169), although very small employers are sometimes excluded. Agricultural employers are governed by the Alatorre-Zenovich-Dunlap-Besman Agricultural Labor Relations Act of 1975 (Labor Code §1140-1166.3). As a practical matter, if the corporation faces a union organizing campaign, it will almost certainly be covered by a wide array of governmental laws, regulations, and procedures. Failure to comply with applicable rules could result in either the expense of rerunning the election or the automatic certification of the union. If the corporation is faced with a union organizing campaign, we recommend that you contact us immediately before taking any action.

## Notices

Employers are required to post, in a conspicuous location, a number of notices on employees' rights. Some of the notices most commonly required, and the agencies from which copies may be obtained, are as follows: Industrial Welfare Commission orders (California Department of Industrial Relations, Division of Labor Standards Enforcement); federal minimum wage notice (Wage and Hour Division, United States Department of Labor); notice titled "Safety and Health Protection on the Job" (California Department of Industrial Relations, Division of Occupational Safety and Health); notice about the California Fair Employment and Housing Act (California Department of Fair Employment and Housing); federal civil rights notice (United States Equal Opportunity Commission); notice of paydays and times and places of payment (Department of Industrial Relations); and workers' compensation notices (which should be obtained from your workers' compensation insurance carrier). If you belong to the local Chamber of Commerce, you can obtain preprinted copies of the notices to post.

## LICENSING

### Federal Licenses

Most businesses do not require any type of federal license. However, there could be some basis for federal licensing. For example, if the corporation intends to employ an alien to carry on substantial trade principally between the United States and the alien's country, a "Treaty Trader" visa entitling the alien to remain in the United States for extended periods of time may be required.

### State and Local Licenses

State and local licensing is required for a wide variety of businesses and professions that may be conducted in the corporate form. Information on California permits and licensing requirements is available at the following website: <http://www.calbusiness.ca.gov/cedpeybplr.asp>.

Licensing requirements imposed by cities, counties, and other local government entities vary widely. Some California cities require certain businesses to obtain a license and pay a tax for the privilege of doing business in that city. This tax is usually imposed on an annual basis. A new business must obtain its registration certificate and a minimum tax must be paid on or before the last day of the month following the date the business commences. You should promptly advise your accountant of the nature of the corporation's business and of the locations in which it will be carrying on business so that the necessary licenses are obtained and the local taxes are paid.

## MISCELLANEOUS MATTERS

### Insurance

In general, it is advisable to obtain fire and extended peril insurance on all property that the corporation owns or for which it is responsible. A comprehensive public liability insurance policy should be obtained, especially if the corporation's business premises are open to the general public. Such a policy should insure the corporation against liability imposed by law for the operation of its business, its automobiles, and the maintenance of its property. Errors and omissions insurance to shield officers and directors should be considered. Product liability insurance and other types of insurance may be available. You should promptly review the corporation's potential insurance requirements with its insurance agent.

### Securities

The corporation's issuance of securities is subject to both federal and state securities laws. Although the

federal and state definitions of a security are not identical, the definitions are quite broad and include stocks, options, warrants, evidences of indebtedness, investment contracts, and interests in a stock or profit-sharing plan. Officers and directors may be held personally liable for criminal and civil violation of securities laws. Thus, whenever a corporation considers offering, issuing, or selling securities, it must be cognizant of applicable federal and state laws. The corporation should also be aware of "private placement" and "limited offering" exemptions from these laws.

Because of the complexity and high risks involved, we recommend that you contact us to assist the corporation with any securities-related transactions—for example, additional investments in the corporation by existing or new investors—before undertaking any phase of the transaction.

### **Fictitious Business Names**

If the corporation plans to transact business under a name other than that listed on its Articles of Incorporation, the corporation must file a Fictitious Business Name Statement with the clerk of the county in which the corporation has its principal place of business. Once the statement is on file with the county clerk, it must be published in a newspaper of general circulation, in the same county, once a week for 4 consecutive weeks. Within 30 days after completion of publication, an affidavit of publication must be filed with the county clerk.

Fictitious Business Name Statement forms are available from the court clerk's office of the county in which you intend to file, or the newspaper that will be publishing the statement. The cost for each county varies, but is around \$50 if you coordinate the filing and publication of the notice yourself. Fees also vary according to the newspaper used. Some newspapers will also file your notice with the county for a fee. For information on such fees, contact the legal advertising department of a newspaper of general circulation in any county in which the corporation intends to file.

### **Trademarks, Trade Names, and Trade Secrets**

When a business has developed a name or symbol that has or will become associated with its products or services and that indicates its unique origin with the company, the business may register that name or symbol as a trademark or trade name. Registration with the state and, if appropriate, the federal government will protect the valuable trademark and trade name assets against loss through improper usage and infringement. If a creative process is involved in making the products, a patent and suitable contractual arrangements may be appropriate to protect and preserve ownership. Trade secrets may be protected by plant security and by requiring employees to sign agreements guaranteeing the safekeeping of trade secrets and confidential information. Intellectual or literary property may qualify for copyright protection.

Filing the Articles of Incorporation setting forth your corporate name does not itself authorize the use of the corporate name in violation of the rights of anyone else who may have previously acquired rights to the name under some other law, such as the Trademark Act of 1946 (Lanham Act) (15 United States Code §§1051-1141n), the Fictitious Business Name Act, or under common law, including rights to a trade name.

### **Buy-Sell Agreements**

Many start-up companies restrict the transfer of securities held by their shareholders through a buy-sell agreement. These agreements are important because they specify the parties' rights and obligations if a shareholder departs, whether voluntarily or involuntarily. A shareholder's death can be extremely disruptive to the future of the corporation, and a buy-sell agreement can provide the terms on which a deceased shareholder's interest may be redeemed. A buy-sell agreement typically covers:

1. Transfer restrictions on when a shareholder may or may not transfer his or her shares, the persons to whom (if anyone) the shareholder may sell his or her shares without consent from the others, and the terms on which any right of first refusal reserved to the other shareholders will be exercised;
2. Any mandatory repurchase obligations (when the corporation and/or shareholders *must* repurchase the corporate stock, such as a shareholder's death or involuntary termination of employment with the corporation);
3. Any optional repurchase obligations (when the corporation and/or the other shareholders *may* repurchase the corporate stock, such as the voluntary termination of a shareholder's employment with the corporation);

and

4. The price and terms of sale for the stock (what valuation method will be used to calculate the price paid for the stock and the terms of payment).

If a buy-sell agreement has not already been prepared for your corporation and one is desired, please feel free to contract us to discuss the various issues involved.

#### **Need for Competent Legal and Accounting Advice**

As you can see, new and continuing corporations must confront many potential legal and accounting issues. Careful planning and competent legal and accounting advice is necessary to maximize the benefits of corporate status and to avoid pitfalls resulting from complex regulatory matters governing the corporation. The foregoing discussion is a generalized summary of some of the legal and accounting issues as they now exist. The laws and regulations applicable to corporations change rapidly and are more detailed than we have been able to cover in this memorandum. Therefore, the corporation must determine how the laws and regulations apply to a particular matter.

We would be happy to assist you in planning your operations. If you have any questions about any of the foregoing matters, please do not hesitate to contact us.

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# 9

## Close Corporations

CEB Staff

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**§9.1 I. SCOPE OF CHAPTER**

This chapter provides a summary of the requirements for formation of California close corporations and the advantages and disadvantages of this corporate form compared to other related business entities. See §§9.4-9.10, 9.17-9.19. The chapter includes a short sample form of articles of incorporation issued by the Secretary of State. See §9.35. Many of the considerations applicable to the corporate form generally apply to close corporations; forming California S and C corporations is discussed in chap 8.

However, unlike an S or a C corporation, close corporations are usually governed by a shareholders' agreement. Accordingly, this chapter discusses such agreements, their role, and considerations in drafting them. See §§9.20-9.33. It includes a checklist of provisions typically found in shareholders' agreements for statutory close corporations. See §9.34. In addition, the chapter sets forth a simplified form of shareholders' agreement. See §§9.36-9.51. Such agreements may include provisions for rights of first refusal or "buy-sell" provisions for the purchase or repurchase of shares by the corporation or other shareholders on the occurrence of certain events. See §§9.28-9.29. However, detailed coverage of rights of first refusal and buy-sell agreements is beyond the scope of this chapter. See Business Buy-Sell Agreements (Cal CEB 1991).

## **II. INTRODUCTION**

### **§9.2 A. Definition of Close Corporation**

A "statutory close corporation" refers to a corporation that conforms to the requirements of Corp C §§158 and 300(b), as discussed in §§9.4-9.9. In general, a close corporation is a corporation with relatively few shareholders who may wish to dispense with the normal formalities of corporate governance or to structure control of the corporation so as to allocate management responsibilities in a way that would otherwise be appropriate only among partners.

The concept of a statutory close corporation is often confused with two other concepts: an S corporation election under IRC §1372, and the notice filing procedure under Corp C §25102(f) or (h). However, each of these three concepts is independent of the other two. In addition, confusion may result from the nontechnical use of the terms "close corporation," "closed corporation," and "closely held corporation," which are often used interchangeably to describe a corporation having a relatively small number of shareholders.

**Source:** Business Law/Selecting and Forming Business Entities/9 Close Corporations/§9.3 B. Advantages of Close Corporation

### **§9.3 B. Advantages of Close Corporation**

If formed in accordance with the requirements of the General Corporation Law (Corp C §§100-2319), California statutory close corporations offer many advantages. They are easy to form and operate, and offer benefits comparable to those offered by partnerships and limited liability companies (but without the related gross receipts tax). Through the effective use of a shareholders' agreement, shareholders may design their own corporate governance regime, including a waiver of mandatory meetings of the board of directors and shareholders. For example, typical characteristics of a close corporation include an emphasis on simplified and informal procedures, general participation by most or all shareholders in decision making (which may even extend to the day-to-day operation of the business), and restrictions on share transfer to limit shifts in shareholdings. This flexibility not only enables a corporation to operate more efficiently and effectively, but may also operate to protect the interests of minority shareholders.

Despite these advantages, use of the statutory close corporation form is infrequent in California. Perhaps because of a perceived risk of increased personal liability of shareholders or a perceived risk of involuntary dissolution, California practitioners have been reluctant to recommend close corporations to their clients. However, the use of the close corporation structure is becoming increasingly common.

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### **III. ORGANIZING A CLOSE CORPORATION**

#### **§9.4 A. Requirement of California For-Profit Corporation**

Organizing a close corporation under the California Corporations Code first requires that a California corporation be organized. See Corp C §158(a). A foreign corporation may not elect close corporation status in California. See Corp C §§158(a), 162.

The entity must also be a business corporation, rather than a not-for-profit corporation. See Corp C §§162, 206. Articles of incorporation, including the required provisions of Corp C §202 (for corporations) and Corp C §158(a) (for close corporations), must be prepared and filed with the Secretary of State under Corp C §200 (and the required \$100 fee paid under Govt C §12186(c)), and bylaws must be adopted.

**Source:** Business Law/Selecting and Forming Business Entities/9 Close Corporations/§9.5 B. Name Requirements

## **§9.5 B. Name Requirements**

The articles of incorporation of all corporations must include the name of the corporation. For a close corporation, the name must include the word "corporation," "incorporated," or "limited," or an abbreviation of one of these words. Corp C §202(a). For further discussion of name requirements, including federal restrictions, see chap 3.

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## **§9.6 C. Contents of Articles of Incorporation**

Close corporations are required to include certain statements in their articles of incorporation. Initially, close corporations must include the provisions required of all corporations. See Corp C §202. See also §§8.37-8.42. In addition, a close corporation must include the following in its articles (Corp C §158(a)):

- A statement that all of the corporation's issued shares of all classes shall be held of record by not more than a specified number of persons, not exceeding 35; and
- The statement "This corporation is a close corporation."

A corporation wishing to elect close corporation status after the issuance of shares may do so by amendment to its articles of incorporation, adding the required statements described above to its articles, but only if the amendment is approved by the affirmative vote of all of the holders of the issued and outstanding shares of all classes of the corporation. Corp C §158(b). Because a corporation ceases to be a close corporation if it has more than the maximum number of holders of record of its shares "specified in its articles," the articles should state that the corporation's issued shares of all classes shall be held by not more than 35 persons, unless there are compelling reasons to state a smaller number. For a sample form of articles of incorporation for a close corporation, see §9.35.

**Source:** Business Law/Selecting and Forming Business Entities/9 Close Corporations/§9.7 D. Filing Articles of Incorporation

## **§9.7 D. Filing Articles of Incorporation**

To file the articles of incorporation, the original and at least two copies should be submitted to the Secretary of State's office, together with the applicable fee of \$100. Govt C §12186(c). Checks should be made payable to the Secretary of State. The articles may be mailed or hand delivered to the Sacramento office, or hand delivered to one of the regional offices in Fresno, Los Angeles, San Diego, or San Francisco. For the addresses of these offices, see the Directory.

No franchise tax deposit is required when the articles of incorporation are submitted for filing. Rev & T C §§23153, 23221(f).

For further discussion of filing requirements, see §§8.13, 8.18. On franchise tax requirements, see §8.21.

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**§9.8 E. Number of Shareholders**

A close corporation may not have more than 35 shareholders of record. See Corp C §158(a). A close corporation may be formed with only a single shareholder. Corp C §200(a). Accordingly, a close corporation may be a wholly owned subsidiary of another corporation.

The restriction on the number of shareholders of a close corporation is on the number of shareholders *of record*, not the number of beneficial owners of the outstanding shares. In determining the number of shareholders of record of a close corporation, the following rules apply (Corp C §158(d)):

- A husband and wife and a personal representative of either are counted as one shareholder regardless of how many shares may be held by either or both of them;
- A trust or personal representative of a decedent are counted as one shareholder, regardless of the number of trustees or beneficiaries of the decedent; and
- A partnership, corporation, or business association holding shares is counted as one shareholder, unless the entity is organized with a primary purpose to acquire or vote the shares of the close corporation, in which event each owner of a beneficial interest in the entity is counted as a separate shareholder.

**Source:** Business Law/Selecting and Forming Business Entities/9 Close Corporations/§9.9 F. Legend on Share Certificates

## §9.9 F. Legend on Share Certificates

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All certificates representing the shares of a close corporation must contain the following "conspicuous" legend on the face of the certificate (Corp C §418(c)):

**THIS CORPORATION IS A CLOSE CORPORATION. THE NUMBER OF HOLDERS OF RECORD OF ITS SHARES OF ALL CLASSES CANNOT EXCEED \_\_[a number not in excess of 35]\_\_. ANY ATTEMPTED VOLUNTARY INTER VIVOS TRANSFER WHICH WOULD VIOLATE THIS REQUIREMENT IS VOID. REFER TO THE ARTICLES, BYLAWS AND ANY AGREEMENTS ON FILE WITH THE SECRETARY OF THE CORPORATION FOR FURTHER RESTRICTIONS.**

If the shares issued by the close corporation are uncertificated (see Corp C §191.1), then—although the Corporations Code is silent on any requirement for this situation—it would be prudent to include the above language in the initial transaction statement, subscription agreement, or other document under which a shareholder acquires the shares of the corporation, as well as in the shareholders' agreement.

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## **§9.10 G. Close Corporations and S Corporation Election**

A California statutory close corporation can make an S corporation election under IRC §1362, provided that the close corporation otherwise qualifies as a "small business corporation" within the meaning of IRC §1361 and Treas Reg §§1.1361-1—1.1361-6. See Rev & T C §§23800-23813; see also §§2.129, 8.5. However, care must be exercised not to include provisions in the shareholders' agreement creating a second class of stock or otherwise destroying the S corporation election. See IRC §1361(b)(1)(D).

An S corporation may have no more than 100 qualifying shareholders, a number in excess of the 35-shareholder limit applicable to a California close corporation. IRC §1361(b)(1)(A). Although a husband and wife and all members of a family (and their estates) are counted as one shareholder (see IRC §1361(c)(1); Treas Reg §1.1361-1(e)(2), (e)(3)), persons who are required to include dividends distributed with respect to the corporation's stock in their gross income are considered to be shareholders of the corporation. Therefore, in tallying the number of shareholders of a corporation for purposes of determining its qualification for the S corporation election, it is ordinarily the beneficial owners of the outstanding shares, not the record owners, that are counted. Treas Reg §1.1361-1(e)(1). See also Treas Reg §1.1361-1(e)(2), (e)(3).

**NOTE:** In contrast, California close corporations ordinarily count only shareholders of record, rather than the beneficial owners, in determining the number of their shareholders (see §9.8). See Corp C §158(d).

In general, an S corporation may only have individual shareholders (excluding nonresident aliens), and certain qualifying estates, trusts, and qualified retirement plans. IRC §1361(b)(1)(B), (C); Treas Reg §1.1361-1(f)-(g).

The most significant limitation of the S corporation election for a California close corporation, however, is that the corporation cannot have more than one class of stock. IRC §1361(b)(1)(D). In general, a corporation is treated as having only one class of stock if all outstanding shares confer identical rights to distribution and liquidation proceeds. Differences in voting rights are disregarded in determining whether the corporation has more than one class of stock. Treas Reg §1.1361-1(l)(1). The determination of whether all outstanding shares confer identical rights to distribution and liquidation proceeds is made based on the corporation's charter, articles of incorporation, bylaws, applicable state law, and binding agreements relating to distribution and liquidation proceeds. Treas Reg §1.1361-1(l)(2).

When two shares are not identical to the other with respect to corporate control, profits, and assets, a corporation has more than one class of shares outstanding. Treas Reg §1.1361-1(l)(1)-(2).

For more on electing S corporation status for a close corporation, see *Organizing Corporations in California*, chap 7 (3d ed Cal CEB 2001).

## **IV. SHAREHOLDER AGREEMENTS**

### **§9.11 A. Role in Corporate Governance**

The general and universal principle of corporate governance is that corporations are managed under the supervision of their boards of directors. Corp C §300(a). A significant exception is afforded close corporations, whose shareholders' agreement—subject to certain limitations—is not necessarily invalidated by provisions that run contrary to the fundamental principle entrusting management and supervision of the business of the corporation to the board. Corp C §300(b).

**NOTE:** When asked to draft a shareholders' agreement, counsel should clarify that he or she represents the corporation rather than any particular shareholder, and advise any unrepresented parties to obtain separate counsel. See Cal Rules of Prof Cond 3-310(B), 3-600(E). On conflicts of interest, see §§1.6-1.9.

Because close corporations are authorized by statute to enter into shareholder agreements modifying most of the default rules of corporate governance set forth in the Corporations Code (see Corp C §300(b)), a statutory close corporation is an appropriate vehicle for closely held corporations whose shareholders desire to tailor the default rules of corporate governance to their particular situation. Shareholders' agreements often contain the provisions that:

- Dispense with the formalities (*e.g.*, meetings) of corporate governance;
- Grant the shareholders extensive direct rights over the management of the corporation;
- Require shareholder votes for matters that would otherwise be within the purview of the board of directors, including supermajority voting or veto power in specified situations;
- Allocate corporate income disproportionately to share holdings;
- Specify the requisite amount of time that shareholders will devote to the business;
- Restrict dissolution, merger, and reorganizations (see Corp C §1111);
- Restrict share transfers;
- Provide for share repurchase by the corporation or other shareholders on certain events; and
- Establish trade secret protections and noncompetition restrictions.

By using these mechanisms, minority shareholders may obtain the benefit of protections that would not otherwise be available to them under the general corporate governance regime. On corporate governance provisions that shareholders' agreements may not vary, see §9.14.

**NOTE:** To the extent mandated by the shareholders' agreement, and for as long as the discretion or powers of the board in its management of corporate affairs is controlled by the shareholders' agreement, each shareholder who is a party to the agreement has liability for any managerial acts performed or omitted by that party that is otherwise imposed on directors under the General Corporation Law (Corp C §§100-2319). The directors are relieved from liability to this extent. Corp C §300(d).

In addition to shifting management duties and protecting minority shareholders, a shareholders' agreement can ensure the continued employment of shareholders. Further, the agreement may establish a procedure by which the corporation will buy back shares on the occurrence of specified events.

**Source:** Business Law/Selecting and Forming Business Entities/9 Close Corporations/ B. Form and Contents/§9.12 1. Requirement of Writing

## **B. Form and Contents**

### **§9.12 1. Requirement of Writing**

A shareholders' agreement is defined in Corp C §186 to mean a "written" agreement among all of the shareholders of a close corporation. If the corporation has only one shareholder, then the agreement is entered into between the shareholder and the corporation. Corporations Code §300(b) validates, in general terms, the provisions of a shareholders' agreement of a close corporation that relate to the "management" of its business, the "division" of its profits, or the "distribution" of its assets on liquidation.

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## **§9.13 2. Optional Provisions From Corp C §204**

Under Corp C §204, certain provisions may be included in the articles of incorporation of a California corporation and these provisions will not be effective unless included in the articles. See §8.15. For close corporations, however, the statute expressly states that any of these provisions of Corp C §204(a)(1)-(11) may be "validly" included in a shareholders' agreement of a close corporation. Corp C §204(a). The optional provisions are ones that (Corp C §204(a)(1)-(11)):

- Grant the power to levy assessments on the outstanding shares of the corporation;
- Grant the shareholders preemptive rights to subscribe to newly issued shares;
- Impose special qualifications on persons who may be shareholders;
- Limit the duration of the corporation's existence;
- Require the vote of a larger proportion or all of the shares of any class or series, or of a larger proportion or all of the directors than is otherwise required by the Corporations Code;
- Limit or restrict the business in which the corporation may engage;
- Confer on the holders of outstanding debt the right to vote in the election of directors or on any other matter on which shareholders may vote;
- Confer on the shareholders the right to determine the consideration for which shares may be issued;
- Require the approval of the shareholders (see Corp C §153), or the approval of the outstanding shares (see Corp C §152), for any corporate action, even if otherwise within the purview of the board;
- Eliminate or limit the personal liability of directors for monetary damages for breach of the directors' duties to the corporation and its shareholders; and
- Authorize the indemnification of agents of the corporation beyond that authorized by Corp C §317.

Counsel should ensure that the provisions of the shareholders' agreement do not conflict with any provisions in the articles of incorporation or bylaws. It may be preferable to reproduce the restrictive provisions of the shareholders' agreement in the articles. If the corporation loses its close corporation status, provisions included in the shareholders' agreement under Corp C §204(a) may not be valid unless expressly authorized elsewhere in the Corporations Code.

**§9.14 3. Corporate Governance Provisions That Shareholders' Agreement May Not Vary**

Although the parties to a shareholders' agreement of a close corporation have wide latitude to vary the default corporate governance provisions of the Corporations Code, that latitude is not unlimited. These statutory provisions may not be varied by a shareholders' agreement (Corp C §300(c)):

- The provisions of Corp C §158;
- The statements required by Corp C §417 on certificates representing classes of shares of all corporations;
- The legends required on share certificates of close corporations by Corp C §418;
- The conditions under which dividends may not be paid to shareholders (Corp C §§500-501);
- The requirement of Corp C §1111 that, in any merger of a close corporation with a non-close corporation, in which the non-close corporation is the survivor, the merger be approved by the affirmative vote of at least two-thirds of each class of the outstanding shares of the disappearing close corporation (the articles of the close corporation may provide for a lesser vote, but not less than a majority of the outstanding shares of each class);
- The provisions of Corp C §1201(e) requiring a similar two-thirds approval (no less than a majority if varied by the articles) for a reorganization involving a close corporation;
- The provisions of Corp C §§2009-2011 governing corporations in dissolution, including a right of recovery for distributions improperly made to shareholders;
- The requirements of record-keeping and reports found in Corp C §1500-1512;
- Rights to inspection of corporate records found in Corp C §1600-1605;
- Provisions regarding the involuntary dissolution of corporations (Corp C §§1800-1809); and
- The crimes and penalty provisions of Corp C §§2200-2260.

**Source:** Business Law/Selecting and Forming Business Entities/9 Close Corporations/§9.15 4. Corporate Governance Provisions That May Be Varied

#### **§9.15 4. Corporate Governance Provisions That May Be Varied**

The nonwaivable provisions listed in Corp C §300(c) do *not* include the provisions listed below. Therefore, shareholders of a close corporation may, by their shareholders' agreement, modify, or prohibit, among others, the following provisions of the Corporations Code:

- Cumulative voting in the election of directors, otherwise required by Corp C §708;
- Dissenters' rights, as specified in the Corporations Code (Corp C §§1300-1313); and
- The right and power of shareholders representing 50 percent or more of the voting power of a corporation to elect to voluntarily wind up and dissolve, otherwise required by Corp C §1900(a).

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**Source:** Business Law/Selecting and Forming Business Entities/9 Close Corporations/§9.16 C. Modification, Revocation, and Termination of Agreement

**§9.16 C. Modification, Revocation, and Termination of Agreement**

A shareholders' agreement may not be modified, extended, or revoked by less than the unanimous consent of the parties unless the agreement permits modification, extension, or revocation by some lesser number. Corp C §300(b). A transferor of shares covered by a shareholders' agreement ceases to be a party to the agreement if the transferor ceases to be a shareholder of the corporation unless the transferor is a party other than as a shareholder.

A shareholders' agreement terminates when the corporation ceases to be a close corporation, except that if the agreement so provides it will continue to the extent it is enforceable apart from Corp C §300(b). Similarly, a shareholders' agreement terminates when the corporation makes an original issuance of shares to a new shareholder who does not become a party to the agreement, unless the agreement provides that it continues to the extent that it is enforceable apart from Corp C §300(b).

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## **V. CLOSE CORPORATIONS AND OTHER ENTITIES**

### **§9.17 A. Close Corporations and Professional Corporations**

Professional corporations are available to persons rendering professional services, as defined in Corp C §13401(b). A professional corporation may elect close corporation status if it meets the requirements for doing so, *i.e.*, its articles contain the statements mandated by Corp C §158(a) and it has no more than 35 shareholders of record.

With respect to restrictions on transfer, beyond the normal restrictions that would be included in any shareholders' agreement of a close corporation, professional corporations must include in their shareholders' agreements restrictions on issuance and transfer of capital stock only to licensed persons, as required by Corp C §§13406-13407.

A professional corporation that qualifies (in terms of number and nature of shareholders) typically elects S corporation status to avoid federal income taxation at the entity level. In doing so, the professional corporation must observe the limitations on the issuance of more than one class of stock.

For further discussion of professional corporations, including a list of professions that may incorporate under the Moscone-Knox Professional Corporation Act (Corp C §§13400-13410), see chap 10.

**Source:** Business Law/Selecting and Forming Business Entities/9 Close Corporations/§9.18 B. Close Corporations and LLPs

## **§9.18 B. Close Corporations and LLPs**

For those firms that qualify (law firms, accounting firms, and architectural firms), the "limited liability partnership" form of doing business has eclipsed the use of the professional corporation. See Corp C §§16101(12), 16951-16962. For tax reasons, certain firms that practiced as professional corporations before the enactment of the limited liability partnership provisions in 1995 continue to practice in professional corporation form. The professional corporation form of doing business continues to be popular in the medical field, because medical practitioners do not have the LLP form of business available to them. For medical firms that will practice in professional corporation form and that will have 35 or fewer shareholders, the close corporation election should be considered. On the considerations involved in forming an LLP, see chap 7.

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## **§9.19 C. Close Corporations versus LLCs**

The limited liability company (LLC) is popular in California as a form of conducting a small business outside of the venture capital arena. LLCs are attractive because they offer limited liability to members (similar to a corporation) and "pass through" tax treatment (similar to a partnership). LLCs also offer the members wide flexibility in structuring their relationship through the use of an operating agreement that, subject to limited exceptions, may contain such provisions as are agreed on by the members. See Corp C §17005. Moreover, unlike a close corporation, which may not have more than 35 shareholders of record (Corp C §158(a)), there is no limit on the number of members of an LLC.

However, one of the benefits of the LLC form of doing business—the flexibility offered to its members through the operating agreement—is also a disadvantage in that counsel is often required to draft an extensive, complicated, and expensive operating agreement.

But the primary disadvantage to the use of the LLC form in California is the tax imposed by the state of California on LLCs. Although LLCs are treated as partnerships under federal income tax law and therefore not subject to tax at the entity level (IRC §701), California imposes an annual franchise tax on LLCs at the entity level and a statutory annual fee based on the amount of the "total income" of the LLC reportable to the state of California. LLCs are subject to the same \$800 franchise tax (deductible for California income tax purposes) for the privilege of doing business in California as are corporations, including close corporations. Rev & T C §§17941(a), 23153(d)(1). In addition, an LLC is subject to tax on its "total income" (not "net income") from all sources derived from or attributable to California as set forth in the table in §11.7. This tax is not deductible for California income tax purposes. Rev & T C §17942.

**EXAMPLE:** A close corporation making the S corporation election, and therefore subject to California's 1.5 percent tax on S corporation taxable income (see Rev & T C §23802(b)(1)), would have to report more than \$786,000 in net income to pay a tax greater than the annual fee (\$11,790) payable by an LLC reporting \$5 million or more in gross income.

Another disadvantage of the LLC form is that it is not available for the rendition of professional services, as defined in Corp C §§13401(a), 13401.3. Corp C §17375. Thus, lawyers, accountants, and medical professionals may not practice in LLC form. For more discussion of the advantages and disadvantages of the LLC form, see chap 2. On forming an LLC, see chap 11.

**Source:** Business Law/Selecting and Forming Business Entities/9 Close Corporations/§9.20 VI. CONSIDERATIONS IN DRAFTING SHAREHOLDERS' AGREEMENT FOR CLOSE CORPORATION

**§9.20 VI. CONSIDERATIONS IN DRAFTING SHAREHOLDERS' AGREEMENT FOR CLOSE CORPORATION**

To receive the full benefits offered by a California close corporation, the shareholders must adopt a shareholders' agreement that satisfies their unique goals and objectives. Some key considerations to be taken into account when drafting a shareholders' agreement for a close corporation are discussed in §§9.20-9.33.

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**§9.21            A. Statutory Requirements**

Only two statutory requirements apply to a shareholders' agreement of a close corporation (Corp C §186):

- The agreement must be in writing (see §9.12); and
- The agreement must be among *all* shareholders of the close corporation (or between a single shareholder and the close corporation if there is only one shareholder).

In addition, to be binding on a transferee of shares of the close corporation, the shareholders' agreement must be filed with the secretary of the close corporation. Corp C §300(b).

**Source:** Business Law/Selecting and Forming Business Entities/9 Close Corporations/§9.22 B. Management and Control

## **§9.22 B. Management and Control**

A common provision in a shareholders' agreement is the waiver of regular annual and special meetings of the board of directors and shareholders. See form in §9.39. The failure of a close corporation to hold board or shareholders' meetings will not be a factor in determining whether to pierce the corporation's veil. See Corp C §300(e). However, to the extent that the discretion and authority of the board of directors of a close corporation is restricted by the shareholders' agreement, shareholders of the close corporation may be exposed to personal liability under Corp C §300(d).

**PRACTICE TIP:** To avoid exposing shareholders to personal liability, a close corporation's shareholders' agreement should ensure that the discretion and power of the board of directors is not limited by the shareholders' agreement, unless the shareholders intend to supplant the powers of the corporation's board of directors.

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**§9.23 C. Distributions**

A key benefit of a close corporation is that the shareholders' agreement may include various provisions for the distribution of profits among the shareholders, as long as these provisions do not violate the restrictions on distributions imposed by Corp C §§500-501. Corp C §300(c). Specifically tailored provisions could be used, for example, to ensure that a certain portion of the profits of the close corporation are distributed to shareholders on a regular basis. See form in §9.40. This requirement may be particularly important if the close corporation is an S corporation, because the shareholders will be taxed on their share of the net income of the corporation whether or not distributions are made. For this reason, it is not uncommon for a shareholders' agreement to have a tax draw clause providing that an amount equal to the estimated tax payable by shareholders will be distributed to them annually. A mandatory distribution provision may also be used to protect minority shareholders or passive investors. Careful drafting of this portion of the shareholders' agreement is necessary for an S corporation to ensure that the shareholders' agreement does not create a second class of stock that would terminate the S election. See §9.10.

**Source:** Business Law/Selecting and Forming Business Entities/9 Close Corporations/§9.24 D. Dissolution

**§9.24 D. Dissolution**

A close corporation shareholders' agreement may not alter the provisions of the Corporations Code regarding involuntary dissolution. See Corp C §§300(c), 1800-1809. However, the agreement may set forth the circumstances under, and the manner in which, the shareholders may voluntarily dissolve the close corporation. See form in §9.47.

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**Source:** Business Law/Selecting and Forming Business Entities/9 Close Corporations/§9.25 E. Certain Voting Requirements

### **§9.25 E. Certain Voting Requirements**

To protect the interest of minority and other shareholders who may not be involved in the day-to-day operations of the close corporation, it may be appropriate to place certain limits on the authority of persons otherwise in control of the corporation. It is not unusual for certain actions to require the prior consent of either a majority, a supermajority, or all of the shareholders of a close corporation. Actions requiring shareholder consent may include (see form in §9.39):

- Amendment, repeal, or alteration of articles of incorporation or bylaws;
- Merger, consolidation, conversion, or sale of all or substantially all of the assets of the close corporation;
- Voluntary dissolution;
- Expenditures in excess of a specific dollar amount, either individually or cumulatively;
- Issuance of additional shares of stock;
- Encumbrance of assets; and
- Transactions with affiliates.

## **§9.26 F. Transfer Restrictions**

In many close corporations, the shareholders want to restrict the transferability of shares to maintain control over their business arrangement and associates. Consequently, it is not unusual to restrict the transfer of shares to other shareholders, family members, revocable trusts of a shareholder, or business entities controlled by a shareholder. See form in §9.41.

Reasonable restrictions on the right to transfer shares of a California corporation are explicitly authorized if included in the articles of incorporation (Corp C §204(b)) or the bylaws (Corp C §212(b)(1)). California courts have long recognized the validity of reasonable restrictions on the transfer of shares. See *Tu-Vu Drive-In Corp. v Ashkins* (1964) 61 C2d 283, 286, 38 CR 348 (bylaws restricting transfer in closed corporations as essential to successful enterprise; they prevent unwanted intrusions by outsiders, preserve integrity of entity, and are often necessary to protect corporation and shareholders against business rivals); see also *Chow v Levi Strauss & Co.* (1975) 49 CA3d 315, 322, 122 CR 816 (courts have uniformly enforced first option provisions in corporate charters or bylaws requiring shareholders to afford corporation, fellow shareholders, or both, opportunity to buy stock before selling to outsiders)

The imposition of transfer restrictions in shareholders' agreements of close corporations is not explicitly authorized by Corp C §300(b). However, transfer restrictions should be permitted in close corporation shareholders' agreements given that reasonable restrictions on transfer are permissible if included in the articles or bylaws. Transfer restrictions are often included in shareholders' agreements rather than in (or in addition to) the articles or bylaws—probably because attorneys have greater confidence that restrictions that might not be considered "reasonable" in the articles or bylaws may, if sufficiently detailed and secured through the informed consent of the contracting parties, be upheld in a contract among the parties. See *Chow v Levi Strauss & Co.*, 49 CA3d at 324. It is important, in any event, to place a legend on all share certificates disclosing that the transferability of the shares represented thereby is restricted, identifying the agreement, and disclosing that the agreement is available for inspection by request to the secretary of the company. See §9.9.

Provided that the shareholders' agreement is filed with the secretary of the corporation and made available for inspection by any prospective purchaser of shares, a prospective purchaser with actual knowledge of the shareholders' agreement *or* notice of it through the legend mandated on the outstanding share certificates by Corp C §418 is bound by the provisions of the agreement and is deemed to be a party to it. Nevertheless, all new shareholders should be required to explicitly adopt the shareholders' agreement. A transferor of shares ceases to be a party to the shareholders' agreement on transfer of all of his or her shares, unless the transferor is a party other than as a shareholder. Corp C §300(b).

**§9.27 G. Rights of First Refusal**

To provide some ability to liquidate a shareholders' investment in the close corporation and to increase the likelihood that the restrictions on transfer are enforceable, shareholders' agreements often provide a right of first refusal in which any shareholder desiring to sell his or her shares must first offer them to the close corporation or the other shareholders. The price and terms of the right of first refusal should be included in the shareholders' agreement. Often, the price and terms relating to the right of first refusal are based on a bona fide offer received by the selling shareholder.

## **§9.28 H. Buy-Sell Provisions**

In addition to transfer restrictions, the shareholders' agreement may set forth certain circumstances in which a shareholder must sell his or her shares in the close corporation. In addition to providing control over the persons with whom the shareholders will be in business, buy-sell provisions may provide some liquidity for the shares of the close corporation. Circumstances that trigger buy-sell provisions typically include the following events:

- Death of a shareholder;
- Incapacity of a shareholder;
- Divorce of a shareholder (in which case, the affected shareholder usually has the first right of refusal);
- Breach of the shareholders' agreement;
- Termination of employment with the close corporation;
- Conviction of certain crimes; and
- Breach of fiduciary duties to the close corporation.

The buy-sell provisions may be mandatory or permissive.

Buy-sell provisions should provide a mechanism for establishing the purchase price and the payment terms, including the amount of a downpayment, interest rate, frequency of payments, term of payments, and the security for the purchase obligation. The most common methods for establishing the purchase price include:

- Periodic agreement of the shareholders;
- Net book value;
- Capitalization of earnings;
- Appraisal or arbitration, or
- Some combination of these.

In addition, shareholders should consider bring-along or tag-along rights. Bring-along rights (also called drag-along rights) provide a shareholder or shareholders owning a certain percentage of the shares with a right to require other shareholders to sell their shares along with such shareholder or shareholders. Tag-along rights provide that certain shareholders (usually control shareholders) will not sell their shares unless certain other shareholders have the option of selling their shares at the same price and on the same terms. Consideration should be given to the purchase of life insurance to fund any purchase obligation.

A full discussion of buy-sell provisions is beyond the scope of this chapter. For further information and forms, see *Business Buy-Sell Agreements* (Cal CEB 1991).

## **§9.29 I. Alternative Dispute Resolution**

In an effort to facilitate the resolution of disputes, to maintain privacy, and to minimize the cost of dispute resolution, shareholders of a close corporation should consider including provisions for alternative dispute resolution. See form in §9.48. With a close corporation, counsel should carefully consider alternatives to address potential dissension and deadlocks within the organization. Such provisions could include mandatory or permissive mediation, private arbitration, judicial arbitration, jury trial waiver, or some combination of these. Counsel should carefully consider all options. There are advantages and disadvantages associated with each. For further information on alternative dispute resolution, see A Litigator's Guide to Effective Use of ADR in California (Cal CEB 2005).

The minimum requirements for enforceability of arbitration clauses covering unwaivable statutory claims were set forth in *Armendariz v Foundation Health Psychcare Servs.* (2000) 24 C4th 83, 99 CR2d 745. Although *Armendariz* concerned an employment agreement, the ruling has been applied to arbitration agreements in other settings. See, e.g., *Azteca Constr., Inc. v ADR Consulting, Inc.* (2004) 121 CA4th 1156, 18 CR3d 142. But see *Boghos v Certain Underwriters at Lloyd's of London* (2005) 36 C4th 495, 30 CR3d 787 (refusing to extend *Armendariz* rule to general common-law claims not tethered to statutory right).

**NOTE:** Counsel should be aware that the grounds for vacating an arbitration award are very limited under CCP §§1286.2 (vacation of award) and 1286.6 (correction of award). Accordingly, the merits of an arbitration award, either on questions of fact or of law, are not subject to judicial review outside these two statutes, even though an error of law appears on the face of an arbitration award and causes substantial injustice. See *Moncharsh v Heily & Blase* (1992) 3 C4th 1, 9, 10 CR2d 183. Further, counsel should be aware that the California Supreme Court has held that predispute jury trial waivers are unenforceable. *Grafton Partners LP v Superior Court* (2005) 36 C4th 944, 32 CR3d 5.

**§9.30 J. Noncompetition; Trade Secrets**

One of the most valuable assets of many close corporations is intellectual property, including trade secrets. It is extremely important to take reasonable precautions to ensure that close corporation shareholders will not use the intellectual property of the close corporation to compete with the corporation during or immediately after their involvement with it. As a result, counsel may wish to include a clause that prohibits a shareholder from competing against the corporation within the parameters of California law. See form in §9.42. In California, covenants not to compete are governed by Bus & P C §§16600-16607. See California Business Litigation, chap 3 (Cal CEB 2002).

Counsel may also desire to include a provision in the shareholders' agreement that identifies and prevents the use or disclosure of the trade secrets of the close corporation. See form in §9.43. For further information on trade secrets issues, see Trade Secrets Practice in California (2d ed Cal CEB 1996).

The agreement should indicate who is authorized to give consent to disclosure. Counsel should exercise care when specifying the name or title of the company representative authorized to approve publication or private use of company information; this authority should not be left to the discretion of a tractable supervisor.

**Source:** Business Law/Selecting and Forming Business Entities/9 Close Corporations/§9.31 K. Legends on Share Certificates

**§9.31 K. Legends on Share Certificates**

In addition to securities law requirements that mandate certain legends on share certificates, all certificates representing shares of a close corporation must include specific statutory language. Corp C §418(c). See §9.9. The shareholders' agreement should specify which legends should appear on the stock certificates of the corporation. See form in §9.46.

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### **§9.32 L. Termination; Amendment**

As with many contracts, it is important to specify when the contract will terminate and the manner in which it may be amended. See forms in §9.50. A close corporation shareholders' agreement automatically terminates when the entity's close corporation status terminates, unless the shareholders' agreement states otherwise and provided that the agreement's provisions are enforceable outside the context of a close corporation. Corp C §300(b). Further, the issuance of shares by a close corporation to a new shareholder who does not become a party to the shareholders' agreement terminates the agreement, unless the agreement provides that it shall continue to the extent it is enforceable independently of Corp C §300(b). See §9.32.

Certain provisions in a shareholders' agreement will be rendered ineffective immediately on the loss of close corporation status, even if the shareholders' agreement purports to survive. These are provisions that, under Corp C §204(a), must be included in the articles of a non-close corporation in order to be effective. See §8.15. As a precautionary measure, counsel should consider having parallel provisions in the close corporation's articles of incorporation. Provisions that the shareholders may desire to survive termination of the entity's close corporation status include:

- Restrictions on transfer of shares;
- Buy-sell provisions;
- Noncompetition and trade secrets;
- Alternative dispute resolution procedures; and
- Miscellaneous provisions.

The shareholders' agreement itself should always include a provision that, unless otherwise specified, its covenants and agreements will continue in full force and effect notwithstanding any termination of close corporation status or by reason of the issuance of shares to a shareholder who does not become a party to the shareholders' agreement. See form in §9.49.

Shareholders' agreements of close corporations may be amended, modified, extended, or revoked by less than unanimous consent of the shareholders only if so permitted by the terms of the shareholders' agreement. Corp C §300(b).

**Source:** Business Law/Selecting and Forming Business Entities/9 Close Corporations/§9.33 M. Miscellaneous Provisions

### **§9.33 M. Miscellaneous Provisions**

Sometimes referred to as legal boilerplate, the miscellaneous provisions of any agreement, including shareholders' agreements, are often extremely important and should be carefully considered by the drafter. See form in §9.50. For a comprehensive discussion of miscellaneous contract provisions, see *Drafting Business Contracts: Principles, Techniques & Forms*, chap 17 (Cal CEB 1994).

Finally, considering California's community property laws, it is often prudent to obtain spousal consents. See generally Fam C §§1100-1103.

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## **§9.34 VII. CHECKLIST: PROVISIONS IN SHAREHOLDERS' AGREEMENT FOR STATUTORY CLOSE CORPORATION**

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► To download **WordPerfect** version, right click and choose *Save Target As*

Ordinarily, it serves little purpose to elect statutory close corporation status in the articles of incorporation unless the corporation also adopts a shareholders' agreement establishing rules different from the normal rules of the Corporations Code. The following checklist indicates subjects that the shareholders of a statutory close corporation may wish to cover in their shareholders' agreement.

### **1. Specific matters that would normally require an articles provision under Corp C §204(a):**

- Share accessibility
- Shareholders' preemptive rights
- Special qualifications for shareholders
- Limitations on the corporate existence
- Requirements for supermajority or unanimous vote of shareholders or directors
- Restrictions on the corporation's business and powers
- Voting rights for debt-holders
- Right of shareholders to determine consideration to be received for shares
- Requiring shareholder approval of actions not normally submitted to shareholders

### **2. Matters of management and voting**

- Waiver of all provisions of the General Corporation Law (Corp C §§100-2319) except those that cannot be waived in a shareholders' agreement (Corp C §§158, 417-418, 500-501, 1111, 1201(e), 1500-1508, 1600-1605, 1800-1809, 2009-2011, 2200-2260) and requirements for filing documents with the Secretary of State. Corp C §300(b)-(c).
- Manner of electing or designating directors and officers
- Long-term employment arrangements for some or all shareholders
- Compensation of directors, officers, and others, including pension plans, insurance, stock option plans, and other fringe benefits
- Provisions on the amount of time each participant is to devote to the corporation and whether other activities are permitted
- Allocation of decision-making authority, including disproportionate authority, to specified individuals in regard to specified matters or all matters
- Creation of power in one or more participants to veto corporate decisions
- Particular decisions requiring shareholder approval; percentage vote required for certain types of corporate action
- Rules on voting of shares in elections

### **3. Dividends**

- Designation of authority to declare dividends
- Accounting basis to determine income and loss
- Corporate retention of portion of net income

- Circumstances in which dividends are to be declared
- Method for allocating dividends

#### **4. Restrictions on transfers of shares (Corp C §204(b))**

- Legends (Corp C §418(c));
- Rights of purchase and first refusal
- Purchase on death of shareholder

#### **5. Dissolution of corporation**

- Involuntary dissolution
- Voluntary dissolution
- Liquidation preferences on shares

#### **6. Termination of agreement**

- Events that will terminate the agreement
- Procedures applicable if agreement is terminated

#### **7. Amendment of shareholders' agreement**

- When amendments are required
- Method of amendment
- Party responsible for amending shareholders' agreement

#### **8. Miscellaneous matters**

- Rights of successors and assigns of shareholders (correlate with restrictions on transfer of shares)
- Settlement of disputes under the agreement; arbitration
- California law as controlling; severability
- Entire agreement

*Comment:* For matters that would normally require a provision in the articles for non-close corporations (item 1), the statutory rules apply unless there is a different provision in the articles of incorporation. For a statutory close corporation, the different provision may appear in the shareholders' agreement instead. Corp C §204(a). See §9.15.

With respect to matters of management and control (item 2), although a provision in a shareholders' agreement waiving most of the General Corporation Law (Corp C §§100-2319) is theoretically possible under Corp C §300(c), the close corporation choosing to do so would have to create for itself a full set of rules to substitute for the statutory rules. The more practical approach is to waive specific sections of the Corporations Code covering areas that the corporation wishes to treat in its own way, and to provide that the Corporations Code applies whenever it has not been waived, or whenever it is not inconsistent with provisions of the shareholders' agreement.

Voting rights can be disproportionate to shareholdings, if the shareholders' agreement so provides. Voting agreements between two or more shareholders of a close corporation can provide for various ways of voting shares, can be subject to specific enforcement, and, if the agreement so provides, can survive the termination of close corporation status. See Corp C §706(a).

The circumstances under which dividends may be declared (item 4) are subject to Corp C §§500-501, which the shareholders' agreement cannot waive. Corp C §300(c). See §9.14. Before adopting a provision for payment of dividends other than in proportion to ownership of shares, the corporation should be fully advised of the tax and securities regulation aspects of the proposed plan.

With respect to dissolution of the corporation (item 5), the involuntary dissolution provisions of Corp C §§1800-1809 cannot be waived. Tax aspects of special preferences should be carefully considered before a proposed plan is adopted. On considerations concerning dissolution of a close corporation, see *Organizing Corporations in California*, chap 7 (3d ed Cal CEB 2001).



**Source:** Business Law/Selecting and Forming Business Entities/9 Close Corporations/ VIII. FORMS/§9.35 A. Form: Secretary of State Sample Articles of Incorporation for Close Corporation

## **VIII. FORMS**

### **§9.35 A. Form: Secretary of State Sample Articles of Incorporation for Close Corporation**



**ARTICLES OF INCORPORATION**

I

The name of this corporation is \_\_\_\_\_ *(NAME OF CORPORATION)* \_\_\_\_\_.

II

The purpose of the corporation is to engage in any lawful act or activity for which a corporation may be organized under the **General Corporation Law** of California other than the banking business, the trust company business or the practice of a profession permitted to be incorporated by the California Corporations Code.

III

The name and address in the State of California of this corporation's initial agent for service of process is:

Name \_\_\_\_\_

Address \_\_\_\_\_

City \_\_\_\_\_ State **CALIFORNIA** Zip \_\_\_\_\_

IV

This corporation is authorized to issue only one class of shares of stock; and the total number of shares which this corporation is authorized to issue is \_\_\_\_\_.

V

This corporation is a **Close Corporation**. All of the corporation's issued shares of stock, of all classes, shall be held of record by not more than \_\_\_\_\_ persons.

\_\_\_\_\_  
*(Signature of Incorporator)*

*(Typed Name of Incorporator), Incorporator*

*If an individual is designated as the initial agent for service of process, include the agent's business or residential street address in California (a P.O. Box address is not acceptable). If another corporation is designated as the initial agent for service of process, do not include the address of the designated corporation.*

*This sample is provided to be used as a guideline ONLY in the preparation of the original document for filing with the Secretary of State.*

## Organization of California Close Corporations

### INSTRUCTIONS:

Articles of Incorporation must be drafted to include all the provisions required by the California Corporations Code. Articles of Incorporation may include other provisions as permitted under California law (e.g., the name and address of each initial director). The attached sample meets the minimum statutory requirements and should only be used as a guide in preparing Articles of Incorporation. The document should be typed with letters in dark contrast to the paper. Documents not suitable for reproduction will be returned unfiled. Note: The file date of Articles of Incorporation is generally the date the document complying with applicable law is received in the Secretary of State's office.

**Article I:** The articles must include a statement of the name of the corporation.

Note: The name must be exactly as you want it to appear on the records of the California Secretary of State. The name of a close corporation must include the word "corporation", "incorporated" or "limited" or an abbreviation of one of these three words.

**Article II:** This exact statement is required by the California Corporations Code and should not be altered.

**Article III:** The articles must include the name of the initial agent for service of process.<sup>1</sup>

- If an individual is designated as agent, include the agent's business or residential **street** address in California (a P.O. Box address is not acceptable). Please do not use "in care of" (c/o) or abbreviate the name of the city.
- If another corporation is designated as agent, do not include the address of the designated corporation.

Note: Before another corporation may be designated as agent, that corporation must have previously filed with the Secretary of State a certificate pursuant to California Corporations Code section 1505. **A corporation cannot act as its own agent** and no domestic or foreign corporation may file pursuant to Section 1505 unless the corporation is currently authorized to engage in business in California and is in good standing on the records of the California Secretary of State.

**Article IV:** The articles must include a statement of the total number of shares the corporation will be authorized to issue.

Note: Before shares of stock are sold or issued the corporation must comply with the Corporate Securities Law administered by the Department of Corporations. Information regarding permits to issue shares can be obtained from the Department of Corporation's website at [www.corp.ca.gov](http://www.corp.ca.gov) or by calling the Department of Corporations at (213) 573-7500.

**Article V:** The articles must include a statement that the corporation is a close corporation and must include the number of persons entitled to hold issued shares. Note: The number of persons cannot exceed 35.

**Execution:** The articles must be signed by each incorporator, or by each initial director named in the articles. If initial directors are named, each director must both sign and acknowledge the articles. Note: If initial directors are not named in the articles, the individual(s) executing the document is the incorporator(s) of the corporation. The name of each incorporator or initial director should be typed beneath their signatures.

<sup>1</sup> An "agent for service of process" is an individual (director, officer or any other person, whether or not affiliated with the corporation) who resides in California or another corporation designated to accept service of process if the corporation is sued. Note: The agent must agree to accept service of process on behalf of the corporation prior to designation.

satisfy the minimum statutory requirements. See Corp C §§158, 200-202. See also §§9.4-9.10. It is available on the Secretary of State's website at [http://www.sos.ca.gov/business/corp/pdf/articles/corp\\_artsclose.pdf](http://www.sos.ca.gov/business/corp/pdf/articles/corp_artsclose.pdf). It may be used as a guide in preparing incorporation documents to be filed with the Secretary of State.

**PRACTICE TIP:** Counsel should carefully consider whether the proposed corporation's specific business requirements require the inclusion of special permissive provisions or even the formation of a general stock corporation rather than a close corporation.

For filing requirements for submitting the articles to the Secretary of State's office, see §8.18.

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**Source:** Business Law/Selecting and Forming Business Entities/9 Close Corporations/§9.36 B. Close Corporation Shareholder Agreement

### **§9.36 B. Close Corporation Shareholder Agreement**

This form is a statutory close corporation shareholder agreement that conforms to the statutes authorizing the use of such shareholder agreements in California. See Corp C §§204(a), 300(b), (c). Because the factual circumstances of any particular statutory close corporation vary, this form represents only a sample of the types of provisions that might be included in a shareholder agreement and must be modified as appropriate in the circumstances.

**NOTE:** This form does not include mandatory rights of first refusal or buy-sell provisions, although these are common elements of shareholders' agreements or may be attached as a separate document. A full discussion of buy-sell provisions is beyond the scope of this chapter. For further information and forms, see Business Buy-Sell Agreements (Cal CEB 1991).

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**Source:** Business Law/Selecting and Forming Business Entities/9 Close Corporations/§9.37 1. Form: Heading, Parties, and Date

## §9.37 1. Form: Heading, Parties, and Date

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9.37-1 Heading, parties, and date

### SHAREHOLDER AGREEMENT FOR \_\_\_[NAME OF CLOSE CORPORATION]\_\_

**THIS SHAREHOLDER AGREEMENT** is entered into as of \_\_\_[date]\_\_ by \_\_\_[names]\_\_ (referred to individually as a Shareholder and collectively as the Shareholders) of the \_\_\_[name of corporation]\_\_ \_\_\_[and]\_\_ \_\_\_[name of corporation]\_\_, a California close corporation]\_\_.

*Comment:* A shareholders' agreement must be in writing (see §9.12), and all the shareholders must be a party to the agreement. Although this form assumes there is more than one shareholder in the corporation, if there is only one shareholder, the corporation must also be a party. Corp C §186. Even if there is more than one shareholder, the corporation should be a party to the agreement because the agreement usually contemplates that the corporation itself will take specified actions under the agreement.

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## §9.38 2. Form: Recitals

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9.38-1 Recitals

### RECITALS

\_\_ *[Name of corporation]* \_\_ is a California statutory close corporation under the provisions of Corporations Code §158. The Shareholders are all of the shareholders of the Corporation.

The Corporation's principal place of business is located at \_\_ *[address]* \_\_, California.

The Corporation's business is described as \_\_ *[describe corporation's business]* \_\_.

The Shareholders intend to enter into this Shareholder Agreement to provide for the consistent and uniform management and control of the affairs of the Corporation, to govern the division of corporate profits, and to control the distribution of the corporation's assets on liquidation.

The Shareholders believe that the shareholders' agreement must secure the continued employment of each Shareholder, specify how each Shareholder will contribute to the business and the management of the Corporation, and restrict the transfer of corporate shares, as set forth in this Agreement.

*[If applicable, add the following option]*

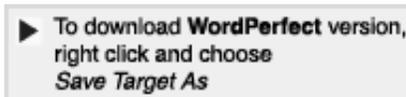
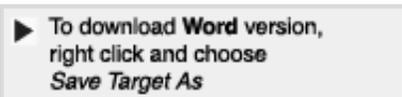
*[Option: Provisions of agreement repeat or expand on articles of incorporation]*

The provisions of this Agreement contain provisions that \_\_ *[repeat/expand]* \_\_ some of the Articles of Incorporation. If any inconsistencies exist between this Agreement and the Articles of Incorporation, this Agreement will control. However, if this Agreement terminates, the provisions in the Articles of Incorporation will remain effective.

*Comment:* These recitals contain a provision acknowledging that the shareholders' agreement may duplicate or expand provisions in the articles of incorporation, and that any inconsistencies are to be resolved in favor of the agreement. They further provide that the articles continue in full effect if the agreement terminates. If the shareholders' agreement terminates, the articles should be reviewed and amended as needed.

### §9.39 3. Form: Management and Control of Corporation

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9.39-1 Management and control of corporation

## ARTICLE I

### MANAGEMENT AND CONTROL OF CORPORATION

**A. Board of Directors.** Each Shareholder shall be a director of the Corporation and member of the Board unless terminated under this Agreement.

**B. Meetings of Board of Directors.** Meetings of the Board of Directors of this Corporation are waived.

**C. Actions by Board.** The Board of Directors is authorized to take the following actions, as appropriate:

1. File any documents, certificates, or information that may be required by the California Secretary of State;
2. Use best efforts to operate the business of the corporation in accordance with generally accepted accounting principles and sound business practices;
3. Ascertain the current assets and liabilities of the Corporation for purposes of corporate distributions;
4. Ensure that an annual report will be prepared and sent to the Shareholders no later than    *[number]*    days after the close of the fiscal year    *[unless the Corporation's bylaws expressly waive this requirement]*   ; and
5. Ensure that the Corporation maintains books and records, as well as any other documents required by Corporations Code §1500.

**D. Officers.** The officers of the Corporation and their salaries will be as follows:

   *[List names, titles, and salary of each shareholder]*   

The title, duties, and the other terms of employment, including each Shareholder's annual salary, may only be altered by the unanimous written consent of the Shareholders.

**E. President as Manager.** The President of the Board manages the ordinary operations of the Corporation.

**F. Approval of Actions by President.** Before the President may perform the following actions,    *[he/she]*    must obtain the approval, in writing, of the holders of    *[all/* *[number, e.g., four-fifths]*       of the outstanding shares of the Corporation:

1. Execution of any contract that will cost the Corporation more than \$    *[amount]*   .
2. Employment of officers;
3. Contracting with outside professionals for amounts of more than \$    *[amount]*   ;
4. Agreement to any business affiliation with another individual or entity;
5.    *[Other operations of corporation subject to approval of shareholders]*   .

**G. Shareholder Employment.** The Shareholders will be employees of the Corporations, and will hold the positions of officers of the Corporation, as set forth in Paragraph D of this Article. To remain so employed, each Shareholder must continue to hold shares and must perform the appropriate duties of his or her position according to this Agreement, the Articles of Incorporation, and the Bylaws of the Corporation.

**H. Termination of Employment.** Any Shareholder may be terminated as an officer and as a director of the Corporation by the unanimous vote of the other Shareholders. Grounds for termination are as follows: \_\_ *[list grounds for termination, e.g., a Shareholder voluntarily resigns from his or her position with the Corporation or sells his or her shares in violation of this Agreement]* \_\_. Before any vote on termination of a Shareholder may be taken, he or she must receive \_\_ *[number, e.g., 20 days]* \_\_ notice of the meeting at which the vote will be taken.

**I. Mandatory Share Buy-Out.** A Shareholder who is terminated from employment agrees to sell his or her shares, as provided in the Buy-Sell Agreement of \_\_ *[name of corporation]* \_\_, dated \_\_ *[date]* \_\_, which is attached to this Agreement and incorporated by reference.

**J. Actions Requiring Approval of All Shareholders.** The following actions may not be taken without the written consent of all of the Shareholders of the Corporation: \_\_ *[list actions that require approval of shareholders, e.g., the issuance of shares of the Corporation, and the repeal of this Agreement]* \_\_.

**K. Shareholders' Meetings.** All Shareholders' meetings are waived.

**L. Special Meetings.** Any Shareholder may call a special meeting at any time under Corporations Code §600(d) or the Bylaws of the Corporation.

*Comment:* Any exhibits to be attached to the shareholders' agreement should be labeled and listed at the end of the agreement. These might include separate buy-sell agreements or employment agreements.

§9.40 4. Form: Distributions

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9.40-1 Distributions

ARTICLE II

DISTRIBUTIONS

**A. Annual Income and Loss Calculation.** For each fiscal year, the Corporation's net profits and losses shall be calculated on an accrual basis. The calculation will be performed according to generally accepted principles of accounting.

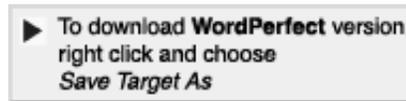
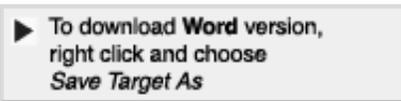
**B. Corporate Retention of Specified Income.** The Corporation shall retain \_\_ *[specify percent]* \_\_ of its net income annually. The Corporation shall also retain any additional amounts that the President reasonably believes necessary to meet the Corporation's current and reasonably anticipated future financial needs.

**C. Distribution of Net Income.** Net income of the Corporation shall be allocated to each Shareholder according to the number of shares he or she owns. The Corporation's net income shall be distributed in this manner: \_\_ *[specify time period, e.g., quarterly or twice yearly]* \_\_.

**Source:** Business Law/Selecting and Forming Business Entities/9 Close Corporations/§9.41 5. Form: Transfer Restrictions

**§9.41 5. Form: Transfer Restrictions**

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9.41-1 Transfer restrictions

**ARTICLE III**

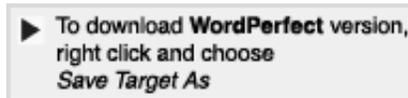
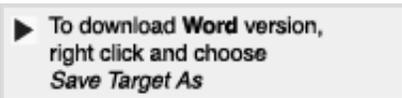
**LIMITATIONS ON TRANSFER AND PERMITTED TRANSFERS**

**A. *Transfer Restrictions.*** No Shareholder shall transfer, sell, assign, hypothecate, encumber, or alienate any of the shares of the Corporation, except as pursuant to the terms of this Agreement and Buy-Sell Agreement of \_\_ *[name of corporation]* \_\_, dated \_\_ *[date]* \_\_, which is attached to this Agreement and incorporated by reference, and the Shareholders agree that any such attempted transaction shall be void and that they shall not recognize it.

**B. *Permitted Transfers.*** Each Shareholder may transfer any or all of his or her shares to a spouse, ancestors, children, or grandchildren (whether natural or adopted) or the spouses of any of such persons, or to any trust established for the benefit of the Shareholder or any of these persons. However, each such permitted transferee must first agree in writing to be subject to the terms of this Agreement.

## §9.42 6. Form: Noncompetition

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9.42-1 Noncompetition

### ARTICLE IV

### NONCOMPETITION

**A. Noncompetition During Employment.** Each Shareholder warrants that, during the time he or she remains a record holder of any of the Corporation's shares, he or she will not:

1. Be employed in any business similar to the Corporation's business, except with the express prior written consent of \_\_ [specify name or title] \_\_;
2. Engage in any employment or activity other than for Corporation in any business in which Corporation is engaged or contemplates engaging;
3. Induce any other employee of or consultant to Corporation to engage in any such employment or activity; or
4. Solicit any clients or potential clients of Corporation for services similar to those performed by Corporation, even if not directly competitive with those services.

**B. Noncompetition After Termination of Employment.** For a period of \_\_ [e.g., 1 year] \_\_ immediately after termination of Shareholder's employment with Corporation, Shareholder will not interfere with Corporation's business by soliciting an employee to leave Corporation's employ, by inducing a consultant to sever the consultant's relationship with Corporation, or by soliciting business from any of Corporation's customers or clients. For these purposes, the Corporation's business is defined as \_\_ [describe corporation's business] \_\_.

**C. Nonsolicitation of Specific Client.** During the term of employment and for a period of \_\_ [e.g., one year] \_\_ immediately after termination of Shareholder's employment with Corporation, Shareholder will not directly solicit \_\_ [insert name of one or a few significant clients of employer] \_\_ for the purpose of \_\_ [insert description of goods or services being provided by employer to named clients] \_\_.

*Comment:* California is one of the minority of states that prohibit postemployment noncompetition covenants except in the limited form of Paragraph B. Business & Professions Code §16600 invalidates contracts by which anyone is restrained from pursuing an entire lawful profession, trade, or business of any kind. However, a provision such as stated in Paragraph C above may preclude an employee from pursuing only a small or limited part of a business, trade, or profession. *General Commercial Packaging, Inc. v TPS Package Eng'g, Inc.* (9th Cir 1997) 126 F3d 1131, 1132. Thus, the statute does not necessarily affect an agreement delimiting how a former employee can compete. For example, Bus & P C §16600 does not invalidate an employee's agreement not to disclose the former employer's confidential customer lists or other trade secrets or not to solicit those customers. *Loral Corp. v Moyes* (1985) 174 CA3d 268, 276, 219 CR 836. In *Gordon v Landau* (1958) 49 C2d 690, 321 P2d 456, the supreme court held that a former employee's right to pursue his or her lawful occupation is not without limitation and enforced a defendant's agreement "not to use plaintiffs' confidential lists to solicit customers for himself for a period of one year following termination of his employment." See *Bourns, Inc. v Raychem Corp.* (9th Cir 2003) 331 F3d 704, 708 (inevitable disclosure doctrine may not be substituted for proving actual or threatened misappropriation of trade secrets by former employee). Thus, a properly drafted provision may preclude an employee from soliciting business from a specifically named client. See *General Commercial*

*Packaging, Inc. v TPS Package Eng'g, Inc., supra*. However, a contract providing that a client would not hire any employee of a consulting firm for 12 months after the contract's termination was unenforceable against a former employee of the consulting firm who had not performed any work for the client and who had not been employed by the consulting firm when the client's contract was performed. *VL Sys., Inc. v Unisen, Inc.* (2007) 152 CA4th 708, 61 CR3d 818 (although contracts precluding former employee from obtaining employment with competitors are generally invalid, reasonably limited restrictions that tend more to promote than restrain trade and business are permissible).

Courts will ordinarily uphold reasonable noninterference clauses preventing a former employee from raiding the former employer's employees or soliciting the former employer's clients. *Loral Corp. v Moyes, supra; Robinson v Jardine Ins. Brokers Int'l Ltd.* (ND Cal 1994) 856 F Supp 554, 558. Further, California courts may enforce a noncompetition clause in an employment agreement that is governed by another state's laws. See *Jones v Humanscale Corp.* (2005) 130 CA4th 401, 29 CR3d 881 (noncompetition clause in employment agreement of New York company with New York choice of law provision enforced).

**NOTE:** Courts ordinarily lack the authority to save an invalid covenant not to compete by reforming the agreement except when the parties have made a mistake. *Kolani v Gluska* (1998) 64 CA4th 402, 407, 75 CR2d 257.

However, when interpreting a covenant not to compete, courts must construe the covenant to be lawful if possible. CC §§1643, 3541; *Loral Corp. v Moyes, supra*.

## §9.43 7. Form: Trade Secrets

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9.43-1 Trade secrets

### ARTICLE V

#### TRADE SECRETS

**A. Protection of Confidential Information.** Each Shareholder acknowledges that the customer lists, trade secrets, processes, methods, and technical information of the Corporation constitute Confidential Information of the Corporation. In addition, other matters as designated by the \_\_ *[President/written consent of all Shareholders]* \_\_ constitute Confidential Information of the Corporation. Each Shareholder warrants that, at all times \_\_ *[during and after Shareholder's employment/while the Shareholder holds, or has the control of, any shares of the Corporation]* \_\_, or at any later time, Shareholder will keep confidential, not make use of, and not disclose or reveal to any third party any Confidential Information, except in the authorized transaction of the Corporation's business and for the benefit of Company unless the Shareholder first obtains the written consent of each of the other Shareholders. Further, no Shareholder will cause the transmission, removal, or transport of Confidential Information or inventions from the Corporation's principal place of business, or such other place of business specified by Corporation, without the prior written approval of \_\_ *[specify name or title]* \_\_.

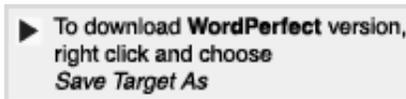
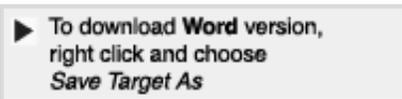
**B. Effect of Disclosure.** Employee acknowledges that the unauthorized use or disclosure of Confidential Information may be highly prejudicial to the interests of the Corporation or its Clients, an invasion of privacy, or an improper disclosure of trade secrets.

*Comment:* A confidentiality agreement will not restrict former employees from voluntarily participating in legitimate investigations into alleged wrongdoing by their former employers. *In re JDS Uniphase Corp. Secs. Litig.* (ND Cal 2002) 238 F Supp 2d 1127, 1135.

**Source:** Business Law/Selecting and Forming Business Entities/9 Close Corporations/§9.44 8. Form: Shares Governed by Agreement

## §9.44 8. Form: Shares Governed by Agreement

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §9.37 and ends in §9.51



9.44-1 Shares governed by agreement

### ARTICLE VI

#### SHARES OF CORPORATION

Each Shareholder owns the number of shares of the Corporation's common stock listed below. These shares comprise all of the issued and outstanding stock of the Corporation. The Shareholders agree that all of the shares listed below and any additional shares in the Corporation that a Shareholder may obtain in the future are governed by this Agreement.

**Name**      **Number of shares**

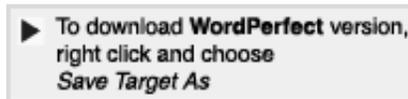
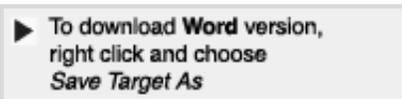
\_\_ *[List each shareholder and number of shares]* \_\_

Each Shareholder has purchased his or her shares from the Corporation for full consideration. Each Shareholder has received certificates representing his or her shares. Each Shareholder is entitled to vote his or her shares held of record and to receive any dividends paid on them until the shares are sold or transferred pursuant to this Agreement.

*Comment:* If the corporation has more than one class of stock, this form should be altered accordingly.

## §9.45 9. Form: Representations and Waivers

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §9.37 and ends in §9.51



9.45-1 Representations and waivers

### ARTICLE VII

#### REPRESENTATIONS, WAIVERS, AND INDEMNIFICATION

**A. Representations.** Each Shareholder acknowledges and represents to the other Shareholders and to the Corporation that:

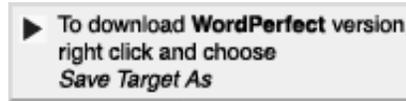
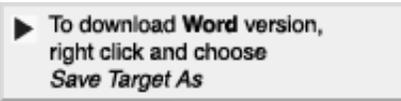
1. He or she has the capacity and authority to enter into this Agreement;
2. Legal counsel for the Corporation specifically advised him or her to seek independent legal counsel to review this Agreement and he or she had sufficient time to do so;
3. He or she understands the contents and effect of this Agreement, which govern the management of the Corporation;
4. He or she understands that the Agreement imposes substantial limitations on subsequent transfers of corporate stock and that these restrictions may limit the market and affect the purchase price;
5. He or she is the record and beneficial owner of the shares referred to in Article VII, and that he or she has not sold, transferred, pledged, or otherwise encumbered those shares, except pursuant to the provisions of this Agreement; and
6. He or she has obtained his or her shares for his or her own account, for investment purposes and not with a view or intention to resell or distribute them, and has no present intention, agreement, or arrangement to divide his or her shareholdings with others or to resell, transfer, or otherwise dispose of all or any part of his or her shares.

**B. Indemnification.** If a Shareholder sells, transfers, or disposes of his or her shares in a manner not in conformity with this Agreement, he or she agrees to indemnify the Corporation and the other Shareholders from any resulting liabilities, costs, and expenses.

**Source:** Business Law/Selecting and Forming Business Entities/9 Close Corporations/§9.46 10. Form: Share Certificate Legend

**§9.46 10. Form: Share Certificate Legend**

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9.46-1 Share certificate legend

**ARTICLE VIII**

**SHARE CERTIFICATE LEGEND**

**Each share certificate of the Corporation shall include this statement conspicuously printed on its face pursuant to Corporations Code §418(c):**

**"This is a close corporation. The number of holders of record of its shares of all classes cannot exceed \_\_[a number not more than 35]\_\_. Any attempted voluntary inter vivos transfer which would violate this requirement is void. Refer to the articles, bylaws, and any agreements on file with the secretary of the corporation for further restrictions."**

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## §9.46A 11. Form: Right of First Refusal

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9.46A-1 Right of first refusal

### ARTICLE IX

#### RIGHT OF FIRST REFUSAL

If any Shareholder (Offeror) wishes to sell or otherwise dispose of his or her shares in the Corporation, the Offeror must first offer to sell all of them to the Corporation. This offer must be in writing and sent by registered mail to the Corporation at its principle place of business and to each other Shareholder. A special meeting of the Shareholders will then be called for a date within    *[specify number, e.g., 30]*    days from the Corporation's receipt of the offer. At the meeting, the Corporation has the option to purchase the Shareholder's shares at the price and on the terms specified in the Buy-Sell Agreement of    *[name of corporation]*   , dated    *[date]*   . If the Corporation refuses to buy the Offeror's shares, then each other Shareholder has the option to purchase them. If more than one Shareholder wishes to purchase the Offeror's shares, then each Shareholder will be permitted to acquire the Offeror's shares in the same proportion of shares that each Shareholder already owns in the Corporation, at the price and on the terms specified in the Buy-Sell Agreement of    *[name of corporation]*   .

**Source:** Business Law/Selecting and Forming Business Entities/9 Close Corporations/§9.46B 12. Form: Purchase of Shares on Shareholder's Death

**§9.46B 12. Form: Purchase of Shares on Shareholder's Death**

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9.46B-1 Purchase of shares on shareholder's death

**ARTICLE X**

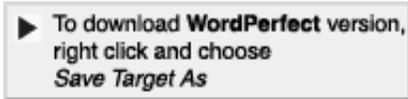
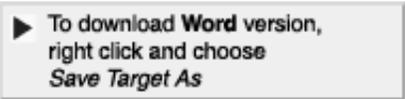
**PURCHASE OF SHARES ON SHAREHOLDER'S DEATH**

***Purchase of Shares on Shareholder's Death.*** The Shareholders agree that the Corporation will purchase all shares of the Corporation held by any Shareholder who dies, at the price and on the terms specified in the Buy-Sell Agreement of \_\_*[name of corporation]*\_\_. The Shareholders intend that each such purchase will be wholly or partially funded by a life insurance policy with respect to each Shareholder.

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§9.47 13. Form: Dissolution

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9.47-1 Dissolution

ARTICLE XI

DISSOLUTION

**A. Voluntary Dissolution.** A voluntary dissolution of the Corporation requires that all Shareholders consent in writing.

**B. Winding Up.** The Corporation will cease to carry on business on commencement of dissolution proceedings, except as necessary to wind up its business and distribute its assets. The President will perform whatever acts are necessary to wind up the affairs of the Corporation.

**C. Distribution of Assets.** On dissolution of the Corporation, the President will apply the assets of the Corporation to debts and liabilities of the Corporation, and then to each Shareholder in proportion to the number of shares of the Corporation he or she holds.

**D. Fair Market Valuation.** Assets distributed in kind will be valued at their fair market value, determined as of the date of the proposed distribution by the President or by an expert hired by the President.

§9.48 14. Form: Arbitration

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9.48-1 Arbitration

**ARTICLE XII**

**ARBITRATION**

**If any dispute arises out of this Agreement, the Shareholders agree that the dispute shall be submitted to binding arbitration, in accordance with Code of Civil Procedure §§1280-1294.2, under the rules of the \_\_[name of arbitration provider]\_\_, in \_\_[county]\_\_. The prevailing party shall be entitled to reasonable attorney fees and costs incurred in enforcing any arbitration award or engaging in any court proceedings.**

*Comment:* A written agreement to submit an existing controversy or one arising thereafter is valid and enforceable. CCP §1281. See *Grafton Partners LP v Superior Court* (2005) 36 C4th 944, 955, 32 CR3d 5 (distinguishing arbitration agreements from predispute jury trial waivers and specifically upholding the former). For further discussion of arbitration, see §1.20.

**Source:** Business Law/Selecting and Forming Business Entities/9 Close Corporations/§9.49 15. Form: Termination of Agreement

## §9.49 15. Form: Termination of Agreement

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9.49-1 Termination of agreement

### ARTICLE XIII

#### TERMINATION OF AGREEMENT

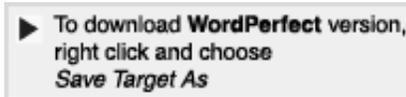
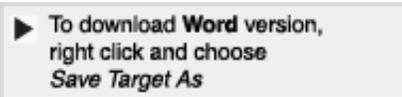
**This Agreement shall continue in effect until all the Shareholders agree in writing to terminate it, or until the Corporation ceases to be a close corporation under Corporations Code §158. The provisions relating to \_\_ [specify, e.g., stock transfer restrictions, noncompetition, and arbitration] \_\_ in sections \_\_ [specify relevant section numbers of Agreement] \_\_ shall remain in effect until they terminate according to their terms or until all the Shareholders execute a written consent to terminate these provisions. Regardless of any original issuance of shares by the Corporation to a new Shareholder who does not become a party to this Agreement, this Agreement will continue to the extent it is enforceable apart from Corporations Code §158.**

*Comment:* A shareholders' agreement terminates when the corporation makes an original issuance of shares to a new shareholder who does not become a party to the agreement unless the agreement provides that it continues to the extent that it is enforceable apart from Corp C §300(b). Corporations Code §300(b) does not apply to an agreement authorized by Corp C §706(a).

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## §9.50 16. Form: Miscellaneous Provisions

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §9.37 and ends in §9.51



9.50-1 Miscellaneous provisions

### ARTICLE XIV

#### MISCELLANEOUS PROVISIONS

**A. Entire Agreement.** This Agreement, including any Exhibits and Schedules attached to it, constitutes the whole and entire agreement of the parties with respect to the subject matter of the Agreement, and it shall not be modified or amended in any respect except by a written instrument executed by all the parties. This Agreement replaces and supersedes all prior written and oral agreements by and among the Shareholders \_\_ [and the Corporation] \_\_. No party to this Agreement shall be bound to the other in any manner by any warranties, representations, or covenants with respect to the subject matter of this Agreement except as specifically set forth in it.

**B. Counterparts.** This Agreement may be executed in one or more counterparts, each of which shall be deemed an original, but all of which together shall constitute one and the same instrument, and shall become effective when there exist copies of this Agreement which, when taken together, bear the authorized signatures of each of the parties to it. Only one such counterpart signed by the party against whom enforceability is sought needs to be produced to evidence the existence of this Agreement.

**C. Governing Law.** This Agreement shall be governed by and construed in accordance with the laws of the State of California. Any action to interpret or enforce this Agreement shall solely be brought in the State of California. To the extent permitted by law, the parties agree that the sole venue for such an action shall be \_\_ [county] \_\_, California. The parties each consent to the jurisdiction of California courts.

**D. Severability.** If any provision of this Agreement is determined by any court of competent jurisdiction or arbitrator to be invalid, illegal, or unenforceable to any extent, that provision shall, if possible, be construed as though more narrowly drawn, if a narrower construction would avoid invalidity, illegality, or unenforceability or, if that is not possible, the provision shall, to the extent of the invalidity, illegality, or unenforceability, be severed, and the remaining provisions of this Agreement shall remain in effect.

**E. Successors and Assigns.** This Agreement shall be binding on and inure to the benefit of the parties and their heirs, legal representatives, successors, and assigns.

**F. Number and Gender.** Whenever used in this Agreement, the singular shall include the plural and the plural shall include the singular, and the neuter gender shall include the male and female as well as a trust, firm, company, or corporation, all as the context and meaning of this Agreement may require.

**G. Further Assurances.** The parties to this Agreement shall promptly execute and deliver any and all additional documents, instruments, notices, and other assurances, and shall do any and all other acts and things, reasonably necessary in connection with the performance of their respective obligations under this Agreement and to carry out the intent of the parties.

**H. Shareholders' Other Business.** Except as provided in this Agreement, no provision of this Agreement shall be construed to limit in any manner the Shareholders in the carrying on of their own respective businesses or activities.

**I. Agent.** Except as provided in this Agreement, no provision of this Agreement shall be construed to

constitute a Shareholder, in the Shareholder's capacity as such, the agent of any other Shareholder.

**J. *Authority to Contract.*** Each Shareholder represents and warrants to the other Shareholders that the Shareholder has the capacity and authority to enter into this Agreement.

**K. *Titles and Headings.*** The article, section, and paragraph titles and headings contained in this Agreement are inserted as matter of convenience and for ease of reference only and shall be disregarded for all other purposes, including the construction or enforcement of this Agreement or any of its provisions.

**L. *Amendment.*** This Agreement may be altered, amended, or repealed only by a writing signed by all of the Shareholders.

**M. *Time of the Essence.*** Time is of the essence of every provision of this Agreement that specifies a time for performance.

**N. *No Third Party Beneficiary Intended.*** This Agreement is made solely for the benefit of the parties to this Agreement and their respective permitted successors and assigns, and no other person or entity shall have or acquire any right by virtue of this Agreement.

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## §9.51 17. Form: Execution and Signatures

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §9.37 and ends in §9.51

▶ To download **Word** version,  
right click and choose  
*Save Target As*

▶ To download **WordPerfect** version,  
right click and choose  
*Save Target As*

9.51-1 Execution and signatures

Executed on \_\_ [date] \_\_, at \_\_ [city] \_\_, \_\_ [county] \_\_, **California.**

### THE SHAREHOLDERS

\_\_ [Signature] \_\_  
\_\_ [Typed name] \_\_  
**Shareholder**

[If corporation is a party to agreement, add the following option]

[Option: Signature block for corporation]

### THE CORPORATION

\_\_ [Name of corporation] \_\_

**By:** \_\_ [Signature] \_\_  
\_\_ [Typed name] \_\_  
**Its: President**

**By:** \_\_ [Signature] \_\_  
\_\_ [Typed name] \_\_  
**Its: Secretary**

*Comment:* Repeat the shareholders' signature block as necessary for additional signatures. This form contains a signature block for the corporation. The corporation must be a party to any shareholders agreement when there is a single shareholder. Corp C §186. See Comment in §9.37.

# 10

## Professional Corporations

**Thomas A. Maier**  
**Elsbeth Delaney-Paul**

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**§10.1 I. SCOPE OF CHAPTER**

This chapter provides an overview of issues that the practitioner must consider in forming a professional corporation. It discusses California law governing these entities (see §§10.2-10.5), considerations in deciding whether to form a professional corporation (see §§10.6-10.15), and formation requirements (see §§10.16-10.20). The chapter includes a chart comparing corporate and noncorporate practice, as well as a comprehensive client questionnaire, and a preincorporation checklist. See §§10.21-10.23. It also includes provisions for use in articles of incorporation for a medical or law professional corporation (see §§10.24-10.32), extensive bylaws provisions (see §§10.33-10.68), selected form provisions for the first meeting of the board of the corporation (see §§10.69-10.75), forms to use in registering a professional corporation (see §§10.76-10.78), a stock purchase agreement (see §§10.79-10.87), and an employment agreement (see §10.89).

## **§10.2 II. DEFINITION AND ELIGIBLE PROFESSIONALS**

A professional corporation is a corporation created under state law to practice a particular profession in corporate form. More specifically, it is a corporation organized under the General Corporation Law (Corp C §§100-2319) to render professional services in a single profession, under a certificate of regulation issued by the government agency regulating the particular profession, that designates itself a professional corporation in its practice. Corp C §13401(b). Certain professional corporations, however, need not obtain a certificate of registration; they are listed in §10.18.

"Professional services" are any type of services that may be rendered pursuant to a license, certification, or registration authorized by the Business and Professions Code, the Chiropractic Act, the Osteopathic Act, or the Yacht and Ship Brokers Act (Harb & N C §§700-740). Corp C §§13401(a), 13401.3.

**NOTE:** A professional law corporation may also be incorporated as a nonprofit public benefit corporation under certain circumstances. See Corp C §13406(b).

The following businesses are among those that may incorporate as professional corporations:

- Accounting (see Bus & P C §§5150-5158);
- Acupuncture (see Bus & P C §§4975-4979);
- Architecture (see Bus & P C §§5610-5610.7);
- Chiropractic (see Bus & P C §§1050-1058);
- Clinical social work (see Bus & P C §§4998-4998.5);
- Dentistry (see Bus & P C §§1701-1701.5, 1800-1808);
- Engineering (see Bus & P C §6738)
- Law (see Bus & P C §§6127.5, 6160-6172);
- Marriage and family therapy (see Bus & P C §§4987.5-4988.2);
- Medicine (see Bus & P C §§2402-2417);
- Naturopathic doctors (see Bus & P C §§3670-3675);
- Nursing (see Bus & P C §§2775-2781);
- Optometry (see Bus & P C §§3160-3167);
- Osteopathy (see Bus & P C §§2402-2417, 3600);
- Pharmacy (see Bus & P C §§4150-4156);
- Physical therapy (see Bus & P C §§2690-2696);
- Physician assistants (see Bus & P C §§3540-3546);
- Podiatry (see Bus & P C §§2402-2417);
- Psychology (see Bus & P C §§2907-2913, 2995-2999);
- Shorthand court reporters (see Bus & P C §§8040-8047);
- Speech-language pathology and audiology (see Bus & P C §§2536-2538); and
- Veterinarians (see Bus & P C §§4910-4915).

### **III. CALIFORNIA LAW GOVERNING PROFESSIONAL CORPORATIONS**

#### **§10.3 A. Forming Professional Corporations**

Professional corporations are governed by the Moscone-Knox Professional Corporation Act (Corp C §§13400-13410). In general, a professional corporation is formed in the same manner as a conventional non-professional corporation and is subject to the same general requirements. The General Corporation Law (Corp C §§100-2319) applies to professional corporations except when its provisions are in conflict with or inconsistent with the Moscone-Knox Professional Corporation Act. Corp C §13403.

Chapter 8 discusses the formation of S and C corporations and contains an extensive group of forms, some of which are relevant to professional corporations.

**Source:** Business Law/Selecting and Forming Business Entities/10 Professional Corporations/§10.4 B. Permissible Business

#### **§10.4 B. Permissible Business**

The purpose clause in the articles of incorporation of a professional corporation must state the particular profession to be practiced by the corporation and that the corporation may practice only that profession. See Corp C §13404. The corporation may engage in another business only if permitted to do so by that profession's governing board. See Corp C §§13401(b), 13404.

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## **§10.5 C. Permissible Shareholders and Directors**

Generally, only a professional licensed to practice the profession of the professional corporation may be a shareholder. Corp C §13401(b), (d). For certain professions, however, other licensed professionals may hold shares, or be officers, directors, or professional employees as long as shares owned by these other licensed professionals do not total more than 49 percent of all shares in the corporation. Corp C §13401.5. For example, in medical corporations, provided other licensed professionals do not hold more than 49 percent of all the shares, all of the following licensed persons may be shareholders, officers, directors, or professional employees (Corp C §13401.5(a)(1)-(10)):

- Doctors of podiatric medicine;
- Psychologists;
- Registered nurses;
- Optometrists;
- Marriage and family therapists;
- Clinical social workers;
- Physician assistants;
- Chiropractors;
- Acupuncturists; and
- Naturopathic doctors.

Corporations Code §13401.5 contains a complete list of licensed persons that may hold shares in any particular professional corporation. The restrictions on who may be a shareholder vary among the professions. Consult the appropriate provisions in the Business and Professions Code and the Corporations Code.

Requirements also vary as to whether a professional may be a shareholder of more than one professional corporation and whether a shareholder of a corporation may be another professional corporation or must be an individual. For example, a medical corporation may be a shareholder in another medical corporation (Bus & P C §2408), but one law corporation may not be a shareholder of another law corporation (Law Corp R IV(A)(2)(a), IV(C)(1)).

The directors of some professional corporations must be licensed professionals. See, e.g., Bus & P C §6165 (law corporation).

A corporation that has only one shareholder need have only one director (who must be that shareholder); that shareholder must also serve as president and treasurer of the corporation. Corp C §13403. The other officers of the corporation in that situation generally need not be licensed persons. Corp C §13403.

A professional corporation that has only two shareholders need have only two directors (who must be those shareholders). The two shareholders must fill the offices of president, vice president, secretary, and treasurer. Corp C §13403.

Because the shareholders of a professional corporation must be licensed professionals, neither the estate of a deceased shareholder nor family members of the deceased may be shareholders. Therefore, a corporation must repurchase the shares of a deceased shareholder within 6 months after the professional's date of death. A corporation must also repurchase the shares of a professional who loses his or her license within 90 days after that event. The corporation's failure to repurchase shares in either instance can result in the suspension or revocation of the corporation's certificate of registration. Corp C §13407. This rule applies even if the corporation is insolvent (in contrast to the rules governing regular corporations; see Corp C §§500-511).

**NOTE:** This 6-month transfer rule has one exception that allows the operation, under certain conditions, of a dental practice for up to 12 months following the death or incapacity of a dentist who was the corporation's sole shareholder. Bus & P C §§1625.3-1625.5; Corp C §13407.

#### **IV. DECIDING WHETHER TO INCORPORATE**

##### **§10.6 A. Nontax Considerations**

The main nontax advantage to professionals operating in corporate form is that, unlike sole proprietors and general partners of a partnership, the shareholders of a professional corporation are not personally liable for the corporation's debts, except certain payroll taxes and malpractice liability arising from the professional shareholder's own negligence. Professionals generally must incorporate to avoid personal liability because limited liability companies (LLCs) may not provide professional services in California. Corp C §17375. Attorneys, accountants, and architects, however, may form limited liability partnerships (LLPs), which have similar limited liability features. Corp C §§16951-16962. See chap 7. In general, partners of California law, accountancy, or architecture LLPs are not vicariously liable for partnership obligations incurred while the firm is an LLP. Corp C §16306. As a result, the limited liability aspect of incorporation carries less significance for eligible law, accountancy, and architecture firms but remains an important consideration for dental and medical professionals.

## **§10.7 1. Limitations on Limited Liability**

There is one key limitation on the limited liability protection conveyed by forming a professional corporation. In particular, professionals may not limit their own malpractice liability by practicing in corporate form. Thus, the personal assets of a practicing shareholder are still subject to the satisfaction of any malpractice obligations arising from his or her work or work that he or she has supervised. An important liability protection for professionals practicing in corporate form is that they may limit their personal liability for the malpractice of their colleagues and for the commercial, general liability, and vendor obligations of their professional corporations. Bus & P C §6160; CC §2343(3).

Attorneys must personally guarantee the malpractice obligations of their professional corporations within prescribed limits. Bus & P C §6171(b); Law Corp R IV(B)(3).

Apart from a professional corporation's malpractice obligations, shareholders may enjoy limited personal liability for the nonprofessional service obligations of their professional corporations, e.g., rent, loans, contracts. Bus & P C §6160. A debtor corporation is not protected by the exemption statutes available to individuals, however. *Canal-Randolph Anaheim, Inc. v J.E. Wilkoski* (1980) 103 CA3d 282, 291, 163 CR 30 (defendant who incorporated was ineligible for protection for statutory personal property exemptions which apply "only to natural persons since the purpose of the statute is to protect an individual debtor and his family, not to bestow exemption benefits on corporations").

Shareholders will be personally liable for any debts or agreements that they personally guarantee. In addition, any person required to collect, truthfully account for, and pay over required federal income tax withholdings and excise taxes who fails to do so, or willfully attempts in any manner to evade or defeat any such tax or payment, is personally liable for a penalty equal to the full amount of that tax. IRC §6672(a). California has a similar provision with respect to California taxes and also imposes criminal penalties in certain circumstances. See Un Ins C §1735; Rev & T C §§19708-19709.

Any applicable ethical rules bearing on practicing in corporate form should also be reviewed before forming a professional corporation. For rules governing attorneys, see Cal Rules of Prof Cond 3-400 and ABA Model Rules of Prof Cond 1.8(h), which provide that an attorney may not attempt to exonerate from or limit liability to a client for personal malpractice. The American Bar Association rule provides that an attorney may not make an agreement prospectively limiting his or her liability to a client for malpractice unless the client is independently represented in making the agreement.

**Source:** Business Law/Selecting and Forming Business Entities/10 Professional Corporations/§10.8 2. Malpractice Insurance Requirement

## **§10.8 2. Malpractice Insurance Requirement**

The following professions must provide malpractice insurance within specified limits. In the absence of malpractice insurance, the shareholders of the corporation are jointly and severally liable for the corporation's malpractice liabilities within the same limits.

- Accountants (16 Cal Code Regs §75.8);
- Attorneys (Law Corp R IV(B)(1)(c));
- Chiropractors (16 Cal Code Regs §367.8(b));
- Dentists (16 Cal Code Regs §1059);
- Optometrists (16 Cal Code Regs §1547); and
- Naturopaths (16 Cal Code Regs §4266).

The following professions either have corporation rules that do not address shareholder liability or security for claims, or they do not have corporation rules:

- Architects (16 Cal Code Regs Div 2);
- Medical doctors (16 Cal Code Regs Div 13, ch 1, art 13);
- Psychologists (16 Cal Code Regs §§1380-1397.71);
- Physical therapists (16 Cal Code Regs Div 13.2, art 9);
- Speech-language pathologists and audiologists (16 Cal Code Regs Div 13.4, art 9);
- Acupuncturists (16 Cal Code Regs Div 13.7, art 7);
- Physician assistants (16 Cal Code Regs Div 13.8);
- Podiatrists (16 Cal Code Regs Div 13.9);
- Nurses (16 Cal Code Regs Div 14);
- Pharmacists (16 Cal Code Regs Div 17);
- Clinical social workers and marriage, family, and child counselors (16 Cal Code Regs Div 18, art 4.5); and
- Certified court reporters (16 Cal Code Regs Div 24, art 7).

### **§10.9 3. Covenants Not to Compete**

Professional corporations often want their shareholders and employees to agree not to compete with the corporation if they terminate employment. In the context of a professional corporation, that would usually mean agreeing not to practice the relevant profession. That desire may come into conflict with Bus & P C §16600, which, with certain exceptions, generally voids contracts that restrain someone from engaging in a lawful profession, trade, or business of any kind.

An owner of a business entity who sells or disposes of all his or her ownership interest may agree with the buyer to refrain from carrying on a similar business within a specified geographic area in which the entity did business as long as the buyer (or any person deriving title to the goodwill or ownership interest from the buyer) carries on a similar business in that area. Bus & P C §16601. That exception also applies to the sale of substantially all the operating assets and goodwill of a division or subsidiary of the entity. Bus & P C §16601. See *Vacco Indus., Inc. v Van Den Berg* (1992) 5 CA4th 34, 6 CR2d 602. See also *Swenson v File* (1970) 3 C3d 389, 90 CR 580 (accountants); *South Bay Radiology Med. Assocs. v W. M. Asher, Inc.* (1990) 220 CA3d 1074, 269 CR 15 (physicians). Thus, a shareholder in a professional corporation could agree not to compete with the corporation in specified cities or counties if the shareholder sells or disposes of all the shareholder's shares in the corporation.

For such a covenant not to compete to be enforceable, however, the issuance of stock must not be a sham designed to get around the statutory proscription in Bus & P C §16600. For example, a noncompetition agreement with a physician employee of a medical corporation was ruled unenforceable because his 9-percent stock ownership interest was purchased for only \$10,000 and he was earning substantially more than that amount, such that the purchase of the shares could not be deemed to include a component for goodwill. *Bosley Med. Group v Abramson* (1984) 161 CA3d 284, 207 CR 477.

Note also that the rules of conduct of particular professions may also limit the use of covenants not to compete. California Rule of Professional Conduct 1-500 provides that an agreement restricting the right of an attorney to practice law can be made part of an employment, shareholder, or partnership agreement, but only if the restrictive agreement does not survive the termination of the employment, shareholder, or partnership relationship. On the other hand, in *Howard v Babcock* (1993) 6 C4th 409, 25 CR2d 80, the court held that a partnership agreement for a law firm that contained a noncompetition clause was enforceable if the terms of the agreement were reasonable. The court stated that Cal Rules of Prof Cond 1-500 was not intended to prohibit a reasonable noncompetition agreement. The court came to this conclusion despite the fact that the partner did not retire from the practice of law and the partnership agreement survived the partnership relationship.

For further discussion of covenants not to compete, see California Business Litigation, chap 3 (Cal CEB 2002).

## **B. Tax Considerations**

### **1. Tax Advantages**

#### **§10.10 a. Deductions for Retirement Benefits and Fringe Benefits**

One of the primary advantages for incorporated professionals is in the treatment of retirement benefits and fringe benefits. Practitioners should be aware, however, that there has been significant convergence in the treatment of corporate and non-corporate retirement benefits in recent years. While retirement and fringe benefit arrangements for a corporation still offer some advantages over similar arrangements for a partnership or sole proprietorship, the corporate advantages are no longer as pronounced as they once were.

A corporation can generally deduct compensation paid to its employees as a business expense. See IRC §162(a)(1); Rev & T C §24343(a). A professional corporation may deduct contributions to a qualified retirement plan trust, subject to the qualified plan or other benefit plan limits, based on the total reasonable compensation it pays its employees. See IRC §404. The source of the funds used to make the contributions is irrelevant; the funds can arise from activities other than the provision of professional services. Most governing boards allow the professional corporation to earn investment income and receive some unrelated business income, although those kinds of income must be significantly secondary to income earned from the practiced profession. Self-employed persons are limited in their contributions to a plan because such contributions may be made only on the earned income received from the trade or business for which the plan was established. IRC §401(d); Rev Rul 68-176, 1968-1 Cum Bull 168.

The adoption of a qualified benefit plan enables the corporation to pay money to a plan trust for the employee's benefit and receive a deduction for the amount paid to the plan trust. Yet, because the money is paid to a qualified plan trust, the employee's recognition of the income for tax purposes is generally delayed until the trust distributes the money to the employee. See IRC §401(a). Additionally, a corporation may take an income tax deduction for the payment of health insurance premiums and certain other fringe and welfare benefits and the payment will not be treated as compensation to the employee. Although health insurance premiums for self-employed individuals are also fully deductible, the fringe benefits arrangements available to a corporation are broader and easier to operate. See IRC §§105-106, 125-127, 132, 162(I).

A corporate employer can establish plans that are not tax exempt or qualified under IRC §401(a) but which compensate an employee with a promise of future payment. These plans are generically referred to as nonqualified plans and most frequently are set up as "Top Hat Plans." They provide deferred compensation for a "select group of management or highly compensated employees" and are not subject to many of the provisions of the Employee Retirement Income Security Act of 1974 (ERISA) (29 USC §§1001-1461). See 29 USC §§1051(2), 1081(a)(3), 1101(a)(1). The corporation receives a deduction and the employees recognize income at the point in time when the amount is distributed to the employee. The funds in this sort of plan are generally subject to the creditors of the business but not to the creditors of the employee.

**PRACTICE TIP:** Any such nonqualified deferred compensation plan must be carefully designed to comply with the requirements of IRC §409A. Tax sanctions may be imposed on nonqualified deferred compensation that does not meet the §409A timing and deferral restrictions. See IRC §409A.

## **§10.11      b. Retirement Plans as Shield for Assets**

In addition to minimizing taxation, retirement plans can prove useful in shielding assets from creditors. Qualified plan assets (assets held in the trust of a IRC §401(a) plan) are held in the name of and for the benefit of an employee. They are exempt from creditor claims in bankruptcy proceedings of either the business or the employee. *Patterson v Shumate* (1992) 504 US 753, 119 L Ed 2d 519, 112 S Ct 2242; *Arkison v UPS Thrift Plan (In re Rueter)* (9th Cir 1993) 11 F3d 850. The plans covered in this rule are, generally, money purchase plans, profit sharing plans (including §401(k) plans), and pension plans that have trusts established by the employer to hold the assets contributed for employees by the employer. The Internal Revenue Code requires all §401(a) plans to prohibit the assignment and alienation of the assets for any purpose other than to pay retirement benefits upon the terms allowed by the plan. See IRC §401(a)(13). This means a plan participant cannot use or receive the assets and generally has no control over the assets while the assets are in the plan. The right to direct investment is not defined as control of the assets for this purpose. Creditors can not garnish or attach assets held by these plans.

The Bankruptcy Abuse Prevention and Consumer Act of 2005 (BAPCPA) (Pub L 109-8, 119 Stat 23) helped to clarify the application of federal bankruptcy law to retirement plans. The BAPCPA extends federal bankruptcy protection to any §401(a) plan, as well as IRC §403(b) plans (annuity plans of some tax exempt charities/schools) and IRC §457(b) plans (non-top hat, non-qualified plans). 11 USC §522(b)(3)(C). The Bankruptcy Code excludes \$1,095,000 of assets held in a self-funded traditional IRA or a Roth IRA from a bankrupt's estate (with this exclusion amount subject to periodic adjustment). 11 USC §522(n). But these protections apply to federal bankruptcy proceedings and are not necessarily complete.

Protection from state law attachment and garnishment is dependent on the relevant state case and statutory law. For California plan sponsors and participants, all §401(a) qualified plans (including §401(k) plans) and many other retirement savings vehicles constitute "private retirement plans" and are therefore exempt from creditors. See CCP §704.115. See also *McMullen v Haycock* (2007) 147 CA4th 753, 54 CR3d 660 (IRA funds, generally only partially exempt from creditors, entitled to full exemption under §704.115 when traced entirely to rollover from exempt private retirement plan). An owner-only plan which covers no employees except the owner may still be a "private retirement plan" exempt from creditor's claims. *In re Watson* (Bankr D Nev 1996) 192 BR 238, 243, aff'd (9th Cir 1998) 161 F3d 593; *In re Witwer* (Bankr CD Cal 1992) 148 BR 930, 939, aff'd (9th Cir 1994) 163 BR 614 (unpublished opinion). This is true even if a participant directs the investment of his or her plan assets. *Schwartzman v Wilshinsky* (1996) 50 CA4th 619, 57 CR2d 790.

For other retirement plan advantages of professional corporations, see *Organizing Corporations in California*, chap 6 (3d ed Cal CEB 2001).

## **§10.12 2. Other Tax Advantages**

Other tax advantages for professional corporations, not directly associated with the adoption of retirement plans, include the following:

- It may be possible to choose a taxable year other than the calendar year, although the choice may not be available to a professional corporation treated as a personal service corporation. IRC §441(i).
- A corporation may take as a deduction 70 percent of dividends received from other domestic corporations. IRC §243(a). No such deduction is available to self-employed individuals or partnerships.
- A professional corporation can redeem the stock of a deceased shareholder up to the amount of estate taxes and certain other expenses with the proceeds being taxed as capital gain. The deceased shareholder's estate may offset the gain with its basis in the stock. This basis is often stepped-up on the shareholder's death so that little or no gain is recognized. In other circumstances, the redemption of a professional's interest in an entity may be taxed as ordinary dividend income rather than capital gain. See IRC §303. The professional corporation may redeem the stock using proceeds from a life insurance policy on the deceased shareholder even if the corporation does not have surplus earnings or is insolvent.
- An individual may not make loans to himself or herself, but a corporation may loan funds to its shareholder-employee. Sometimes those loans may be interest free if the requirements of IRC §7872 are met. The individual may then make temporary use of funds without immediate income tax consequences.
- An employee may exclude from gross income up to \$230 per month (in 2010) for "qualified parking" or for public transit. IRC §132(f)(2); Rev Proc 2009-50, 2009-45 Int Rev Bull 617. (The exclusion ceiling for public transit has been increased temporarily, during the period from February 17, 2009 through January 1, 2011, to equal the exclusion ceiling for qualified parking.) This exclusion does not apply to self-employed individuals, partners in a partnership, or 2 percent shareholders of S corporations. IRC §§132(f)(5)(E), 1372.
- The premiums for disability insurance policies for professionals may be fully deductible. See IRC §162(l).

A comparison of the tax advantages and disadvantages of professional corporations and sole proprietorships or partnerships is summarized in the chart in §10.21.

### **§10.13 3. Tax Disadvantages**

Perhaps the most significant disadvantage of a professional corporation (that does not make an S corporation election) is that it will probably be treated as a "personal service corporation" under one or more of the definitions in the Internal Revenue Code, which will result in the corporation's being taxed at a flat 35-percent rate rather than graduated rates. See IRC §11(b)(2).

Many professional corporations try to "zero out" taxable income to avoid the corporate level tax. The difficulty of determining income as of the end of the taxable year is a major reason large professional groups do not incorporate. Not only is it difficult to "zero out" taxable income each year because many expenses are nondeductible, it is difficult to accurately calculate the corporation's taxable income on or near the last day of the taxable year, the day on which a corporation typically writes shareholder bonus checks. In a partnership, on the other hand, there is no entity level tax and the taxable income flows through to the partners automatically. IRC §§701-702.

Further, a corporation cannot deduct "unreasonable compensation" for income tax purposes. See *Klamath Med. Serv. Bureau* (1957) 29 TC 339, aff'd (9th Cir 1958) 261 F2d 842, cert denied (1959) 359 US 966; *Eduardo Catalano, Inc.*, TC Memo 1979-183. Thus, distributions made to a shareholder that are determined to be unreasonable compensation will be taxed as a dividend, subjecting the distributions to tax at both the corporate and the shareholder level, unless the corporation elects S corporation status. See §10.14.

The Internal Revenue Code defines a "personal service corporation" as one for which substantially all the activities involve the performance of services in the fields of health, law, engineering, architecture, accounting, or consulting and all the stock of which is directly or indirectly held through one or more partnerships, S corporations, or qualified personal service corporations by employees performing services for the corporation in connection with activities in one of the mentioned fields. IRC §448(d)(2). If a corporation is a personal service corporation under a similar definition in IRC §269A(b)(1), the corporation may not choose a taxable year other than the calendar year, except in limited circumstances. See IRC §§441(i), 444; Treas Reg §§1.441-1(b)(2)(B), 1.441-3. Internal Revenue Code §269A gives the IRS the power to allocate income between certain personal service corporations and their shareholders. To use this power, the IRS must show that (IRC §269A(a)):

- Substantially all of the services of the corporation are performed for or on behalf of one other corporation, partnership, or other entity, and
- The principal purpose for forming the corporation was to avoid or evade federal income tax by reducing the income of, or securing the benefit of, any expense, deduction, credit, exclusion, or other allowance for an owner-employee that would not otherwise be available.

Other restrictions on personal service corporations are found in IRC §§263A(h)(3)(D), 414(m)(3), 469(j)(2), 535(c)(2)(B), 1202(e)(3)(A).

**Source:** Business Law/Selecting and Forming Business Entities/10 Professional Corporations/§10.14 4. Tax Ramifications of S Corporation Election

#### **§10.14 4. Tax Ramifications of S Corporation Election**

A professional corporation may elect S corporation status. See §§2.27-2.30, 8.5. As noted in §10.13, an S corporation election will prevent the professional corporation from being treated as a personal service corporation. With regard to fringe benefits, S corporations are treated as partnerships, with all shareholders holding more than 2 percent of the corporation's stock being treated as partners of a partnership. IRC §1372(a)(2). Thus, a professional choosing S corporation status typically remains self-employed for purposes of fringe benefit treatment. Generally, S corporations may establish retirement plans for their employees, including those who are also shareholders. See *Durando v U.S.* (9th Cir 1995) 70 F3d 548. However, an S corporation election may preclude retirement plan loans to shareholders who own 50 percent or more of the corporate stock. IRC §4975(f)(6). S corporations, like personal service corporations and partnerships, are also limited in their choice of a taxable year. See IRC §444.

Under California tax rules, S corporations are generally treated as "flow-through" entities for income tax purposes, but they must still pay a reduced rate of California tax on corporate income. For 2010, the rate is 1.5 percent. See Rev & T C §§23151, 23501, 23802(b)(1). The existence of this tax will compel many shareholders of California S corporations to seek to zero out taxable income even after electing S status.

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**§10.15      5. State Taxation**

The California state income tax and unemployment tax treatment of a professional corporation is the same as for a corporation formed under the General Corporation Law (Corp C §§100-2319). Rev & T C §23038(b); Lab C §3300.

Professional corporations must pay the Franchise Tax Board the \$800 minimum tax regardless of whether the corporation has taxable income. Rev & T C §23153(d)(1). The minimum tax is waived for the first year of incorporation. Rev & T C §23153(f)(1).

## **V. FORMATION REQUIREMENTS**

### **§10.16 A. Name of Professional Corporation**

Typically, unless a professional corporation has obtained an appropriate fictitious name permit, the corporation must bear the surname of one or more of the present, past, or prospective shareholders. See, *e.g.*, Bus & P C §§1804, 2285. A professional corporation may adopt any name permitted by law expressly applicable to the profession in which the corporation is engaged. Corp C §13409. Under all circumstances, the name must include the words "professional corporation," "law/medical/dental corporation" (as appropriate), "corporation," "incorporated," or an abbreviated form of one these terms. Corp C §13409. See, *e.g.*, Bus & P C §§1804, 2415, 6171; 16 Cal Code Regs §1344; Law Corp R IV(A)(5). The requirements for a medical corporation to obtain a fictitious-name permit are set forth in Bus & P C §2415.

For more detailed discussion of selecting a name for the professional corporation, see §3.24. On procedures for conducting a search to check for name conflicts, see §§3.30-3.32.

**Source:** Business Law/Selecting and Forming Business Entities/10 Professional Corporations/§10.17 B. Articles of Incorporation

## **§10.17 B. Articles of Incorporation**

The articles of incorporation of a professional corporation are similar to those of a corporation formed under the General Corporation Law. The primary differences are in the purpose clause (see form in §10.26) and the shareholder restrictions (see form in §10.28). There are six minimum requirements for articles of incorporation for a professional corporation (see Corp C §§200(b), 202, 13404):

- (1) The name of the corporation;
- (2) A statement of the purpose of the corporation, in the exact language specified in Corp C §202(b) and an additional statement that the corporation is a professional corporation within the meaning of the Moscone-Knox Professional Corporation Act (Corp C §§13400-13410);
- (3) The name and address of the agent for service of process;
- (4) If the corporation is authorized to issue one class of shares, the total number of shares;
- (5) If the corporation is authorized to issue more than one series or class of shares, the total number authorized, the designation of each series or class, and rights and restrictions of each series or class; and
- (6) The signatures and acknowledgments of the initial directors, if they are named in the articles, or, if not, the signatures of the incorporators.

For more on the required contents of the articles of incorporation, see §8.14.

The professional corporation is considered formed on the date when the Secretary of State files its articles of incorporation. Corp C §110.

For sample articles of incorporation, see §§10.24-10.32.

**Source:** Business Law/Selecting and Forming Business Entities/10 Professional Corporations/§10.18 C. Registration With Licensing Boards

### **§10.18 C. Registration With Licensing Boards**

Law corporations are required to obtain certificates of registration from the State Bar of California. See Corp C §§13401(b), 13404; Bus & P C §6161; Law Corp R III. Other professionals, except those specifically exempt, must also comply with registration requirements, including payment of a fee. For registration forms, see §§10.76-10.78.

Professional corporations rendering professional services by persons licensed by the following are exempt from the registration requirements (Corp C §13401(b)):

- The Medical Board of California
- The Osteopathic Medical Board of California;
- The Dental Board of California;
- The California State Board of Pharmacy;
- The Veterinary Medical Board;
- The California Architects Board;
- The Court Reporters Board of California;
- The Board of Behavioral Sciences;
- The Speech-Language Pathology and Audiology Board;
- The Board of Registered Nursing; or
- The State Board of Optometry.

**Source:** Business Law/Selecting and Forming Business Entities/10 Professional Corporations/§10.19 D. Bylaws

**§10.19 D. Bylaws**

The bylaws of a professional corporation serve the same purpose as those of an ordinary corporation with additional or substituted clauses that relate to its professional nature. For sample bylaws, see §§10.33-10.68. See also §§8.59-8.104. On general bylaw provisions, see Organizing Corporations in California, chap 2 (3d ed Cal CEB 2001).

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**§10.20 E. Other Filings**

Because a professional corporation is a separate entity for tax purposes, it must obtain a federal employer identification number (FEIN) before it may open bank accounts and file tax returns. The practitioner may obtain an FEIN for a professional corporation by completing and filing IRS Form SS-4 (Application for Employer Identification Number) with the IRS. For a form of SS-4, see §2.207; For a discussion of completing and filing an SS-4, see §2.200.

A California employer identification number must also be obtained from the California Employment Development Department. See §§2.201, 2.208.

Professional corporations are generally exempt from federal securities laws as an intrastate business or a private placement and are expressly exempt from California securities laws. 10 Cal Code Regs §260.105.6. However, a professional corporation with shareholders that are not residents of California should ensure that any private placement complies with applicable exemptions to federal securities law other than the intrastate exemption and confirm that the offering also complies with any exemptions available in the state where the out-of-state shareholder resides. See Financing and Protecting California Businesses, chap 6 (Cal CEB 2006).

**Source:** Business Law/Selecting and Forming Business Entities/10 Professional Corporations/ VI. CHARTS AND CHECKLISTS/§10.21 A. Chart: Comparison of Corporate Practice With Sole Proprietor or Partnership Practice

## VI. CHARTS AND CHECKLISTS

### §10.21 A. Chart: Comparison of Corporate Practice With Sole Proprietor or Partnership Practice

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<i>Practice</i>	<i>Corporate Shareholder/ Employer</i>	<i>Sole Proprietor or Partner</i>
Retirement plan contribution limited to earnings from business for which plan was established	No	Yes
Additional limitation on deducting retirement plan contributions used to purchase insurance	No	Yes
Possible net operating loss from plan contributions	Yes	No
Entitled to qualified group term life insurance plan participation	Yes	No
Entitled to \$5000 qualified death benefit	Yes	No, but similar amount available from qualified retirement plan
70-percent dividend received deduction available	Yes	No
Clear separation of personal and business expenses	Yes	No
IRC §303 stock redemption treatment available	Yes	No
Unlimited malpractice liability	No	Yes (No for limited liability partnership)
Unreasonable compensation problem	Yes	No
IRS may, under some circumstances, disregard corporate entity for tax purposes	Yes	Not applicable
May be subject to double taxation	Yes	No
Subject to tax on unreasonable accumulation of earnings and profits	Yes	No
May be subject to personal holding company tax	Yes	No
Must pay Federal Unemployment Tax Act (IRC §§3301-3311) taxes	Yes	No
Must pay California unemployment taxes and workers' compensation premiums	Generally	No
Must pay minimum California franchise tax annually	Yes	No (Yes for limited liability partnership)
May be subject to income bunching on incorporation	Yes	No
Higher tax cost of liquidation	Yes	No
Must pay social security taxes	Yes	Yes

Net operating loss limitations	Yes	No
Passive activity loss limitations	Yes	No
May be subject to additional reporting rules	Yes	Yes
Alternative minimum tax on buy-sell agreements funded by corporate-owned life insurance	Yes	Not applicable
Can zero out taxable income	Yes, but difficult	Yes
S corporation election	Yes	Not applicable
Higher legal and accounting costs	Yes	No (Some additional costs for limited liability partnerships)
Professional employees must respect financial separateness of corporation	Yes	No (Yes for limited liability partnership)
Must comply with California Moscone-Knox Professional Corporation Act (Corp C §§13400-13410)	Yes	No
Must maintain corporate formalities, e.g., hold annual meetings	Yes	No
Must file annual/semi-annual statements with Secretary of State	Yes	No (Yes for limited liability partnership)

§10.22 B. Checklist: Client Questionnaire

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This questionnaire is designed to be used during the initial interview to gather facts needed to make the tax, economic, and legal decisions that are necessary when forming professional corporations.

**Organization Questionnaire**

1. Introductory information

Date \_\_\_\_\_

Interviewed by \_\_\_\_\_

File No. \_\_\_\_\_

Names of clients interviewed	Business address	Phone
_____	_____	_____
_____	_____	_____
_____	_____	_____
_____	_____	_____
_____	_____	_____

Reason(s) why client is considering incorporation (e.g., anticipated tax advantages, other businesses)  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

2. Present organizational information

a. General

(1) Name of organization \_\_\_\_\_

Address (principal office) \_\_\_\_\_  
\_\_\_\_\_

Phone \_\_\_\_\_

Addresses & phone numbers (other offices)  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

(2) Profession \_\_\_\_\_

(a) Specialties \_\_\_\_\_

(b) Other business engaged in \_\_\_\_\_

(3) Form of practice (e.g., partnership, business trust, sole practice). Obtain documents.

\_\_\_\_\_  
\_\_\_\_\_

\_\_\_\_\_

(4) Contractual arrangements with other organizations (e.g., clinics, hospitals). Obtain documents.

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

(5) Contractual arrangements with clients (e.g., personal service contracts). Obtain documents.

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

(6) Insurance policies (e.g., liability, errors and omissions, automobile). Obtain documents.

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

b. Personnel

(1) Professional

Name	Age	Years with organization	Status (e.g., partner, associate, employee). Length of association with firm; estimated partnership date.
_____	_____	_____	_____
_____	_____	_____	_____
_____	_____	_____	_____

Employment arrangement (e.g., contract, partnership agreement, none).  
Salary and bonus or professional income  
Estimated retirement age

Obtain documents

	Last year	Current year (projection)	
_____	_____	_____	_____
_____	_____	_____	_____
_____	_____	_____	_____

(2) Nonprofessional

Name	Age	Years with organization	Title of position
_____	_____	_____	_____
_____	_____	_____	_____
_____	_____	_____	_____

Salary and bonus		Estimated retirement age
Last year	Current year (projection)	
_____	_____	_____
_____	_____	_____
_____	_____	_____

_____	_____	_____
_____	_____	_____

(3) Personnel turnover

	Hired	
	Last year	Year before last
Professional	_____	_____
Nonprofessional	_____	_____

	Dismissed	
	Last year	Year before last
Professional	_____	_____
Nonprofessional	_____	_____

	Resigned	
	Last year	Year before last
Professional	_____	_____
Nonprofessional	_____	_____

c. Financial

(1) Financial statements and budgets

Obtain financial statements (e.g., balance sheets, profit and loss statements) and tax return budgets for last 2 years. If accounts receivable and work in process are not reflected in these statements, secure these figures.

(2) Income

(a) Total income of organization	Last year	Current year (projection)
	_____	_____

(b) Has there been substantial fluctuation in the organization's income in the past 5 years? Give details.

\_\_\_\_\_

\_\_\_\_\_

(c) Do you anticipate substantial fluctuation in income in the next 5 years? Give details.

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

(3) Expenses

(a) Total salaries and bonuses	Last year	Current year (projection)
	_____	_____

(b) Employee benefits (list specific types, e.g., HR-10 retirement plans, health insurance).	_____	_____
Obtain documents	_____	_____

(c) Taxes:	State	Income	_____	_____
		Property	_____	_____
		Sales	_____	_____
		Other	_____	_____
	Federal	Income	_____	_____
		Property	_____	_____
		Sales	_____	_____
		Other	_____	_____

(d) Insurance

(i) Premium costs (errors and omissions, malpractice, public liability)

Company, policy number, broker, policy limits	Last year	Current year (projection)
_____	_____	_____
_____	_____	_____
_____	_____	_____
Total	_____	_____

(ii) Premium costs (all other insurance)

Company, policy number, broker, policy limits	Last year	Current year (projection)
_____	_____	_____
_____	_____	_____
_____	_____	_____
Total	_____	_____

(e) Other expenses \_\_\_\_\_

(f) Total cost of operation (including all above items) \_\_\_\_\_

(4) Assets

(a) Cash on hand \_\_\_\_\_

(b) List property owned by organization (e.g., real property, buildings, office equipment, furnishings, securities, other investments), indicating estimated value, and approximate equity if property not wholly owned. Obtain all contracts of sale for items not wholly owned.

Item	Estimated actual value	Book value
_____	_____	_____
_____	_____	_____
_____	_____	_____
Deprec. method		Approx. equity
_____		_____

(c) List property leased by organization (e.g., equipment, automobiles) indicating monthly charges.

Item	Monthly Charge	Is lease transferable to corporation?
_____	_____	_____
_____	_____	_____
_____	_____	_____

(d) Estimated value of accounts receivable

\_\_\_\_\_

(e) Estimated value of work in process

\_\_\_\_\_

(5) Liabilities of organization (e.g., loans). Obtain all documents.

Nature	Amount	Due date
_____	_____	_____

3. Corporate organizational data

Check all regulations applicable to the profession to be incorporated

a. Corporate personnel

(1) Directors (see Corp C §13403)

Full name	Prof. lic. number	Name as person will sign	Home address, telephone
_____	_____	_____	_____
Chairman of Bd.	_____	_____	_____
_____	_____	_____	_____
_____	_____	_____	_____

(2) Officers (see Corp C §§312, 13403)

Full name	Prof. lic. number	Name as person will sign	Home address, telephone
_____	_____	_____	_____
President	_____	_____	_____
_____	_____	_____	_____
Vice President	_____	_____	_____
_____	_____	_____	_____
Secretary	_____	_____	_____
_____	_____	_____	_____
Treasurer	_____	_____	_____
_____	_____	_____	_____
Others	_____	_____	_____
_____	_____	_____	_____
_____	_____	_____	_____

(3) Shareholders (see Corp C §13406)

Full name	Prof. lic. number	Name as person will sign	Amount and nature of consideration
_____	_____	_____	_____
_____	_____	_____	_____
_____	_____	_____	_____

(4) Other professional employees of corporation

Name	Prof. lic. number
_____	_____
_____	_____
_____	_____

b. Corporate name, addresses, and real property

(1) Proposed corporate name

\_\_\_\_\_

(2) Alternative names (if selected name not available)

\_\_\_\_\_  
 \_\_\_\_\_  
 \_\_\_\_\_

(3) Address of principal office of corporation

Address	County	Phone
_____	_____	_____
_____	_____	_____

(4) Addresses of corporation's other offices

Address	County	Phone
_____	_____	_____
_____	_____	_____
_____	_____	_____

(5) Location of real property owned or to be owned by corporation

Address	County	Phone
_____	_____	_____
_____	_____	_____
_____	_____	_____

c. Capital structure

(1) Initial equity

Cash \$

\_\_\_\_\_

Property (description)

Value of property

\_\_\_\_\_  
 \_\_\_\_\_

(2) Initial indebtedness

Secured

Unsecured

\_\_\_\_\_

(3) Authorized capital

Total number of shares	Par or stated value of each share	Aggregate par or stated value
_____	_____	_____

(4) Limitations on transfer of shares (including but not limited to transfer to licensed persons or the professional corporation; see Corp C §13407)

\_\_\_\_\_  
\_\_\_\_\_

d. Plan of operation

(1) Do you or any professional personnel to be associated with the corporation plan to practice professionally

(a) In one location in California? \_\_\_\_\_

(b) In more than one location in California? (be specific)

\_\_\_\_\_

(b) In any locations outside California? (be specific)

\_\_\_\_\_

(2) Do you plan to engage in other, nonprofessional businesses in California? (be specific)

\_\_\_\_\_

Outside California? (be specific)

\_\_\_\_\_

e. Administrative data

(1) Name and address of proposed corporation's attorney \_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

(2) Name and address of predecessor's attorney, if different \_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

(3) Name and address of proposed corporation's accountant \_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

(4) Name and address of proposed corporation's bank \_\_\_\_\_

\_\_\_\_\_

Authorized signatures: \_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

(5) Name and address of insurance agent \_\_\_\_\_

\_\_\_\_\_

(6) Dates, times, and place of regular directors' meetings, if any

\_\_\_\_\_

\_\_\_\_\_



professional practice	_____	_____	_____
Income from other sources	_____	_____	_____
Approximate net worth	_____	_____	_____

b.	Expenses	Year before last	Last year	Current year (projection)
(1)	List generally all personal and nonreimbursed expenses, including taxes, except insurance	_____	_____	_____
		_____	_____	_____
		_____	_____	_____
(2)	List specific insurance expenses (e.g., health, disability, life, annuity). See 5 below on professional liability insurance	_____	_____	_____
		_____	_____	_____
		_____	_____	_____

c. Savings

(1)	Amounts	_____	_____	_____
		_____	_____	_____

(2) Have you projected estimated savings beyond one year? If so, give details

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

d. Investments

(1) What type of investment program do you now follow?

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

(2) What type of program do you wish to follow in the future (e.g., growth, income, secured, speculative)?

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

4. Retirement data

a. Estimated age at retirement

\_\_\_\_\_

b. Estimated retirement date

\_\_\_\_\_

c. Required retirement income

\_\_\_\_\_

d. Existing retirement plans (e.g., Social Security, HR-10 plan, IRA, private investment program)

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5. Professional liability insurance

a. Errors and omissions or malpractice policies

Insurer \_\_\_\_\_ Policy limitations \_\_\_\_\_

b. If attorney, will you elect in writing to be personally liable for the professional obligations of the corporation's attorneys?

Yes \_\_\_ No \_\_\_

6. Other

What additional factors (e.g., health problems, disabilities, insurability, military commitment, personal considerations) should be evaluated when considering incorporation in relation to your own situation?

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---

7. Opinions

a. Are you in favor of incorporating your practice? Yes \_\_\_ No \_\_\_

If yes, why? \_\_\_\_\_

---

If not, why not? \_\_\_\_\_

---

b. Do you feel you are in a position to leave some after-tax income in the incorporation? Yes \_\_\_ No \_\_\_

If not, why not? \_\_\_\_\_

---

c. Do you feel you are in a position to have the corporation make contributions on your behalf to a retirement plan? Yes \_\_\_ No \_\_\_

d. Do you prefer a:

Defined benefit pension plan \_\_\_\_\_ ;

Money purchase pension plan \_\_\_\_\_ ;

Profit-sharing plan \_\_\_\_\_ ;

Cash or Deferred Plan? \_\_\_\_\_

## §10.23 C. Checklist: Preincorporation

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This checklist sets forth procedures typically followed in forming a professional corporation. These procedures should not be undertaken until the information requested in the client questionnaire has been obtained and those factors affecting advisability of incorporation have been evaluated. For a form of client questionnaire, see §10.22.

- Select name. Check with Secretary of State on availability of name and reserve it with Secretary of State. See Corp C §201(c). See generally chap 3.
- Obtain approval, if necessary, from appropriate licensing board for use of fictitious business name.
- Prepare articles.
- Prepare bylaws.
- Have incorporator(s) and named first director(s), if any, sign articles. Have signature(s) acknowledged. Corp C §200(b).
- File articles with Secretary of State and request two certified copies. Corp C §§110, 209.
- Order corporate package, including, e.g., seal, stationery.
- Draft contract documents and arrange to assign existing contracts.
- Give required notice of first meeting of board of directors or secure waiver of notice. Corp C §307(a)(3).
- Hold first meeting of board of directors:
  - Elect temporary chairperson and secretary of meeting.
  - Adopt bylaws.
  - Adopt corporate seal.
  - Adopt form of stock certificate.
  - Adopt other resolutions relating to formation of corporations.
  - Adopt resolution to apply for certificate of registration and authorize registration fee, if necessary.
  - Adopt insurance or personal guaranty resolution.
  - Approve contracts and agreements prepared earlier. Note, however, that no contracts may be executed on corporation's behalf until certificate of registration has been issued.
  - Adopt resolutions to open bank accounts and to authorize officers to endorse checks and conduct other bank transactions.
  - Adopt resolutions setting salaries of officers and approving employment contracts with officers or other employees and restrictive stock agreements.
  - Adopt resolution authorizing payment of costs and expenses of organizing the corporation.
  - Adopt resolution designating principal office of corporation.
  - Adopt tax resolutions as required.
- Prepare corporate books and minutes of first meeting.
- Prepare and submit application for certificate of registration (including required data, documents, and registration fee) to appropriate professional board.
- Issue stock with appropriate legend as specified in rules of appropriate board. See, e.g., 16 Cal Code Regs §1060(d); Law Corp R IV(C)(4).

*Comment:* The actions listed above under "Hold first meeting of board of directors" are often taken during several meetings of the board of directors, rather than all at the first meeting. For example, often the only actions taken at the first meeting are the adoption of bylaws and the approval of filing the application for certification with the appropriate professional board. At a second meeting, issuance of stock may be authorized. At a third meeting, employment agreements may be approved. Some items listed (e.g., adoption of tax year, retirement plans) need not take place until several months after the corporation has begun to operate. While these actions may be achieved at a live meeting of the board of directors, they may also be achieved through the unanimous written consent of all directors, provided the number of members of the board serving at the time constitutes a quorum. Corp C §307(b).

For forms of minutes of the first meeting of the board of directors and common resolutions, see §§8.107-8.124.

Note that, until a certificate of registration has been issued by the appropriate board, most professionals may not provide professional services under the corporate structure and no contracts may be executed on the corporation's behalf.

**Source:** Business Law/Selecting and Forming Business Entities/10 Professional Corporations/ VII. FORMS/§10.24 A. Articles of Incorporation for Medical or Law Corporations: Selected Provisions

## **VII. FORMS**

### **§10.24 A. Articles of Incorporation for Medical or Law Corporations: Selected Provisions**

The forms in §§10.25-10.32 comprise articles of incorporation for a professional medical or law corporation. Taken together, they include the minimum contents for articles of incorporations for professional corporations as specified in Corp C §§200(b) and 202. See §10.17. In addition to the required contents, the articles may include optional provisions. See forms in §§8.43-8.57.

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**Source:** Business Law/Selecting and Forming Business Entities/10 Professional Corporations/§10.25 1. Form: Heading; Name of Corporation

**§10.25 1. Form: Heading; Name of Corporation**

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10.25-1 Heading; name

**ARTICLES OF INCORPORATION**

**OF**

\_\_\_\_\_, Inc.,

**A California Professional \_\_[Medical/Law]\_\_ Corporation**

**ARTICLE I**

**NAME OF CORPORATION**

**The name of this corporation is \_\_[full name of corporation]\_\_.**

*Comment:* The name of a law corporation and any other names under which it practices must comply with the California Rules of Professional Conduct. Law Corp R IV(A)(5). See Cal Rules of Prof Cond 1-400, Standards (6)-(7), (9).

Unless a medical corporation uses a fictitious name under Bus & P C §2415, its name must be the name or surname of one or more of the present, prospective, or former shareholders who are physicians for the medical corporation (e.g., Jane Smith, M.D., Inc.). Corp C §13409. If the medical corporation obtains a fictitious name permit, the fictitious name of the corporation must contain words or abbreviations denoting corporate existence, limited as provided in Corp C §13401.5. See also 16 Cal Code Regs §1350.3(c) (regulating fictitious names and group names containing both corporate and noncorporate entities or partnerships of corporations).

**Source:** Business Law/Selecting and Forming Business Entities/10 Professional Corporations/§10.26 2. Form: Purpose; Statement of Professional Corporation

## §10.26 2. Form: Purpose; Statement of Professional Corporation

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §10.25 and ends in §10.32

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10.26-1 Purpose; professional corporation statement

### ARTICLE II

#### PURPOSE OF CORPORATION

**A. Purpose of Corporation.** The purpose of this corporation is to engage in the profession of \_\_[law/medicine]\_\_ and any other lawful activities (other than the banking or trust company business) not prohibited to a corporation engaging in such profession by applicable laws and regulations.

**B. Professional Corporation.** This corporation is a professional corporation within the meaning of Title 1, Division 3, Part 4 of the California Corporations Code.

*Comment:* The articles of incorporation of a professional corporation must contain a statement that the corporation is a professional corporation within the meaning of the appropriate provision of the Corporations Code. Corp C §13404. See also Corp C §202(b)(1)(ii), (b)(4).

**Source:** Business Law/Selecting and Forming Business Entities/10 Professional Corporations/§10.27 3. Form: Number of Shares

### §10.27 3. Form: Number of Shares

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10.27-1 Number of shares

## ARTICLE III

### SHARES OF CORPORATION

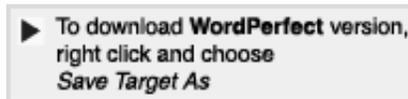
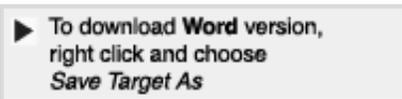
**A. *Number of Shares.*** This corporation is authorized to issue a total of   *[number]*   shares of common stock.

**B. *Authority to Issue Additional Shares.*** The Corporation's Board of Directors shall have the authority to issue additional shares of stock, from time to time, on such terms and conditions, and for such price or prices, as the Board of Directors may determine in its sole discretion.

*Comment:* The total number of shares that the corporation is authorized to issue must be stated. Corp C §202(d). This form assumes that the corporation is authorized to issue only one class of shares. If more than one class is authorized or if a class has more than one series, the wording must be changed accordingly. See Corp C §202(e). See generally chap 8.

## §10.28 4. Form: Shareholder Restrictions

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §10.25 and ends in §10.32



10.28-1 Shareholder restrictions

[Add one of the following alternatives]

[Alternative 1: Shareholder restrictions specific to medical corporation]

**C. Restrictions on Shareholders.** This corporation is subject to the restrictions on the qualifications of shareholders imposed by Corporations Code §§13400-13408 and other applicable laws, rules, and regulations, which provide that only the following may be shareholders of a medical corporation:

1. Holders of a valid physician's or surgeon's certificate issued by the Division of Licensing of the Medical Board of California;

2. Licensed persons as defined by Corporations Code §13401.5(a) as long as the number of shares in the corporation owned by such persons does not exceed 49 percent of the total shares issued by the corporation and the number of such persons owning shares in the corporation does not exceed the number of licensed physicians and surgeons owning shares in the corporation; and

3. Medical corporations with only one shareholder who is a licensed person as defined by Corporations Code §13401.

[If applicable, add the following option to Alternative 1]

[Option: No split ownership of shares]

No share or fractional share of the corporation may be owned by more than one person; nor may more than one person have any beneficial interest in any share or fractional share of this corporation.

[Alternative 2: Shareholder restrictions specific to law corporation]

**C. Restrictions on Shareholders.** The shares of this law corporation may be owned only by:

1. This corporation;

2. An active member of the California State Bar; or

3. A person who is licensed to practice law in the jurisdiction or jurisdictions in which the person practices.

*Comments:* In medical corporations, each shareholder, officer, or director generally must hold a physician's or surgeon's certificate or be a licensed person as defined by Corp C §§13401, 13401.5.

In law corporations, the shares may be owned only by the corporation itself, by an active member of the State Bar, or by a person who is licensed to practice law in the jurisdiction or jurisdictions in which the person practices. Law Corp R IV(C)(1). See also Bus & P C §§6160, 6165; Corp C §§13401-13410.

Under a special rule applicable only to dental corporations, a legal guardian or executor may hold the dentist's shares for a period of up to 12 months (if certain conditions are satisfied) on the incapacity or death of a dentist who is the sole shareholder of the dental corporation. Bus & P C §§1625.3-1625.5; Corp C §13407.

**Source:** Business Law/Selecting and Forming Business Entities/10 Professional Corporations/§10.29 5. Form: Board of Directors

**§10.29 5. Form: Board of Directors**

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §10.25 and ends in §10.32

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10.29-1 Board of directors

**ARTICLE IV**

**BOARD OF DIRECTORS**

***Number of Directors.*** The number of the Corporation's Board of Directors shall be no less than \_\_ *[number]* \_\_ directors and no more than \_\_ *[number]* \_\_ directors.

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**Source:** Business Law/Selecting and Forming Business Entities/10 Professional Corporations/§10.30 6. Form: Agent for Service of Process

## §10.30 6. Form: Agent for Service of Process

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10.30-1 Agent for service

### ARTICLE V

#### AGENT FOR SERVICE OF PROCESS

**The name and address in the State of California of this corporation's initial agent for service of process is:**

\_\_ *[name and address of agent]* \_\_.

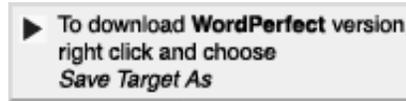
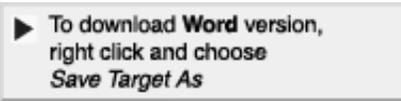
*Comment:* The articles of a professional corporation must designate an agent for service of process who is a natural person residing in California or a corporate agent complying with Corp C §1505. Corp C §202(c).

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**Source:** Business Law/Selecting and Forming Business Entities/10 Professional Corporations/§10.31 7. Form: Limits on Liability; Indemnification

**§10.31 7. Form: Limits on Liability; Indemnification**

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §10.25 and ends in §10.32



10.31-1 Limits on liability; indemnification

**ARTICLE VI**

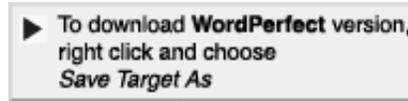
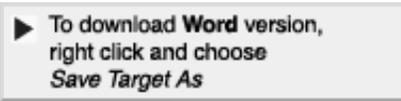
**LIMITS ON LIABILITY AND INDEMNIFICATION**

**A. *Limits on Liability.*** The liability of the directors of this corporation for monetary damages shall be limited to the fullest extent permissible under California law. This corporation is authorized to indemnify the directors and officers of the corporation to the fullest extent permissible under California law.

**B. *Indemnification.*** This corporation is authorized to provide, by bylaws, shareholder agreement, or otherwise, for the indemnification of agents, as defined in Corporations Code §317, in excess of the indemnification expressly permitted by §317 for breach of duty to this corporation and its shareholders, provided, however, that such provision shall not provide for indemnification of any agent for any acts or omissions or transactions from which a director may not be relieved of liability as set forth in the exception to Corporations Code §204(a)(10), or as to circumstances in which indemnity is expressly prohibited by Corporations Code §317.

**§10.32 8. Form: Signature Block**

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10.32-1 Signatures

*[Add one of the following alternatives]*

*[Alternative 1: Signature of individual incorporator(s)]*

\_\_ *[Signature of individual incorporator]* \_\_

\_\_ *[Typed name]* \_\_

**Incorporator**

*[Repeat as necessary]*

*[Alternative 2: Signature of entity incorporator(s)]*

\_\_ *[Name of entity incorporator]* \_\_ ,

**Incorporator**

**By** \_\_ *[Signature of authorized individual]* \_\_

\_\_ *[Typed name]* \_\_

*[Repeat as necessary]*

*[Alternative 3: Signature of initial director(s)]*

\_\_ *[Signature of initial director]* \_\_

\_\_ *[Typed name]* \_\_

**Director**

*[Repeat as necessary]*

**Source:** Business Law/Selecting and Forming Business Entities/10 Professional Corporations/ B. Bylaws Provisions for Medical or Law Corporations/§10.33 1. Form: Heading, Purpose, and Offices

## B. Bylaws Provisions for Medical or Law Corporations

### §10.33 1. Form: Heading, Purpose, and Offices

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10.33-1 Heading

**BYLAWS OF** \_ \_*[NAME OF CORPORATION]*\_ \_

10.33-2 Purpose

#### ARTICLE I

#### PURPOSE AND OFFICES OF CORPORATION

**A. Purpose.** The purpose of this Corporation is to engage in the profession of \_ \_*[medicine/law]*\_ \_ , including contracting or arranging for the provision of \_ \_*[physician/attorney]*\_ \_ services, and any other lawful activities (other than the banking business or trust company business) not prohibited to a corporation engaging in such profession by applicable laws and regulations.

10.33-3 Offices

*[Add one of the following alternatives]*

*[Alternative 1: Board will determine offices]*

**B. Offices.** The Board of Directors of the Corporation (referred to in these Bylaws as the "Board" or the "directors") shall fix, and shall have full power and authority to change, the location of the principal executive office of the Corporation in the State of California.

*[Alternative 2: Address of principal office specified]*

**B. Offices.** The principal executive office of the Corporation is \_ \_*[address]*\_ \_ , California. The Board of Directors of the Corporation (referred to in these Bylaws as the "Board" or the "directors") shall have full power and authority to change the location of the principal executive office of the Corporation in the State of California.

*[Continue]*

**Branch or subordinate offices may at any time be established by direction of the officers at any place or places within or without the State of California.**

*Comment:* On the location of the offices of the corporation, see Organizing Corporations in California, chap 2 (3d ed Cal CEB 2001).

**Source:** Business Law/Selecting and Forming Business Entities/10 Professional Corporations/§10.34 2. Form: Stock in Corporation

## §10.34 2. Form: Stock in Corporation

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10.34-1 Authorized shares and issuance of shares

### ARTICLE II

#### SHARES AND SHAREHOLDERS

**A. Authorized Shares.** The Corporation is authorized to issue \_\_ *[number of classes of common stock]* \_\_ classes of common stock and \_\_ *[number of classes of preferred stock]* \_\_ classes of preferred stock, unless such amounts of authorized shares are increased or otherwise revised pursuant to an amendment of the Corporation's Articles of Incorporation, as approved by the Board of Directors and Shareholders.

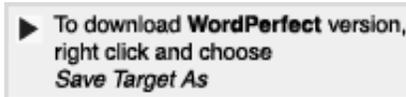
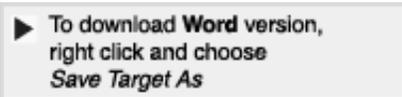
**B. Issuance of Additional Shares.** The Board of Directors shall have the authority to issue additional shares of stock, including non-voting stock as authorized by the Articles of Incorporation of the Corporation, from time to time, on such terms and conditions, and for such price or prices, as the Board of Directors may determine in its sole discretion; provided, however, that shares of stock of Corporation may only be issued to persons who meet the qualifications set forth in \_\_ *[specify article and section where qualifications set forth]* \_\_ of these Bylaws \_\_ *[and who sign and agree to be bound by the terms of the Shareholders' Agreement]* \_\_.

*Comment:* Corporations Code §§400-423 governs the issuance of corporate stock, classes and series of shares, preferences, privileges, and restrictions on shares, and share certificates. See generally §§8.45-8.54.

**Source:** Business Law/Selecting and Forming Business Entities/10 Professional Corporations/§10.35 3. Form: Qualified Shareholders--Medical Corporation

### §10.35 3. Form: Qualified Shareholders—Medical Corporation

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §10.33 and ends in §10.68



10.35-1 Qualified shareholders—medical corporation

**C. Authorized Shareholders.** Shares of the stock of Corporation may be owned only by "licensed persons," as the term is defined in Corporations Code §13401(d) and by such additional persons who are authorized to own shares in a professional corporation by Corporations Code §13401.5, and by persons who qualify as stockholders of professional corporations, as described in Business and Professions Code §§2400-2417, and by 16 California Code of Regulations §§1341.2-1349. Shares may not be owned by a "disqualified person" as defined in Corporations Code §13401(e). A medical corporation that has only one shareholder may be a shareholder of this Corporation.

**Despite any provision to the contrary, income of the corporation attributable to its practice of medicine while a shareholder is a disqualified person as defined by Corporations Code §13401(e) shall not in any manner accrue to the benefit of that shareholder or his or her shares.**

*Comment:* Shares owned by an ineligible shareholder or a licensed person who becomes legally disqualified to render professional services may not be counted for voting or for quorum purposes. See Bus & P C §2408; Corp C §13406-13407; 16 Cal Code Regs §1345.

A medical corporation may not, in general, own stock in another medical corporation; however, a medical corporation that has only one shareholder may hold shares in a medical corporation that renders professional services. See Bus & P C §2408.

The prohibition against receipt of the medical corporation's income by a shareholder-professional while he or she is a disqualified person is found at Bus & P C §2409.

Shares of a professional corporation may be owned, subject to certain restrictions, by a revocable living trust. See Department of Consumer Affairs Legal Opinion 79-5 (Feb. 16, 1979), reprinted in Drafting California Revocable Trusts §19.17 (4th ed Cal CEB 2003).

Under a special rule applicable only to dental corporations, a legal guardian or executor may hold the dentist's shares for a period of up to 12 months (if certain conditions are satisfied) on the incapacity or death of a dentist who is the sole shareholder of the dental corporation. Bus & P C §§1625.3-1625.5; Corp C §13407.

**Source:** Business Law/Selecting and Forming Business Entities/10 Professional Corporations/§10.36 4. Form: Qualified Shareholders--Law Corporation

#### §10.36 4. Form: Qualified Shareholders—Law Corporation

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10.36-1 Qualified shareholders—law corporation

**C. Authorized Shareholders.** Shares of the stock of the Corporation may be owned only by this Corporation, an active member of the State Bar of California, or a person who is licensed to practice law in the jurisdiction or jurisdictions in which the person practices. Shares may not be owned by a "disqualified person" as defined in Corporations Code §13401(e). Shares in this Corporation may only be held by licensed persons.

Despite any provision to the contrary, income of the corporation attributable to its practice of law while a shareholder is a disqualified person as defined by Corporations Code §13401(e) shall not in any manner accrue to the benefit of that shareholder or his or her shares.

*Comment:* Shares owned by an ineligible shareholder or a licensed person who becomes legally disqualified to render professional services may not be counted for voting or for quorum purposes. See Bus & P C §6165; Law Corp R IV(A), (C).

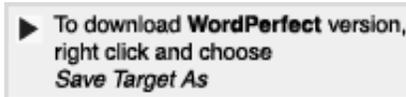
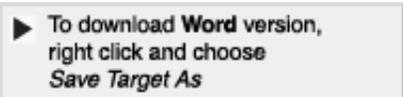
Shares of a professional corporation may be owned, subject to certain restrictions, by a revocable living trust. See Department of Consumer Affairs Legal Opinion 79-5 (Feb. 16, 1979), reprinted in Drafting California Revocable Trusts §19.17 (4th ed Cal CEB 2003).

An attorney may own stock in two different law corporations if the attorney's name is not used in two different law corporations in the same community. See Cal Rules of Prof Cond 1-400(E), standard (9).

The disqualification provision in the last paragraph of this form is required by Law Corp R IV(C)(5), which prohibit the accrual of any income from the practice of law to the benefit of a disqualified shareholder or that shareholder's shares.

**§10.37 5. Form: Voting of Shares**

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §10.33 and ends in §10.68



10.37-1 Voting of shares

**D. *Voting of Shares.*** Unless otherwise specifically provided in the Articles of Incorporation, the holders of the shares in the Corporation shall vote on all actions to be taken, authorized, or approved by shareholders pursuant to law, the Articles of Incorporation, the Bylaws, or the Shareholders' Agreement. Except as otherwise provided by law or the Articles of Incorporation, each outstanding share shall be entitled to one vote on each matter submitted to a vote of the Shareholders.

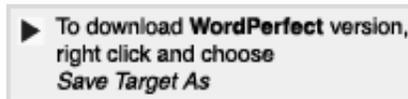
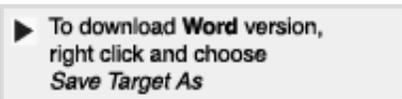
*[If applicable, add the following option]*

*[Option: Bylaws subject to shareholder agreement]*

All provisions in these Bylaws are subject and subordinate to the provisions of the separately executed Shareholders' Agreement ("Shareholders' Agreement"). In the event of any conflict between the provisions of these Bylaws and the Shareholders' Agreement, the provisions of the Shareholders' Agreement shall prevail.

## §10.38 6. Form: Meetings of Shareholders

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §10.33 and ends in §10.68



10.38-1 Shareholder meetings

**E. Meetings of Shareholders.** Meetings of shareholders shall be held either at the principal executive office of the Corporation or at any other place within or without the State of California which may be designated by the Board. In the absence of any such designation, shareholders' meetings shall be held at the principal executive office of the Corporation.

**F. Annual Meetings of Shareholders.** The annual meetings of shareholders shall be held each year on a date to be established by the Board not more than five (5) months after the close of the fiscal accounting period of the Corporation, and within fifteen (15) months after the later of the last annual meeting or the date of organization of this Corporation. At the annual meeting, directors shall be elected, reports of the affairs of the Corporation shall be considered, and any other proper business may be transacted.

**G. Special Meetings of Shareholders.** Special meetings of the shareholders, for any purpose or purposes whatsoever, may be called at any time by the Chairman of the Board, the President or Chief Executive Officer, the Executive Vice President, the Vice President, the Treasurer or Chief Financial Officer, the Secretary, the Board, or shareholders holding not less than      *[specify, e.g., 10]*      percent of the voting powers of the Corporation.

If a special meeting is called by any person or persons other than the Board, the request shall be in writing, specifying the time of the meeting and the general nature of the business proposed to be transacted, and shall be delivered personally or sent by registered mail or by telegraphic or other facsimile transmission to the President or the Secretary of the Corporation. The officer receiving the request shall cause notice to be promptly given to the shareholders, in accordance with the provisions of      *[specify section]*      of these Bylaws, that a meeting will be held at the time requested by the person or persons calling the meeting, not less than thirty-five (35) nor more than sixty (60) days after receipt of the request. If the notice is not given within twenty (20) days after receipt of the request, the person or persons requesting the meeting may give the notice. Nothing contained in this Section G shall be construed as limiting, fixing, or affecting the time when a meeting of shareholders called by action of the Board may be held.

**H. Notice of Shareholder Meetings.** All notices of meetings of shareholders shall be given not less than ten (10), or if sent by third-class mail, not less than thirty (30), nor more than sixty (60) days before the date of the meeting. The notice shall specify the place, date, and hour of the meeting and

1. In the case of a special meeting, the general nature of the business to be transacted, and that no other business may be transacted, or

2. In the case of the annual meeting, those matters which the Board, at the time of giving the notice, intends to present for action by the shareholders (which shall not limit the matters which may properly be presented at the meeting for action).

Notices of meetings at which directors are to be elected shall include a list of the candidates for director developed by the Shareholders.

**I. Action Proposed at Meeting.** If action is proposed to be taken at any meeting for approval of any of the following, the notice of meeting shall also state the general nature of that proposal:

1. A contract or transaction in which a director has a direct or indirect financial interest, pursuant to

Corporations Code §310;

2. An amendment of the Articles of Incorporation, pursuant to Corporations Code §902;

3. A reorganization of the Corporation, pursuant to Corporations Code §1201;

4. A voluntary dissolution of the Corporation, pursuant to Corporations Code §1900; or

5. A distribution in dissolution other than in accordance with the rights for outstanding preferred shares, pursuant to Corporations Code §2007.

**J. Manner of Giving Notice.** Notice of any meeting of shareholders shall be given either personally or by first-class mail or telegraphic or other written communication, charges prepaid, addressed to the shareholder at the address of that shareholder appearing on the books of the Corporation or given by the shareholder to the Corporation for the purpose of notice. If no such address appears on the Corporation's books or is given, notice shall be deemed to have been given if sent to that shareholder at the Corporation's principal executive office, or if published at least once in a newspaper of general circulation in the county where that office is located. Notice shall be deemed to have been given at the time when delivered personally or deposited in the mail or sent by telegram or other means of written communication.

An affidavit of the mailing or other means of giving any notice of any shareholders' meeting may be executed by the Secretary, Assistant Secretary, or any transfer agent of the Corporation giving the notice, and shall be filed and maintained in the minute book of the Corporation.

**K. Required Quorum.** The presence in person or by proxy of the holders of a majority of the shares (of all classes), which holders are eligible to vote at meetings of shareholders on the subject matter for which a vote is required, shall constitute a quorum for the transaction of business. The shareholders present at a duly called or held meeting at which a quorum is present may continue to do business until adjournment, notwithstanding the withdrawal of enough shareholders to leave less than a quorum, if any action taken (other than adjournment) is approved by at least a majority of the shares required to constitute a quorum.

*Comment:* Special meetings of the shareholders may be called by holders of shares entitled to cast at least 10 percent if the votes at the meeting, but this threshold may be increased. Corp C §600(d).

**Source:** Business Law/Selecting and Forming Business Entities/10 Professional Corporations/§10.39 7. Form: Adjournment of Meeting

## §10.39 7. Form: Adjournment of Meeting

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §10.33 and ends in §10.68

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10.39-1 Adjournment

**L. *Adjournment of Meeting.*** Any shareholders' meeting, annual or special, whether or not a quorum is present, may be adjourned from time to time by a vote of the majority of the shares entitled to vote, in person or by proxy, but in the absence of a quorum (except as provided in Section G of this Article VI), no other business may be transacted at such meeting.

It shall not be necessary to give notice of the time, place, or business to be transacted at the adjourned meeting, other than by announcement at the meeting at which such adjournment is taken, unless the meeting is adjourned for more than forty-five (45) days or a new record date for the adjourned meeting is fixed, in which case notice of the adjourned meeting shall be given as in the case of the original meeting. Any business may be transacted at the adjourned meeting which might have been transacted at the original meeting.

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**Source:** Business Law/Selecting and Forming Business Entities/10 Professional Corporations/§10.40 8. Form: Voting at Meeting

## §10.40 8. Form: Voting at Meeting

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10.40-1 Voting at meeting

**M. *Voting at Meeting.*** The shareholders entitled to vote at any meeting of shareholders shall be determined in accordance with this Article and the Shareholders' Agreement, subject to the provisions of Corporations Code §§702-704. The shareholders' vote may be by voice vote or by ballot, except that if any shareholder so demands before the voting begins, any election for directors must be by ballot. If a quorum is present, the affirmative vote of a majority of shares entitled to vote, shall be the act of the shareholders, unless the vote of a greater number is required by the Code, the Articles of Incorporation, the Shareholders' Agreement or any provision of these Bylaws.

On any matter other than the election of directors, any shareholder may vote part of the shares in favor of the proposal and refrain from voting the remaining shares or vote them against the proposal, but, if the shareholder fails to specify the number of shares such shareholder is voting affirmatively, it will be conclusively presumed that the shareholders' approving vote is with respect to all shares such shareholder is entitled to vote.

**Source:** Business Law/Selecting and Forming Business Entities/10 Professional Corporations/§10.41 9. Form: Determining Shareholders of Record

## §10.41 9. Form: Determining Shareholders of Record

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10.41-1 Shareholders of record

**N. *Shareholders of Record.*** For purposes of determining the shareholders entitled to notice of any meeting or to vote or entitled to give consent to corporate action without a meeting, the Board may fix, in advance, a record date, which shall not be more than sixty (60) days nor less than ten (10) days before the date of any such action without a meeting, and in this event only shareholders of record on the date so fixed are entitled to notice and to vote or to give consents, as the case may be, notwithstanding any transfer of any shares on the books of the Corporation after the record date.

If the Board does not so fix a record date, the record date shall be determined in accordance with Corporations Code §701.

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**Source:** Business Law/Selecting and Forming Business Entities/10 Professional Corporations/§10.42 10. Form: Voting Trusts and Proxies

## §10.42 10. Form: Voting Trusts and Proxies

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10.42-1 Voting trusts and proxies

**O. Voting Trusts and Proxies.** Every person entitled to vote may do so either in person or by one or more persons authorized by a written proxy executed (manually or otherwise) by the person (or his or her duly authorized agent) and filed with the Secretary of the Corporation.

A proxy shall not be valid after the expiration of eleven (11) months from the date of its execution unless otherwise provided in the proxy. Any proxy duly executed is not revoked and continues in full force and effect until revoked prior to the vote pursuant thereto by an instrument delivered to the Corporation revoking it, or by presentation of a duly executed proxy bearing a later date, or by attendance at the meeting and voting in person by the person entitled to vote, or by receipt of written notice of the death or incapacity of the maker before the vote is counted. The revocability of a proxy that states on its face that it is irrevocable shall be governed by the provisions of the Corporations Code.

The above notwithstanding, no proxy to vote the shares of stock of this Corporation shall be valid except in favor of a person who is a non-disqualified shareholder of record of this Corporation. Any purported voting trust, proxy, or other arrangement with any other person is void.

*Comment:* A proxy or voting trust is valid only if voting power is vested in another licensed person who is a shareholder of the corporation. See Corp C §13406(a).

**Source:** Business Law/Selecting and Forming Business Entities/10 Professional Corporations/§10.43 11. Form: Disqualified Persons

## §10.43 11. Form: Disqualified Persons

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §10.33 and ends in §10.68

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10.43-1 Disqualified persons

**P. *Disqualified Persons.*** The income of the Corporation attributable to services rendered while a shareholder is a "Disqualified Person" shall not in any manner accrue to the benefit of such shareholder or his or her shares. Corporations Code §13401(e) defines "Disqualified Person" to mean a licensed person who for any reason becomes legally disqualified (temporarily or permanently) to render the professional services which the particular professional corporation of which he or she is an officer, director, shareholder, or employee is or was rendering.

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**Source:** Business Law/Selecting and Forming Business Entities/10 Professional Corporations/§10.44 12. Form: Consent of Absentees

## §10.44 12. Form: Consent of Absentees

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10.44-1 Consent of absentees

**Q. *Consent of Absentees.*** The transactions of any meeting of shareholders, either annual or special, however called and noticed, and wherever held, shall be as valid as though had at a meeting duly held after regular call and notice, if a quorum be present either in person or by proxy, and if, either before or after the meeting, each person entitled to vote, not present in person or by proxy, signs a written waiver of notice, or a consent to the holding of such meeting, or an approval of the minutes thereof. All such waivers, consents, or approvals shall be filed with the corporate records or made a part of the minutes of the meeting. The waiver of notice, consent, or approval need not state the business to be transacted at or the purpose of any annual or special meeting of shareholders; except that a waiver of notice or consent shall state the general nature of any proposal specified in \_\_ *[specify section]* \_\_ of these Bylaws.

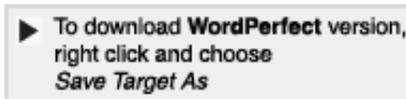
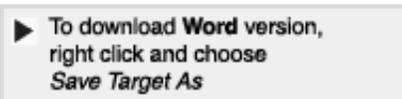
Attendance by a person at a meeting shall also constitute a waiver of notice of that meeting, except when the person objects, at the beginning of the meeting, to the transaction of any business because the meeting is not lawfully called or convened, and except that attendance at a meeting is not a waiver of any right to object to the consideration of matters not included in the notice of the meeting if that objection is expressly made at the meeting.

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**Source:** Business Law/Selecting and Forming Business Entities/10 Professional Corporations/§10.45 13. Form: Shareholder Action Without Meeting

## **§10.45 13. Form: Shareholder Action Without Meeting**

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10.45-1 Shareholder action without meeting

**R. Shareholder Action Without Meeting.** Except as otherwise provided in these Bylaws or by the Code, any action which may be taken at any annual or special meeting of shareholders may be taken without a meeting and without prior notice, if a consent in writing, setting forth the action so taken, is signed by the holders of outstanding shares having not less than the minimum number of votes that would be necessary to authorize or take that action at a meeting at which all shares of each class entitled to vote on that action were present and voted. All such consents shall be filed with the Secretary of the Corporation and shall be maintained in the corporate records. Any person giving a written consent may revoke the consent by a writing received by the Secretary of the Corporation before written consents of the number of shares required to authorize the proposed action have been filed with the Secretary.

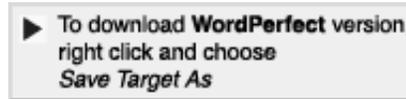
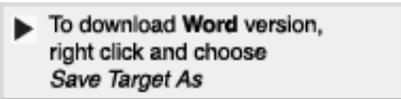
If the consents of all shareholders entitled to vote have not been solicited in writing, or if the unanimous written consent of all such shareholders shall not have been received, the Secretary shall give prompt notice of the corporate action approved by the shareholders without a meeting. This notice shall be given in the manner specified in \_\_[specify section]\_\_ of these Bylaws. In the case of approval of any of the following, the notice shall be given at least ten (10) days before the consummation of any action authorized by that approval:

1. Contracts or transactions in which a director has a direct or indirect financial interest, pursuant to Corporations Code §310;
2. Indemnification of agents of the Corporation, pursuant to Corporations Code §317;
3. A reorganization of the Corporation, pursuant to Corporations Code §1201; and
4. A distribution in dissolution other than in accordance with the rights of outstanding preferred shares, pursuant to Corporations Code §2007.

**Source:** Business Law/Selecting and Forming Business Entities/10 Professional Corporations/§10.46 14. Form: Inspectors of Election

## §10.46 14. Form: Inspectors of Election

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §10.33 and ends in §10.68



10.46-1 Inspectors of election

**S. *Inspectors of Election.*** In advance of any meeting of shareholders, the Board may appoint any persons other than nominees for office as inspectors of election to act at the meeting and any adjournment of it. If inspectors of election are not so appointed, or if any persons so appointed fail to appear or refuse to act, the chairman of any such meeting may, and on the request of any shareholder entitled to vote or shareholder's proxy entitled to vote, shall make the appointment at the meeting. The number of inspectors shall be either one or three. If appointed at a meeting on the request of one or more shareholders or proxies, the holders of at least a majority of shares present and entitled to vote shall determine whether one or three inspectors are to be appointed.

Such inspectors shall determine the number of shares outstanding and the voting power of each, the number of shares represented at the meeting, the existence of a quorum, and the authenticity, validity, and effect of proxies; receive votes, ballots or consents; hear and determine all challenges and questions in any way arising in connection with the right to vote; count and tabulate all votes or consents; determine when the polls shall close; determine the results; and do such acts as may be proper to conduct the election or vote with fairness to all shareholders. If there are three inspectors of election, the decision, act, or certificate of a majority is effective in all respects as the decision, act, or certificate of all.

**Source:** Business Law/Selecting and Forming Business Entities/10 Professional Corporations/§10.47 15. Form: Record Date for Purposes Other Than Notice and Voting

## §10.47 15. Form: Record Date for Purposes Other Than Notice and Voting

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10.47-1 Record date

**T. Record Date for Purposes Other Than Notice and Voting.** For purposes of determining the shareholders entitled to receive payment of dividends or other distributions or allotment of rights, or entitled to exercise any rights in respect of any other lawful action (other than voting at and receiving notice of shareholders' meetings and giving written consent of the shareholders without a meeting), the board of directors may fix in advance a record date, which shall be not more than 60 nor less than 10 days before the date of the dividend payment, distribution, allotment, or other action. If a record date is so fixed, only shareholders of record at the close of business on that date shall be entitled to receive the dividend, distribution, or allotment of rights, or to exercise the other rights, as the case may be, notwithstanding any transfer of shares on the corporation's books after the record date, except as otherwise provided by statute.

**U. Record Date for Purposes Other Than Notice and Voting if Board Does Not Fix Date.** If the board of directors does not so fix a record date in advance, the record date shall be at the close of business on the later of

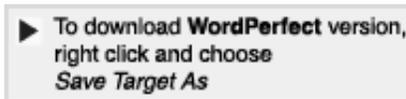
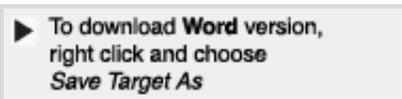
1. The day on which the board of directors adopts the applicable resolution, or
2. The 60th day before the date of the dividend payment, distribution, allotment of rights, or other action.

*Comment:* The first paragraph of this form substantially follows the portions of Corp C §701 concerning the record date for purposes other than shareholders' meetings and shareholders' action by written consent.

**Source:** Business Law/Selecting and Forming Business Entities/10 Professional Corporations/§10.48 16. Form: Powers, Numbers, and Election of Directors

## §10.48 16. Form: Powers, Numbers, and Election of Directors

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §10.33 and ends in §10.68



10.48-1 Powers, numbers, election of directors

### ARTICLE III

#### BOARD OF DIRECTORS

**A. Powers of Directors.** Subject to limitations of the Articles of Incorporation,    *[the Shareholders' Agreement, ]*    these Bylaws, and of the Corporations Code as to actions required to be authorized or approved by the shareholders or by the outstanding shares, the business and affairs of the Corporation shall be managed and all corporate powers shall be exercised by or under the direction of the Board. Without prejudice to such general powers, and subject to the same limitations, it is expressly declared that the directors shall have the following powers:

1. To select and remove all the other officers, agents, and employees of the Corporation, prescribe such powers and duties for them as may not be inconsistent with the law, the Articles of Incorporation, or these Bylaws, fix their compensation, and require from them security for faithful service;
2. To conduct, manage, and control the affairs and business of the Corporation and to make such rules and regulations not inconsistent with law, the Articles of Incorporation, or these Bylaws, as they may deem best;
3. To fix, and to change the principal executive office for the transaction of the business of the Corporation from one location to another within the State of California; to fix and locate from time to time one or more subsidiary offices of the Corporation within or without the State of California; to designate any place within or without the State of California for the holding of any shareholders' meeting or meetings; and to cause the Corporation to be qualified to do business in any other state, jurisdiction, or country;
4. To adopt, make, and use a corporate seal and to prescribe the forms of certificates of stock and to alter the form of the seal and the certificates from time to time, as in their judgment they may deem best, provided the seal and the certificates shall at all times comply with the provisions of law;
5. To authorize the issuance of shares of stock of the Corporation from time to time, upon such terms as may be lawful, in consideration of money paid, labor done, services actually rendered, debts or securities cancelled, or tangible or intangible property actually received; and
6. To borrow money and incur indebtedness for the purposes of the Corporation, and to cause to be executed and delivered, in the corporate name, promissory notes, bonds, debentures, deeds of trust, mortgages, pledges, hypothecations, or other evidences of debt and security.

**B. Number and Qualifications of Directors.** If the Corporation has only one (1) shareholder, the Corporation shall have only one (1) director who shall be the shareholder. If the Corporation has only two (2) shareholders, the Corporation shall have only two (2) directors who shall be the shareholders. If the Corporation has three (3) or more shareholders, the Corporation shall have a minimum of    *[number]*    directors and a maximum of    *[number]*    directors, as fixed by a majority vote of the Board of Directors. Directors need not be shareholders of the Corporation, except as stated above. Directors of the Corporation shall be licensed persons, as defined by Corporations Code §13401(d)    *[and Corporations Code §13401.5]*   . If a director becomes a disqualified person as defined by Corporations Code §13401(e), he or she shall immediately cease to be a director on the effective date of such disqualification and his or her office as a director shall become vacant without the necessity of corporate action.

**C. Election and Term of Offices.** Directors shall be elected at each annual meeting of the shareholders to hold office until the next annual meeting. Each director, including a director elected to fill a vacancy, shall hold office until the expiration of the term for which elected and until a successor has been elected and qualified. An ex officio director shall hold office so long as he or she holds the position which is the basis for such person's directorship, unless terminated sooner pursuant to these Bylaws. A director's term of office shall begin on the first day of the month subsequent to the adjournment of the meeting of the Board at which he or she is elected, unless otherwise specified by the Board.

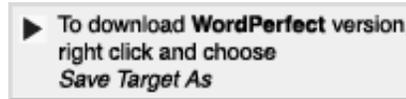
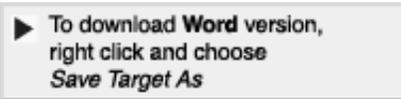
*Comment:* In paragraph B of this form, the language referencing Corp C §13401.5 should be added if the corporation is a medical corporation.

The following statutes govern numbers and qualifications of directors: Corp C §§13401(d), 13401.5 (medical corporations), and 13403; Bus & P C §6165 (law corporations), and Law Corp R IV(A)(2). Election and term of office is governed by Corp C §13403. Corporations Code §13403 also permits a professional medical corporation to set forth in its bylaws the powers and duties of its directors, which allows for some flexibility in reserving certain powers with certain directors.

**Source:** Business Law/Selecting and Forming Business Entities/10 Professional Corporations/§10.49 17. Form: Definition of Board Vacancies

## §10.49 17. Form: Definition of Board Vacancies

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10.49-1 Definition of vacancies

**D. Events Creating Vacancies. A vacancy or vacancies in the Board shall be deemed to exist:**

- 1. In the event of the death, resignation, or removal of any director;**
- 2. If the Board by resolution declares vacant the office of a director who has been declared of unsound mind by an order of court or convicted of a felony;**
- 3. If the authorized number of directors is increased;**
- 4. If the shareholders fail, at any meeting of shareholders at which any director or directors are elected, to elect the full number of directors to be voted for at that meeting; or**
- 5. If a director becomes a disqualified person as defined by Corporations Code §13401(e).**

*Comment:* Vacancies are defined in Corp C §192. For a professional corporation, the bylaw provision defining vacancies must state that one of the events causing a vacancy will be if a director becomes a disqualified person, as defined by Corp C §13401(e).

The procedures for filling vacancies in the board are covered in Corp C §§301-306. Vacancies created by removal of a director are filled by the shareholders by a simple majority of those present and voting at a meeting or without a meeting by unanimous written consent (Corp C §§305(a)-(b), 603(d)), unless the articles or bylaws expressly permit the board to fill such vacancies.

**Source:** Business Law/Selecting and Forming Business Entities/10 Professional Corporations/§10.50 18. Form: Resignation of Director

## §10.50 18. Form: Resignation of Director

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10.50-1 Resignation of director

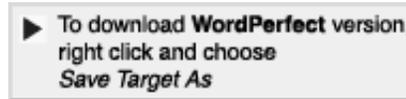
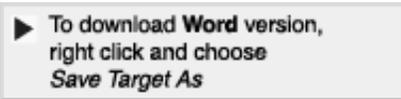
**E. Resignation.** Any director may resign effective on giving written notice to the President, the Secretary, or the Board, unless the notice specifies a later time for that resignation to become effective. If the resignation of a director is effective at a future time, the Board may, prior to the effective date of the resignation, elect a successor to take office at such time as the resignation becomes effective.

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**Source:** Business Law/Selecting and Forming Business Entities/10 Professional Corporations/§10.51 19. Form: Removal of Director

## §10.51 19. Form: Removal of Director

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10.51-1 Removal of director

**F. Removal.** No reduction of the authorized number of directors shall have the effect of removing any director before that director's term of office expires.

The entire Board or any individual director may be removed from office as provided by Corporations Code §§302 (removal of a director who has been declared of unsound mind by an order of court or convicted of a felony) and 304 (removal by a shareholders' suit). In addition, a director may be removed by the affirmative vote of a majority of the shares entitled to vote.

A vacancy on the Board caused by the removal of a director may be filled only by the shareholders. Despite the foregoing, a majority of the Board of Directors may fill a vacancy caused by the death, resignation, or removal of any director, if the Board by resolution declares vacant the office of a director who has been declared of unsound mind by an order of court or convicted of a felony.

*Comment:* Corporations Code §305(a) permits shareholders to approve an article or bylaw allowing directors to fill vacancies resulting from removal. This clause assumes that no such article or bylaw has been adopted. If written consent procedures are used, the unanimous consent of the outstanding shares entitled to vote is required when a vacancy is created by removal. Corp C §305(b).

**Source:** Business Law/Selecting and Forming Business Entities/10 Professional Corporations/§10.52 20. Form: Filling Vacancies

## §10.52 20. Form: Filling Vacancies

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10.52-1 Filling vacancies

**G. Filling Vacancies.** Except as provided in Section F of this Article, vacancies on the Board may be filled by approval of the Board or, if the number of directors then in office is less than a quorum, by:

- 1. The unanimous written consent of the directors then in office;**
- 2. The affirmative vote of a majority of the directors then in office at a meeting held under notice or waivers of notice complying with Corporations Code §307; or**
- 3. A sole remaining director.**

*Comment:* If after the board has filled a vacancy, the number of directors who were elected by the shareholders is less than a majority of the board, the holders of 5 percent or more of the outstanding shares with voting rights may call a special shareholders' meeting (Corp C §305(c)(1)) or may apply to the superior court for a summary order requiring a special meeting, at which the entire board will be elected (Corp C §305(c)(2)).

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**Source:** Business Law/Selecting and Forming Business Entities/10 Professional Corporations/§10.53 21. Form: Shareholders to Fill Vacancies Not Filled by Board

## §10.53 21. Form: Shareholders to Fill Vacancies Not Filled by Board

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10.53-1 Vacancies not filled by board

**H. Vacancies Not Filled by Board.** The shareholders may elect a director at any time to fill a vacancy not filled by the Board of Directors. The term of office of a director elected to fill a vacancy shall run until the next annual meeting of the shareholders. Such a director shall hold office until a successor is elected and qualified.

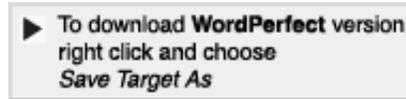
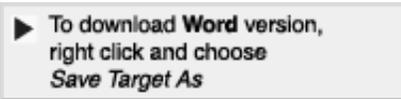
*Comment:* Under Corp C §305(a), the articles or bylaws may require shareholder approval of the filling of any board vacancy. Any vacancies not filled by the directors may be filled by the shareholders. If written consent procedures are used, the consent of a majority of the outstanding shares entitled to vote is required when a vacancy is not created by removal.

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**Source:** Business Law/Selecting and Forming Business Entities/10 Professional Corporations/§10.54 22. Form: Meetings of Directors

## §10.54 22. Form: Meetings of Directors

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §10.33 and ends in §10.68



10.54-1 Director meetings

**I. Place of Meetings.** Meetings of the Board may be held at any place within or without the State which has been designated from time to time by resolution of the Board. In the absence of such designation, regular or special meetings shall be held at the principal executive office of the Corporation.

**J. Annual Meetings.** Immediately following each annual meeting of shareholders, the Board shall hold an annual meeting for the purpose of organization, election of officers, and the transaction of other business. Notice of the meeting shall not be required. If an annual meeting of the shareholders is not held, the Board shall hold an annual meeting for the purposes described in this section, within the time period set forth in \_\_[specify section]\_\_ of these Bylaws.

**K. Other Regular Meetings.** Other regular meetings of the Board shall be held without call at such times and at such places as the Board shall from time to time determine. Such regular meetings of the Board may be held without notice.

**L. Special Meetings.** Special meetings of the Board for any purpose or purposes may be called at any time by the \_\_[specify, e.g., President, Vice President, Treasurer,]\_\_ the Secretary, the Board, or shareholders holding at least 10 percent of the voting rights.

Notice of the time and place of special meetings shall be delivered personally or by telephone to each director or sent to each director by first-class mail or telegram, charges prepaid, addressed to the director at his or her address as shown on the records of the Corporation. The notice shall be delivered personally or by telephone or delivered to the telegraph company at least forty-eight (48) hours before the holding of the meeting. If the notice is mailed, it shall be deposited in the United States mail at least four (4) days before the holding of the meeting. Oral notice given personally or by telephone may be communicated either to the director or to a person at the office of the director who the person giving the notice has reason to believe will promptly communicate it to the director. The notice need not specify the purpose of the meeting, nor the place if it is to be held at the principal executive office of the Corporation.

**M. Required Quorum.** A majority of the authorized number of directors shall be necessary to constitute a quorum for the transaction of business, except to adjourn the meeting as provided in these Bylaws. Every act or decision done or made by a majority of the directors present at a meeting duly held at which a quorum is present shall be regarded as the act of the Board, unless a greater number be required by law, by the Articles of Incorporation, \_\_[the Shareholders' Agreement,]\_\_ or by these Bylaws. A meeting at which a quorum is initially present may continue to transact business notwithstanding the withdrawal of directors, if any action taken is approved by at least a majority of the required quorum for that meeting.

**N. Waiver of Notice.** The transactions of any meeting of the Board, however called and noticed or wherever held, shall be as valid as though had at a meeting duly held after regular call and notice, if a quorum be present and if, either before or after the meeting, each of the directors not present signs a written waiver of notice or a consent to holding such meeting (neither of which need specify the purpose of the meeting) or an approval of the minutes thereof. All such waivers, consents, or approvals shall be filed with the corporate records or made a part of the minutes of the meeting. Notice shall be deemed given to any director who attends the meeting without protesting, before or at its commencement, the lack of notice to that director.

**O. Electronic Meetings.** Members of the Board may participate in a meeting through use of conference telephone or similar communications equipment, as long as all members participating in the meeting can hear

one another.

**P. *Adjournment.*** A majority of the directors present, whether or not constituting a quorum, may adjourn any meeting to another time and place.

**Q. *Notice of Adjournment.*** Notice of the time and place of an adjourned meeting need not be given, unless the meeting is adjourned for more than twenty-four (24) hours, in which case notice of the time and place shall be given before the time of the adjourned meeting, in the manner specified in \_\_ *[specify section]* \_\_ of these Bylaws, to the directors who were not present at the time of the adjournment.

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**Source:** Business Law/Selecting and Forming Business Entities/10 Professional Corporations/§10.55 23. Form: Fees and Compensation for Directors

**§10.55 23. Form: Fees and Compensation for Directors**

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10.55-1 Director fees and compensation

**R. Fees and Compensation.** Directors and members of committees may receive compensation, if any, for their services, and reimbursement for expenses, as fixed or determined by the Board. Any director may serve the Corporation in any other capacity as an officer, agent, employee, or otherwise, and receive compensation in that capacity.

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**Source:** Business Law/Selecting and Forming Business Entities/10 Professional Corporations/§10.56 24. Form: Board Action Without Meeting

**§10.56 24. Form: Board Action Without Meeting**

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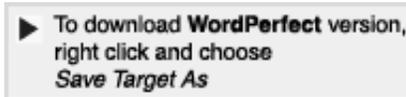
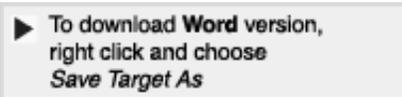
10.56-1 Board action without meeting

**S. *Board Action Without Meeting.* Any action required or permitted to be taken by the Board may be taken without a meeting, if all directors individually or collectively consent in writing to the action. The written consent or consents shall be filed with the minutes of the proceedings of the Board. The action by written consent shall have the same force and effect as a unanimous vote of the directors.**

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## §10.57 25. Form: Board Committees

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §10.33 and ends in §10.68



### 10.57-1 Board committees

**T. Board Committees.** The Board may appoint one or more committees, each consisting of two or more directors, and delegate to such committees any of the authority of the Board, except with respect to:

1. The approval of any action for which the Code also requires shareholders' approval or approval of the outstanding shares;

2. The filling of vacancies on the Board or on any committee;

3. The fixing of compensation of the directors for serving on the Board or on any committee;

4. The amendment or repeal of these Bylaws or the adoption of new Bylaws;

5. The amendment or repeal of any resolution of the Board which by its express terms is not so amendable or repealable;

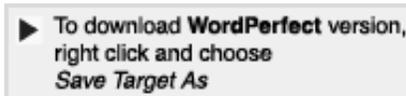
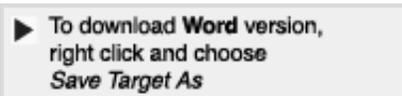
6. A distribution to the shareholders of the Corporation, except at a rate or in a periodic amount or within a price range determined by the Board; or

7. The appointment of other committees of the Board or the members of it.

Any such committee must be appointed by resolution adopted by a majority of the authorized number of directors and may be designated an Executive Committee or by any other name the Board shall specify. The Board shall have the power to prescribe the manner in which proceedings of any such committee shall be conducted. In the absence of any prescription, the committee shall have the power to prescribe the manner in which its proceedings shall be conducted. Unless the Board or any such committee provides otherwise, the regular and special meetings and other actions of a committee shall be governed by the provisions of this Article applicable to meetings and actions of the Board. Minutes shall be kept of each meeting of each committee.

## §10.58 26. Form: Officers

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §10.33 and ends in §10.68



10.58-1 Officers of corporation

### ARTICLE IV OFFICERS

**A. Officers.** The officers of the Corporation shall be a \_\_ \_\_[*President/Chief Executive Officer*]\_\_ \_\_, a \_\_ \_\_[*Treasurer/Chief Financial Officer*]\_\_ \_\_, and a Secretary. A person may hold two or more offices. The Corporation may also have, at the discretion of the Board, one or more Vice-Presidents, one or more Assistant Secretaries, one or more Assistant Chief Financial Officers, and such other officers as may be appointed in accordance with these Bylaws or the Shareholders' Agreement. The officers of the corporation shall be licensed persons as defined by Corporations Code §13401(d). Any number of offices may be held by the same person.

**B. Appointment.** The officers of the Corporation shall be appointed annually by the Board, and each shall hold office until he or she resigns, is removed, or is otherwise disqualified to serve, or his or her successor is elected and qualified.

**C. Subordinate Officers.** The Board may appoint such other officers as the business of the Corporation may require, each of whom shall hold office for such period, have such authority, and perform such duties as are provided in these Bylaws or as the Board may from time to time determine. The Board may delegate to the President or any other officer or committee the power to appoint any such subordinate officers, committees, or agents, to specify their duties, and to determine their compensation.

**D. Removal and Resignation.** Any officer who becomes a disqualified person as defined by Corporations Code §13401(e) shall cease to be an officer on the effective date of disqualification. Any officer chosen by the Board of Directors may be removed at any time, with or without cause or notice, by the Board of Directors; subject to the rights, if any, of an officer under any contract of employment.

Subordinate officers appointed by persons other than the Board may be removed at any time, with or without cause or notice, by the Board of Directors or by the officer by whom appointed. Officers may be employed for a specified term under a contract of employment if authorized by the Board of Directors. Such officers may be removed from office at any time under this Section and shall have no claim against the corporation or individual officers or board members because of the removal except any right to monetary compensation to which the officer may be entitled under the contract of employment.

Any officer may resign at any time by giving written notice to the corporation. Resignations shall take effect on the date of receipt of the notice, unless a later time is specified in the notice. Unless otherwise specified in the notice, acceptance of the resignation is not necessary to make it effective. Any resignation is without prejudice to the rights, if any, of the corporation to monetary damages under any contract of employment to which the officer is a party.

**E. Vacancies.** A vacancy in any office because of death, resignation, removal, disqualification, or any other cause shall be filled by a majority vote of the directors.

**F. Compensation.** Salaries of officers and other shareholders employed by the Corporation shall be fixed from time to time by the board of directors or established under employment agreements approved by the board of directors. No officer shall be prevented from receiving this salary because he or she is also a director of the corporation.

*Comment:* The bylaw provision concerning the qualifications and election of officers (paragraph A) may be basically identical to that for ordinary business corporations except that the bylaws should provide that the principal officer or officers must be licensed persons as defined by Corp C §13401(d). For law corporations, see also Law Corp R IV(A)(2).

Corporations Code §13403 provides that a corporation that has only one shareholder need have only one director who may be that shareholder and who may also serve as the president and treasurer of the corporation; the other officers of the corporation in this situation need not be licensed persons.

Unless the articles or bylaws provide otherwise, the same person may hold any number of offices, including those of both president and secretary. Corp C §312(a). As a practical matter, however, banks, brokers, and others needing documents signed on behalf of the corporation may object to having the same person sign twice, once as president and once as secretary. If at all possible, the corporation should have at least two people acting as officers, even if one is president, secretary, and treasurer and the other is merely a vice president or an assistant secretary.

The clause concerning removal and resignation (paragraph D) must provide that an officer who becomes a disqualified person as defined by Corp C §13401(e) shall cease to be an officer on the effective date of disqualification.

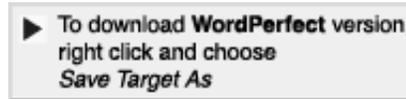
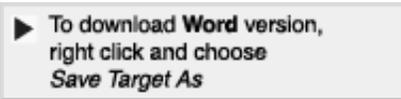
The removal and resignation of officers are "subject to" or "without prejudice to" any rights of the other party under an employment contract. Corp C §312(b). Despite such a contract, either party retains the power (if not the right) to terminate the relationship at any time. The other party's rights, if any, under an employment contract and under Corp C §312(b) are limited to damages. See 1 Marsh, Finkle & Sonsini, Marsh's California Corporation Law §10.13 (4th ed 2000).

Although a professional corporation's principal executive officers must be licensed persons, Bus & P C §2408 permits a professional medical corporation to have non-licensed persons serve as administrators with the business title of executive vice president, chief executive officer, executive secretary, or any other title indicating administrative function within the professional corporation. The professional medical corporation's bylaws may provide for such administrative officers.

**Source:** Business Law/Selecting and Forming Business Entities/10 Professional Corporations/§10.59 27. Form: Indemnification of Directors, Officers, Employees, and Other Agents

## §10.59 27. Form: Indemnification of Directors, Officers, Employees, and Other Agents

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10.59-1 Indemnification

### ARTICLE V INDEMNIFICATION OF DIRECTORS, OFFICERS, EMPLOYEES, AND OTHER AGENTS

**A. *Indemnification of Directors and Officers.*** The Corporation shall, to the maximum extent permitted by the Code, indemnify each of its agents against expenses, judgments, fines, settlements, and other amounts actually and reasonably incurred in connection with any proceeding arising by reason of the fact that any such person is or was an agent of the Corporation. For purposes of this Article V, an "agent" of the Corporation includes any person who is or was a director, officer, employee, or other agent of the Corporation, including a person involved in any peer review process, or who is or was serving at the request of the Corporation as a director, officer, employee, or agent of another foreign or domestic corporation, partnership, joint venture, trust, or other enterprise.

**B. *Indemnification of Other Agents.*** The Corporation may, in its absolute discretion, up to the maximum extent permitted by California law, indemnify each of its agents who are not required to be indemnified under Section A of this Article V against expenses, judgments, fines, settlements, and other amounts actually and reasonably incurred in connection with any proceeding arising by reason of the fact that any such person is or was an agent of the Corporation. For purposes of this Section B, an "agent" of the Corporation includes any person who is or was an employee or other agent of the Corporation, or is or was serving at the request of the Corporation as a director, officer, employee, or agent of another corporation, partnership, joint venture, trust, or other enterprise, or was a director, officer, employee, or agent of a corporation which was a predecessor corporation of the Corporation or of another enterprise at the request of such predecessor corporation.

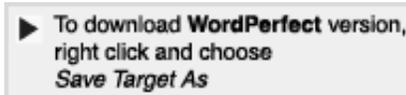
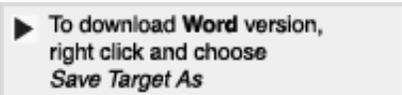
**C. *Insurance.*** The Board may authorize the purchase and maintenance by the Corporation of insurance on behalf of any director, officer, or agent of the Corporation against liability asserted against or incurred by the director, officer, or agent in such capacity or arising out of the director's, officer's, or agent's status as such, whether or not the Corporation is empowered to indemnify the director, officer, or agent against such liability under the provisions of this Article V.

**D. *Advance of Expenses.*** Expenses incurred in defending any proceeding in the cases described in Sections A and B of this Article V may be advanced by the Corporation prior to the final disposition of such proceeding on receipt of an undertaking by or on behalf of the director, officer, or agent to repay such amount unless it shall be determined ultimately that the director, officer, or agent is entitled to be indemnified as authorized in this Article V.

**Source:** Business Law/Selecting and Forming Business Entities/10 Professional Corporations/§10.60 28. Form: Records; Contracts; Restrictions on Transfer

## **§10.60 28. Form: Records; Contracts; Restrictions on Transfer**

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### **ARTICLE VI GENERAL PROVISIONS**

**A. Maintenance of Records.** The Corporation shall maintain adequate and correct accounts, books, and records of its business and properties in accordance with generally accepted accounting principles. Minutes of proceedings shall be kept in written form. Such other books and records shall be kept in written form or in any other form capable of being converted to written form. All such books, record, and accounts shall be kept at the Corporation's principal place of business in the State of California, as fixed by the Board from time to time.

#### **B. Inspection of Records.**

1. A shareholder or shareholders holding at least 5 percent in the aggregate of the outstanding voting shares of the Corporation shall have an absolute right to do either or both of the following:

(a) To inspect and copy the record of shareholders' names and addresses and shareholdings during usual business hours on five (5) business days' prior written demand upon the Corporation; or

(b) To obtain from the transfer agent, if any, for the Corporation, on five (5) business days' prior written demand and on the tender of its usual charges for such a list (the amount of which charges shall be stated to the shareholder by the transfer agent on request), a list of the shareholders' names and addresses and their shareholdings, as of the most recent record date for which it has been compiled or as of a date specified by the shareholder subsequent to the date of demand.

2. The record of shareholders shall also be open to inspection and copying by any shareholder or holder of a voting trust certificate at any time during usual business hours on written demand on the Corporation, for a purpose reasonably related to such holder's interest as a shareholder or holder of a voting trust certificate.

3. The accounting books and records and minutes of proceedings of the shareholders and the Board and committees of the Board shall be open to inspection on written demand on the Corporation of any shareholder or holder of a voting trust certificate at any reasonable time during usual business hours, for a purpose reasonably related to such holder's interests as a shareholder or as a holder of such voting trust certificate.

4. Any inspection and copying under this Article may be made in person or by agent or attorney and any copies shall be paid for by the person requesting the copies.

**C. Inspection of Bylaws.** The Corporation shall keep in its principal executive office the original or a copy of these Bylaws as amended to date which shall be open to inspection by shareholders at all reasonable times during office hours.

**D. Endorsement of Documents and Contracts.** Subject to the provisions of applicable law, any note, mortgage, evidence of indebtedness, contract, share certificate, conveyance, or other instrument in writing, and any assignment or endorsement on it of less than \$ \_\_[amount]\_\_, executed or entered into between this Corporation and any other person, when signed by the \_\_[President/Chief Executive Officer]\_\_ of this Corporation shall be valid and binding on this Corporation in the absence of actual knowledge on the part of the other person that the signing officers had no authority to execute the same. Any note, mortgage, evidence of indebtedness, contract, share certificate, conveyance, or other instrument in writing, and any assignment or endorsement on it of \$ \_\_[amount]\_\_ or more, executed or entered into between this Corporation and any other person, when signed by the \_\_[President/Chief Executive Officer]\_\_ and one other officer of this Corporation

shall be valid and binding on this Corporation in the absence of actual knowledge on the part of the other person that the signing officers had no authority to execute the same. Any such instruments may be signed by any other person or persons and in such manner as from time to time shall be determined by the Board and, unless so authorized by the Board, no officer, agent, or employee shall have any power or authority to bind the Corporation by any contract or engagement or to pledge its credit or to render it liable for any purpose or amount.

[Add one of the following alternatives]

[Alternative 1: Restrictions on transfer—medical corporation]

**E. Restrictions on Transfer.** No shareholder of the Corporation shall sell, alienate, assign, give, pledge, hypothecate, encumber, or in any way transfer any of his or her shares of the Corporation's stock whether voluntarily or by operation of the law, whether or not for value, except to licensed physicians or surgeons, a medical corporation with a single shareholder who is a licensed physician or surgeon, or licensed persons as defined by Corporation Code §13401.5 and in compliance with the requirements and restrictions provided in the \_\_[Shareholders' Agreement]\_\_, Articles of Incorporation, and other terms contained in these Bylaws.

[Alternative 2: Restrictions on transfer—law corporation]

**E. Restrictions on Transfer.** Shares of this corporation may be transferred only to licensed persons or to the corporation. The shares of this corporation owned by a person who dies, ceases to be an eligible shareholder, or becomes a disqualified person as defined by Corporations Code §13401(e) for a period exceeding 90 days, shall be sold and transferred to the corporation or its shareholders on such terms as are agreed upon by the corporation and its shareholders. Such sale or transfer shall occur not later than six (6) months after any such death and not later than 90 days after the date the shareholder ceases to be an eligible shareholder, or 90 days after the date the shareholder becomes a disqualified person.

[Continue]

**F. Sale or Transfer on Death or Disqualification.** If there are two or more shareholders in the Corporation and one of the shareholders dies or becomes a disqualified person as defined in Corporations Code §13401(e), his or her shares shall be sold or transferred to the Corporation, its shareholders, or other eligible licensed persons on such terms as are agreed on or provided for in the Shareholders' Agreement. Such sale or transfer shall not be later than six (6) months after any such death and not later than ninety (90) days after the shareholder becomes a disqualified person. The Corporation and its shareholders may, but need not, agree that shares sold to it by a person who becomes a disqualified person may be resold to such person if and when he or she again becomes an eligible shareholder.

*Comment:* Transfer restrictions on shares in professional corporations are required by Corp C §13407. Qualifications of shareholders of a medical corporation are provided in 16 Cal Code Regs §1343-1344. For law corporations, the California State Bar Office of Certification requires the use of the exact language in Alternative 2 of this form. Law Corp R IV(C)(2).

Any shares issued to one other than a licensed person are void, and shares may be transferred only to a licensed person or to the professional corporation. Corp C §13406-13407.

Under a special rule applicable only to dental corporations, a legal guardian or executor may hold the dentist's shares for a period of up to 12 months (if certain conditions are satisfied) on the incapacity or death of a dentist who is the sole shareholder of the dental corporation. Bus & P C §§1625.3-1625.5; Corp C §13407. See §10.5.

## §10.61 29. Form: Stock Certificates

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10.61-1 Stock certificates

### G. Certificates of Stock.

1. Every holder of shares of the Corporation shall be entitled to have a certificate signed in the name of the Corporation by the \_\_ *[President/Chief Executive Officer]* \_\_ or a Vice-President and by the \_\_ *[Treasurer/Chief Financial Officer]* \_\_ or an Assistant Chief Financial Officer or the Secretary or an Assistant Secretary, certifying the number of shares owned by the shareholder. Any or all of the signatures on the certificate may be facsimile. If any officer, transfer agent, or registrar who has signed or whose facsimile signature has been placed on a certificate shall have ceased to be an officer, transfer agent, or registrar before the certificate is issued, it may be issued by the Corporation with the same effect as if such person were an officer, transfer agent, or registrar at the date of issue.

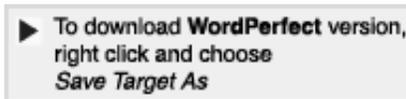
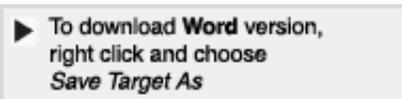
2. Certificates for shares may be issued prior to full payment under such restrictions and for such purposes as the Board may specify; provided, however, that on any certificate issued to represent any partly paid shares, the total amount of the consideration to be paid therefor and the amount paid thereon shall be stated.

3. Except as provided in this Section G, no new certificate for shares shall be issued in lieu of an old one unless the latter is surrendered and canceled at the same time. The Board, may, however, in case any certificate for shares is alleged to have been lost, stolen, or destroyed, authorize the issuance of a new certificate in lieu of the lost, stolen, or destroyed certificate, and the Corporation may require that the Corporation be given a bond or other adequate security sufficient to indemnify it against any claim that may be made against it (including expense or liability) on account of the alleged loss, theft, or destruction of the old certificate or the issuance of the new certificate.

**Source:** Business Law/Selecting and Forming Business Entities/10 Professional Corporations/§10.62 30. Form: Legend on Certificates

## §10.62 30. Form: Legend on Certificates

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10.62-1 Legend on stock certificates

[Add one of the following alternatives]

[Alternative 1: Legend on certificates—medical corporations]

### H. Legend on Certificates.

1. The Corporation shall endorse on each certificate of stock of Corporation now owned or hereafter acquired by a shareholder the following legend:

**THE SHARES OF THIS CORPORATION MAY BE OWNED ONLY BY LICENSED PERSONS AS DEFINED IN THE CALIFORNIA CORPORATIONS CODE. THE SALE, ASSIGNMENT, HYPOTHECATION, GIFT, PLEDGE, OR OTHER TRANSFER OF ANY SHARES REPRESENTED BY THIS CERTIFICATE, OR ANY RIGHT OR INTEREST THEREIN, IS PROHIBITED BY RESTRICTIONS CONTAINED IN THE BYLAWS OF CORPORATION AND A SHAREHOLDERS' AGREEMENT. A COPY OF THE BYLAWS AND THE SHAREHOLDERS' AGREEMENT CAN BE OBTAINED FROM THE SECRETARY OF CORPORATION AND THE PROVISIONS OF SUCH RESTRICTIONS ARE INCORPORATED BY REFERENCE INTO THIS CERTIFICATE.**

2. Share certificates of this Corporation shall bear a legend setting forth the applicable restrictions of 16 California Code of Regulations §1345 and of this Corporation's Articles of Incorporation.

3. The Corporation shall also endorse on each certificate of stock of the Corporation now owned or hereafter acquired by a shareholder any legend required pursuant to the Federal Securities Act of 1933, the California Corporate Securities Law of 1968, and any statute, regulation, or administrative code provision applicable to a California medical professional corporation.

[Alternative 2: Legend on certificates—law corporation]

**H. Legend on Certificates. All share certificates shall bear a legend setting forth restrictions on share ownership and transfer required by law, in the form prescribed by the Law Corporation Rules as adopted from time to time by the California State Bar.**

*Comment:* The provision governing certificates for shares and their issuance is the same for a law corporation as for a business corporation except that Law Corp R IV(C)(4) requires that this clause must be added. For additional statements that may be required on share certificates for either law or medical corporations, see Corp C §418.

**Source:** Business Law/Selecting and Forming Business Entities/10 Professional Corporations/§10.63 31. Form: Shares of Other Corporations; Financial Statements

## §10.63 31. Form: Shares of Other Corporations; Financial Statements

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §10.33 and ends in §10.68

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10.63-1 Shares of other corporations; financial statements

**I. Shares of Other Corporations.** The President or any other officer or officers authorized by the Board or the President are each authorized to vote, represent, and exercise on behalf of the Corporation all rights incident to any and all shares of any other corporation or corporations standing in the name of the Corporation. This authority may be exercised either by any such officer in person or by any other person authorized to do so by proxy or power of attorney duly executed by that officer.

### **J. Financial Statements.**

1. A copy of any annual financial statement and any income statement of the Corporation for each quarterly period of each fiscal year, and any accompanying balance sheet of the Corporation as of the end of each such period, that has been prepared by the Corporation shall be kept on file in the principal executive office of the Corporation for twelve (12) months and each such statement shall be exhibited at all reasonable times to any shareholder demanding an examination of any such statement or a copy shall be mailed to any such shareholder.

2. If a shareholder or shareholders holding at least 5 percent of the outstanding shares of any class of stock of the Corporation makes a written request to the Corporation for an income statement of the Corporation for the three (3)-month, six (6)-month, or nine (9)-month period of the then current fiscal year ending more than thirty (30) days before the date of the request, and a balance sheet of the Corporation as of the end of that period, the \_\_[*Treasurer/Chief Financial Officer*]\_\_ shall cause that statement to be prepared, if not already prepared, and shall deliver personally or by mail that statement or statements to the person making the request within thirty (30) days after the receipt of the request. If the Corporation has not sent to the shareholders its annual report for the last fiscal year, this report shall likewise be delivered or mailed to the shareholder or shareholders within thirty (30) days after the request.

3. The Corporation shall also, on the written request of any shareholder, mail to the shareholder a copy of the last annual, semi-annual, or quarterly income statement which it has prepared, and a balance sheet as of the end of that period.

4. The quarterly income statements and balance sheets referred to in this Section J shall be accompanied by the report, if any, of any independent accountants engaged by the Corporation or the certificate of an authorized officer of the Corporation that the financial statements were prepared without audit from the books and records of the Corporation.

**Source:** Business Law/Selecting and Forming Business Entities/10 Professional Corporations/§10.64 32. Form: Reporting Requirements for Law Corporations

## §10.64 32. Form: Reporting Requirements for Law Corporations

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §10.33 and ends in §10.68

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10.64-1 Reporting requirements—law corporations

### ***K. Reporting Requirements.***

**1. Every year, on or before March 31, the Corporation shall file an annual report covering the calendar year immediately preceding, on a form provided by the California State Bar. This report shall be signed and verified by an officer of the Corporation.**

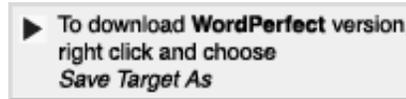
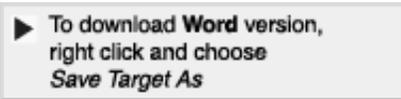
**2. In accordance with Law Corporation Rule VI, the Corporation shall file a special report on a form provided by the California State Bar within 30 days of any change relating to the requirements of Law Corporation Rule IV, including any change in directors, officers, employees practicing law, share ownership, amendments to the articles of incorporation, and amendments to portions of the bylaws required by the Law Corporation Rules to be filed. A copy of all notices received from an insurance company of termination or cancellation of, or intention to terminate or cancel, malpractice insurance required shall be filed immediately with the State Bar.**

*Comment:* The provisions of paragraph 1 are required by Bus & P C §6163 and Law Corp R VI. The provisions of paragraph 2 are required by Bus & P C §6163 and Law Corp R VI.

**Source:** Business Law/Selecting and Forming Business Entities/10 Professional Corporations/§10.65 33. Form: Malpractice Insurance for Law Corporation

### §10.65 33. Form: Malpractice Insurance for Law Corporation

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §10.33 and ends in §10.68



10.65-1 Malpractice insurance

**L. Malpractice Insurance.** In accordance with the requirements set forth in Law Corporation Rule IV(B), the Corporation shall provide and maintain security by insurance or otherwise for claims against it by its clients for errors and omissions arising out of the Corporation's practice of law.

*Comment:* Law corporations are required to maintain insurance as a condition of obtaining a certificate under the Professional Corporation Act. Bus & P C §6171(b). The amounts of insurance must be at least \$50,000 per claim, multiplied by the number of licensed persons who practice law, with an aggregate maximum liability per policy per year of at least \$100,000, multiplied by the number of these licensed employees. These requirements are subject to maximum coverage not to exceed \$500,000 for each claim and \$500,000 for all claims during the policy year. The deductible portion of the insurance may not exceed \$2000, multiplied by the number of employees. Law Corp R IV(B).

Express requirements regarding amounts of malpractice insurance are no longer provided in the Medical Corporation Rules. Such regulations may be adopted by the Division of Licensing. Bus & P C §2412. Note, however, that for medical corporations which assume risk (e.g., under a capitated insurance policy), the medical corporation may need to comply with the rules of the California Department of Managed Health Care regarding insurance amounts and financial reserves.

**Source:** Business Law/Selecting and Forming Business Entities/10 Professional Corporations/§10.66 34. Form: Fiscal Year; Construction of Bylaws

## §10.66 34. Form: Fiscal Year; Construction of Bylaws

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §10.33 and ends in §10.68

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10.66-1 Fiscal year; construction of bylaws

**M. *Fiscal Year.*** The Board shall, by resolution, establish the fiscal year of the Corporation.

**N. *Construction of Bylaws.*** Unless the context requires otherwise, the provisions regarding professional corporations and, to the extent they are not inconsistent, the general provisions, rules of construction, and definitions in the Corporations Code shall govern the construction of these Bylaws.

**O. *Number and Gender.*** Whenever used in this Agreement, the singular shall include the plural and the plural shall include the singular, and the term "person" includes both a corporation and a natural person.

**P. *Titles and Headings.*** The article, section, and paragraph titles and headings contained in these Bylaws are inserted as matter of convenience and for ease of reference only and shall be disregarded for all other purposes, including the construction or enforcement of these Bylaws or any of their provisions.

**Source:** Business Law/Selecting and Forming Business Entities/10 Professional Corporations/§10.67 35. Form: Amendments

## §10.67 35. Form: Amendments

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §10.33 and ends in §10.68

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10.67-1 Amendments

### ARTICLE VII AMENDMENTS

**A. Amendment of Articles of Incorporation.** Except as otherwise required by the Corporation's Articles of Incorporation, applicable law, or \_\_[the Law Corporation Rules/the Professional Corporation Regulations of the Medical Board of California]\_\_, amendments to the Articles of Incorporation may be adopted if approved by the directors and approved by a majority of the outstanding shares entitled to vote, before or after approval by the directors. An amendment to the Articles of Incorporation shall be effective as of the date that the appropriate certificate of amendment is filed with the Secretary of State of California.

*[If applicable, add the following option]*

*[Option: Amendment of Articles to be reported to State Bar]*

All amendments to the Articles of Incorporation shall be reported to the California State Bar, as provided in Law Corporation Rule VI.

*[Continue]*

**B. Amendment of Bylaws.** Except as otherwise required by the Corporation's Articles of Incorporation, applicable law, or \_\_[the Law Corporation Rules/the Professional Corporation Regulations of the Medical Board of California]\_\_, amendments to these Bylaws may be adopted if approved by the directors or approved by a majority of the outstanding shares entitled to vote.

Whenever an amendment or new Bylaw is adopted, a copy of it shall be appended or noted at the appropriate place in the original Bylaws. If any Bylaw is repealed, the fact of repeal with the date of the meeting in which the repeal was enacted or written consent was filed shall be designated or noted at the appropriate place in the original Bylaws.

*[If applicable, add the following option]*

*[Option: Amendment of Bylaws to be reported to State Bar]*

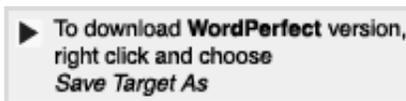
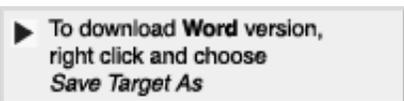
Changes in portions of these Bylaws which are required to be filed with the California State Bar, as provided in Law Corporation Rule VI, shall be promptly reported to the California State Bar.

*Comment:* For a law corporation, any amendments to the bylaws relating to the requirements of Law Corp Rule IV must be reported to the State Bar. Law Corp R VI(B). These include any change in directors, officers, employees practicing law, and share ownership.

**Source:** Business Law/Selecting and Forming Business Entities/10 Professional Corporations/§10.68 36. Form: Certificate of Secretary

**§10.68 36. Form: Certificate of Secretary**

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §10.33 and ends in §10.68



10.68-1 Certificate of secretary

**CERTIFICATE OF SECRETARY**

**I, the undersigned, do hereby certify:**

**1. That I am the duly elected and acting Secretary of \_\_[name]\_\_, a California professional corporation.**

**2. That the foregoing Bylaws, consisting of \_\_[number]\_\_ Articles, constitute the Bylaws of this Corporation as duly adopted by the Board of Directors of this Corporation on \_\_[date]\_\_.**

**IN WITNESS WHEREOF, the undersigned has executed this Certificate of Secretary and affixed the seal of said Corporation this \_\_[day]\_\_ day of \_\_[month, year]\_\_.**

\_\_[Signature]\_\_  
\_\_[Typed name]\_\_  
**Secretary**

[SEAL]

**Source:** Business Law/Selecting and Forming Business Entities/10 Professional Corporations/§10.69 C. Selected Provisions of Minutes of First Meeting of Board of Directors

**§10.69 C. Selected Provisions of Minutes of First Meeting of Board of Directors**

For general forms relating to the matters typically covered at the first meeting of the board of directors, see §§8.107-8.124. In addition, a professional law corporation and other professional corporations not exempt from the registration requirements will need to add the resolutions in §10.70. Medical corporations are exempt from registration requirements (Corp C §13401(b)), but need to file a fictitious name permit. See §§10.77-10.78. For a list of other professional corporations exempt from the registration requirements, see §10.18.

The forms in §§10.71-10.75 deal with matters that typically arise in the formation of any professional corporation.

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**Source:** Business Law/Selecting and Forming Business Entities/10 Professional Corporations/§10.70 1. Form: Resolutions Regarding Application for Certificate of Registration

**§10.70 1. Form: Resolutions Regarding Application for Certificate of Registration**

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10.70-1 Resolutions regarding application for certificate of registration

**After discussion, on motion duly made and carried, the following resolutions were adopted:**

**RESOLVED that:**

1.      *[Name and title]*      of this corporation be authorized and directed to make appropriate application on behalf of this Corporation to the      *[State Bar of California/other professional board]*      for a certificate of registration as a      *[law/other]*      corporation; and

2.      *[Name and title]*      of this corporation be authorized and directed to submit with this application a filing fee of \$      *[amount]*     .

*Comment:* The application for registration is ordinarily made on a form, furnished by the appropriate agency, that indicates which documents and information must accompany the application. See Bus & P C §6161; Law Corp R III(A) (law corporations). For the State Bar form of registration, see §10.76.

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**Source:** Business Law/Selecting and Forming Business Entities/10 Professional Corporations/§10.71 2. Form: Resolutions Regarding Approval of Employment Agreement

**§10.71 2. Form: Resolutions Regarding Approval of Employment Agreement**

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10.71-1 Resolutions regarding approval of employment agreement

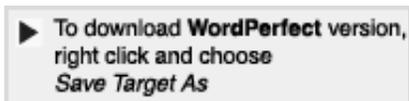
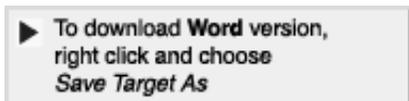
**After discussion, on motion duly made and carried, the following resolutions were \_\_ *[also]* \_\_ adopted:**

**RESOLVED that:**

**1. The Board of Directors approve the terms of \_\_ *[a proposed written agreement/proposed written agreements]* \_\_ between this corporation and the following employee(s): \_\_ *[List names of employees]* \_\_; and**

**2. The officers of the corporation be authorized and directed to execute \_\_ *[that/those]* \_\_ agreement(s) on behalf of the corporation and to file \_\_ *[a copy/copies]* \_\_ of the executed agreement(s) in the corporation's minute book immediately following the minutes of this meeting.**

§10.72 3. Form: Resolutions Adopting Tax-Qualified or Profit-Sharing Plan



10.72-1 Resolutions adopting tax-qualified or profit-sharing plan

The Corporation wishes to adopt a \_\_*[profit-sharing/cash or deferred/pension]*\_\_ plan and an attendant trust, qualified under Internal Revenue Code §§401(a) and 501(a), to provide for the retirement of its employees and to promote employee loyalty and productivity. In view of this, it is

**RESOLVED that:**

1. The board of directors of this corporation adopt the \_\_*[insert full name of plan]*\_\_ (Plan) and the \_\_*[insert full name of trust]*\_\_ (Trust) in the forms attached to these resolutions as Exhibits \_\_*[number]*\_\_ and \_\_*[number]*\_\_, respectively; \_\_*[and]*\_\_

2. The Plan and Trust be adopted effective \_\_*[date]*\_\_;

*[Add one of the following alternatives]*

*[Alternative 1: Authority to act]*

3. The President or Vice President and the Secretary of this Corporation and each of them be authorized and directed for and on behalf of this Corporation to execute the Plan and Trust;

4. The President and the Secretary, and the officers, agents, attorneys, and employees that the President and the Secretary deem appropriate, be authorized to do all things; incur all expenses; prepare, execute, and file all such documents and reports as are necessary, desirable, or convenient to establish and operate the Plan and Trust; and take whatever steps they deem advisable or necessary to secure their approval by any government or taxing body concerned with the administration of the Plan;

*[Alternative 2: Appointment of Plan Administrator; attorney for plan]*

3. \_\_*[Name and title of Plan Administrator]*\_\_ be appointed as, and shall be, the Plan Administrator of the Plan in accordance with its provisions; and

4. The officers of the Corporation be authorized and directed to execute a power of attorney on behalf of the Corporation appointing \_\_*[name of attorney]*\_\_ to deal with the Internal Revenue Service and other governmental agencies on behalf of the Corporation in all matters pertaining to the Plan and Trust.

*Comment:* The effective date of the plan may be a date before or after its adoption. The date should, however, be in the taxable year in which the plan is adopted. If the plan administrator is a committee, the resolution should be appropriately modified.

**Source:** Business Law/Selecting and Forming Business Entities/10 Professional Corporations/§10.73 4. Form: Resolutions Regarding Election of Limitation Year [Deleted]

**§10.73 4. Form: Resolutions Regarding Election of Limitation Year [Deleted]**

The form clause in this section has been deleted because the IRS has removed Treas Reg §1.415-2.

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**Source:** Business Law/Selecting and Forming Business Entities/10 Professional Corporations/§10.74 5. Form: Resolutions Designating Process Agent and Investment Committee

## §10.74 5. Form: Resolutions Designating Process Agent and Investment Committee

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10.74-1 Resolutions designating process agent and investment committee

The Employee Retirement Income Security Act of 1974 (ERISA) §502(d)(1) (29 United States Code §1132(d)(1)) provides that service of legal process on the Secretary of the Department of Labor constitutes service on the Plan unless an individual is designated as the agent of the Plan for such service in the summary plan description of the Plan. In view of this, it is

**RESOLVED that:**

1. The Plan Administrator be appointed as the agent of the Plan for the service of legal process, provided that an additional or successor agent for the service of process may be appointed by this Corporation at any time and that this agent may resign at any time by notifying this Corporation in writing of the resignation;  
\_\_ *[and]* \_\_

*[If applicable, add one or more of the following options]*

*[Option: Designation of agent for service of legal process]*

2. This agent be designated as the agent of the Plan for the service of legal process in the summary plan description of the Plan; and

*[Option: Appointment of investment committee]*

[3.] \_\_ *[Names and titles of investment committee members]* \_\_ be appointed to and constitute the Investment Committee responsible for the investment and control of the Plan assets, subject to the provisions of the Plan and Trust.

*Comment:* The plan may sue or be sued as an entity. 29 USC §1132(d)(1).

**Source:** Business Law/Selecting and Forming Business Entities/10 Professional Corporations/§10.75 6. Form: Adjournment

**§10.75 6. Form: Adjournment**

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10.75-1 Adjournment; signatures

**There being no further business, on motion duly made and carried, the meeting was adjourned to \_\_ [date; time]\_ \_.**

\_\_ [Signature of secretary]\_\_  
\_ \_ [Typed name]\_ \_

**Source:** Business Law/Selecting and Forming Business Entities/10 Professional Corporations/ D. Registration Forms for Professional Corporations/§10.76 1. Form: Application for Issuance of Certificate of Registration as a Law Corporation (State Bar of California)

**D. Registration Forms for Professional Corporations**

**§10.76 1. Form: Application for Issuance of Certificate of Registration as a Law Corporation (State Bar of California)**



The State Bar of California  
Application for Issuance of Registration as a

FOR OFFICE USE ONLY:



\$200

No Check

File No. \_\_\_\_\_

Print out, complete and return the entire form to the address above. A \$200 non-refundable fee must accompany this application. Make check payable to the State Bar of California. Please read the Instructions.

1. Name of Law Corporation:

---

2. Address for State Bar Purposes:

---

3. Contact Name and Phone Number:

---

4. Complete and Attach the Following:

Attachment A, listing all shareholders, officers, directors and all other attorneys practicing law on behalf of the corporation, including all individuals/entities practicing in partnership, association, "of counsel," part-time, and/or on a contract basis.

Attachment B-1, the Standard Law Corporation Guarantee, or Attachment B-2, the Standard Law Corporation Guarantee for Law Corporations Practicing in Partnership with other Law Corporations.

Attachment C, Declaration of Compliance with Rule 1- 400, Rules of Professional Conduct of the State Bar of California

Secretary of State Certification

- California Law Corporation. Attach an original certified copy of the law corporation's Articles of Incorporation (including the original blue and white cover page).
- Out-of-State Law Corporation. Attach BOTH an original certified copy of Statement and Designation by Foreign Corporation (including the original blue and white cover page) AND an original Certificate of Status of Foreign Corporation.

Bylaws Excerpts, showing the exact language from Rule IV-C, paragraphs 1, 2, 4 and 5 of the Law Corporation Rules of the State Bar, amended January, 1994. Do not submit your entire set of bylaws.

Secretary's Certification of Bylaws Excerpts, certifying that the excerpts attached are a true and correct copy of excerpts from the bylaws of the corporation. Signature of the corporate secretary must be original.

SHARE CERTIFICATE(photocopy of both sides, containing the legend required by State Bar Law Corporation Rule IV-C, paragraph 4.)

**5. DECLARATION**

I am \_\_\_\_\_,  
(Name of Officer) (Title of Officer)

of \_\_\_\_\_  
(Complete Name of Corporation)

and as such make this declaration for and on behalf of said corporation. I have read the foregoing and all attachments thereto and know the contents thereof and the same are true of my own knowledge. I declare under penalty of perjury under the laws of the State of California that the foregoing application and all attachments are true and correct and that the applicant is an existing corporation and its organization, bylaws, Articles of Incorporation and general plan of operation are such that its affairs will be conducted in compliance with the State Bar Act, the applicable provisions of the Corporations Code, the Rules of Professional Conduct of the State Bar, the Law Corporation Rules of the State Bar and such other laws, rules and regulations as may be applicable.

Executed on \_\_\_\_\_

Signature \_\_\_\_\_

Print Name \_\_\_\_\_

**Return Application and Attachments to:**

The State Bar of California  
Law Corporation  
180 Howard Street  
San Francisco, CA 94105-1639  
415/538-2100

**The State Bar of California**

File No. \_\_\_\_\_  
(to be completed by State Bar)



**ATTACHMENT A**

Complete Name of Law Corporation: \_\_\_\_\_

**YOU MUST COMPLETE ITEMS 1 THROUGH 9 ON THIS ATTACHMENT.**

**1. SHAREHOLDERS**

**A. Name**

Name	CA Bar Number (If Applicable)	Jurisdiction(s) in Which Admitted to Practice

**B. Are any of the above-listed shareholders:**

• Shareholders in another California law corporation?	___ Yes ___ No
• Partners in a limited liability partnership (LLP)?	___ Yes ___ No

**C. If you checked Yes for any question in B above, complete the following:**

Name of Law Corporation or LLP	CA State Bar Cert. of Reg. No.	Law Practice Relationship With Applicant Law Corporation (Check One Item)			
		"Of Counsel"	In Partnership	In Association	No Law Practice Relationship

**2. OFFICERS**

**NOTE:** In law corporations with more than one shareholder, all officers must be shareholders. See California Corporations Code §13043 and Law Corporations Rule IV-A[2].

Name	CA Bar Number (If Applicable)	Jurisdiction(s) in Which Admitted to Practice
President:		
Treasurer:		
Secretary:		

**3. DIRECTORS**

**NOTE:** Directors of a law corporation must also be shareholders. See California Corporations Code §13043 and Law Corporation Rule IV-A [2].)

Name	CA Bar Number (If Applicable)	Jurisdiction(s) in Which Admitted to Practice

**4. ATTORNEY EMPLOYEE**

Name	CA Bar Number (If Applicable)	Jurisdiction(s) in Which Admitted to Practice

**5. ATTORNEYS PRACTICING LAW ON BEHALF OF A PARTNERSHIP IN WHICH THE LAW CORPORATION IS A PARTNER**

A. Name	CA Bar Number (If Applicable)	Jurisdiction(s) in Which Admitted to Practice
B. Is the partnership a limited liability partnership (LLP)?		___ Yes ___ No
C. If yes:	LLP Name	CA State Bar LLP Cert. of Reg. No.

**6. ATTORNEYS PRACTICING LAW ON BEHALF OF AN ASSOCIATION WITH WHICH THE LAW CORPORATION HAS ESTABLISHED A RELATIONSHIP OF A CONTINUOUS NATURE**

Name	CA Bar Number (If Applicable)	Jurisdiction(s) in Which Admitted to Practice

**7. OTHER LAW CORPORATIONS PRACTICING IN THE PARTNERSHIP OR ASSOCIATION**

Name	State of Incorporation	CA State Bar Cert. of Reg. No. (If Applicable)

**8. OTHER ATTORNEYS ("OF COUNSEL," CONTRACT ATTORNEYS, PART-TIME ATTORNEYS)**

Name	CA Bar Number (If Applicable)	Jurisdiction(s) in Which Admitted to Practice

**9. TOTAL NUMBER OF PERSONS PRACTICING LAW ON BEHALF OF THE LAW CORPORATION:\*** \_\_\_\_\_

Count all individual attorneys/law corporations listed in Items 1 through 8.

\*Use the Total in Item #9 to calculate the dollar amounts to be set forth on the Standard Law Corporation Guarantee (Attachment B-1) or Standard Law Corporation Guarantee for Law Corporations Practicing in Partnership with other Law Corporations (Attachment B-2). See the Guarantee Worksheet for how to calculate the correct dollar amounts for the guarantee.

*This guarantee is not valid without original signatures.*

FILE NO. \_\_\_\_\_

**Attachment B-1  
Guarantee 1**

State Bar of California  
Law Corporation  
180 Howard Street  
San Francisco CA 94105-1639  
(415) 538-2100

**STANDARD LAW CORPORATION GUARANTEE**

The undersigned, being shareholder(s) of

\_\_\_\_\_  
(Set forth complete name of corporation)

hereby guarantee(s) payment by the corporation (and, if our corporation shall have more than one shareholder, this obligation shall be joint and several among the shareholders) of all claims established against it by its clients for errors or omissions arising out of the practice of law by the corporation in an amount not to exceed\$\_\_\_\_\_ for each claim with an aggregate maximum liability not to exceed\$\_\_\_\_\_ per calendar year; provided that any payment required to be made hereunder shall be offset by the amount paid by any insurance company providing errors or omissions insurance for the corporation or any of its shareholders.

DATE EFFECTIVE: \_\_\_\_\_ DATE EXECUTED: \_\_\_\_\_

For new applicants, date effective is the date received in our office.

**SHAREHOLDER(S) SIGNATURE(S)**

*(Please type name under each signature. Signatures must be original.)*

_____	_____
_____	_____
_____	_____
_____	_____
_____	_____
_____	_____
_____	_____
_____	_____
_____	_____

This guarantee is not valid without original signatures.

FILE NO. \_\_\_\_\_

**Attachment B-2  
Guarantee 2**

State Bar of California  
Law Corporation  
180 Howard Street  
San Francisco CA 94105-1639  
(415) 538-2100

**STANDARD LAW CORPORATION GUARANTEE  
FOR LAW CORPORATIONS PRACTICING IN PARTNERSHIP  
WITH OTHER LAW CORPORATIONS**

The undersigned, being shareholder(s) of the respective corporation(s) set forth below beside our name(s), hereby guarantee payment by our respective corporation (and, if any one of our corporations shall have more than one shareholder, this obligation shall be joint and several among the shareholders of that corporation) of all claims established against our respective corporation by its clients for errors and omissions arising out of the practice of law by our respective corporation, whether our respective corporation is acting in its individual capacity or acting with any third person or entity, in an amount not to exceed \$ \_\_\_\_\_ for each claim with an aggregate maximum liability not to exceed \$ \_\_\_\_\_ per calendar year; provided that any payment required to be made hereunder shall be offset by the amount paid by any insurance company providing errors and omissions insurance for our respective corporation or its shareholder(s).

DATE EFFECTIVE: \_\_\_\_\_ DATE EXECUTED: \_\_\_\_\_

For new applicants, date effective is the date received in our office.

**NAME OF CORPORATION**

(Set forth complete name of each corporation.)

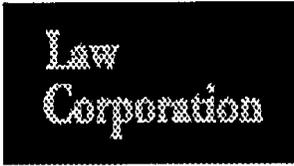
**SHAREHOLDER SIGNATURES**

(Please type name under each signature. Signatures must be original.)

_____	_____
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_____	_____

The State Bar of California

File No. \_\_\_\_\_  
(to be completed by State Bar)



**ATTACHMENT C**

**Law Corporation**

**Declaration of Compliance with Rule 1-400,  
of the State Bar of California**

The undersigned, on behalf of

\_\_\_\_\_  
(Set forth complete name of corporation and designation)

does hereby certify that the name of this law corporation complies with the Rules of Professional Conduct of the State Bar of California, Rule 1-400.

**Declaration**

I am \_\_\_\_\_  
(Person with authority to sign on behalf of the corporation)

and do hereby make this declaration on behalf of said corporation. I have read the foregoing and the same is true of my own knowledge. I declare, under penalty of perjury under the laws of the State of California, that the foregoing is true and correct.

Executed on \_\_\_\_\_

Signed \_\_\_\_\_

Print Name \_\_\_\_\_

*Comment:* The completed form should be submitted to the State Bar of California, at the address listed in the form,

accompanied by a \$200 fee. The form may be printed from the State Bar website. For the website address, see the Directory.

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**Source:** Business Law/Selecting and Forming Business Entities/10 Professional Corporations/ 2. Medical Corporations/  
§10.77 a. Fictitious Name Permit Requirement

## **2. Medical Corporations**

### **§10.77 a. Fictitious Name Permit Requirement**

A medical corporation may be named in the name of the physician, if the corporation is a sole shareholder medical corporation (e.g., John Smith, M.D., Inc.). However, a physician may only practice under a fictitious name (e.g., Smith Medical Group, Inc.) if the medical corporation first obtains a fictitious name permit from the Medical Board of California Licensing Program. Names that are currently in use are listed on the Medical Board's website; the applicant should review this list first to see if the desired name is available. For the website address, see the Directory. No medical services should be rendered by the medical corporation before obtaining the fictitious name permit. Bus & P C §§2285, 2415; Corp C §13409; 16 Cal Code Regs §1350.

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**Source:** Business Law/Selecting and Forming Business Entities/10 Professional Corporations/§10.78 b. Form: Fictitious Name Permit Application (Medical Board of California Form FNP-001)

**§10.78      b. Form: Fictitious Name Permit Application (Medical Board of California Form FNP-001)**





**MEDICAL BOARD OF CALIFORNIA**  
Licensing Program



**FICTITIOUS NAME PERMIT APPLICATION**

FOR OFFICE USE ONLY	
Fee Paid:	Receipt No.:

**INSTRUCTIONS:**

Please print or type. ALL INCOMPLETE OR COPIED APPLICATIONS WILL BE RETURNED.

For Individuals (Sole Proprietor) or Partnerships\*: fill out items 1, 2, 3, 4, and 5 and mail with the \$50 fee.

For Corporations\*\*: fill out items 1, 2, 3, 6a or 6b and 7 and mail with a copy of the endorsed Articles of Incorporation (articles that were originally filed with the Secretary of State and any amendments) and the \$50 fee.

\* For Partnerships comprised of corporations, submit endorsed Articles of Incorporation for each corporation.

\*\* In California you may only practice medicine as a corporation if you are a California Professional Medical Corporation (Business and Professions Code §2402, Corporations Code §13401.5).

Mail application to: Medical Board of California  
Licensing Program  
2005 Evergreen Street, Suite 1200  
Sacramento, CA 95815-3831

Fee: \$50 (non-refundable) check, money order or cashier's check  
Payable to: Medical Board of California

<b>1.</b>	<b>Practice Address (must be a physical address in California)</b>			
	Physician or Corporation Name			
	Street Address (P.O. Boxes are not acceptable)			
	City	State	Zip Code	Telephone No.
		CA		
	Additional Practice Locations: Yes <input type="checkbox"/> No <input type="checkbox"/> (List additional practice address(es) and telephone number(s) on a separate attachment)			
	<b>Mailing Address for the Fictitious Name Permit (if different than the practice address)</b>			
	Name			
	Address			
		City	State	Zip Code
<b>2.</b>	<b>Business Type</b>			
	The applicant is applying as: (check only one)			
	<input type="checkbox"/> Professional Medical Corporation*	<input type="checkbox"/> Individual (Sole Proprietor)		
	<input type="checkbox"/> Professional Podiatry Corporation	<input type="checkbox"/> Partnership		
		<input type="checkbox"/> Medical Group		
*The corporation must be a California professional medical corporation incorporated under California Corporations Code §13400 et. seq.				

<b>3.</b>	<p><b>Fictitious Name Choices</b></p> <p>Enter your fictitious name choices in order of preference. If the name is an acronym or includes abbreviations, foreign words or a name other than your own, please provide an explanation of its meaning.</p> <p>Names of current Fictitious Name Permits are on the Medical Board of California web site, <a href="http://www.mbc.ca.gov">www.mbc.ca.gov</a>. Please review the site to determine if your name is available. Business and Professions Code §2285 prohibits practicing under a fictitious name until the Board has issued a Fictitious Name Permit.</p> <p>1. _____</p> <p>2. _____</p> <p>3. _____</p>
-----------	---

**FOR INDIVIDUALS (SOLE PROPRIETORS) AND PARTNERSHIPS ONLY**

<b>4.</b>	<p>If applying as an <b>Individual (Sole Proprietor)</b>, enter your Social Security Number: _____</p> <p>If applying as a <b>Partnership</b>, enter your Federal Employer Identification Number (FEIN): _____</p>	
<b>5.</b>	<p><b>Owners</b></p> <p>Those with an ownership interest in the applicant must be listed and must sign below. Attach additional sheet(s) if necessary.</p> <p>The undersigned and each of the undersigned hereby certifies under penalty of perjury under the laws of the State of California that statements made on this Fictitious Name Permit Application, and all attachments thereto, are true and correct.</p>	
	Type/Print Name	Medical License #
	Signature	Date
	Type/Print Name	Medical License #
	Signature	Date
	Type/Print Name	Medical License #
	Signature	Date
	Type/Print Name	Medical License #
	Signature	Date
	Type/Print Name	Medical License #
	Signature	Date
	Type/Print Name	Medical License #
	Signature	Date

<b>FOR PROFESSIONAL CORPORATIONS ONLY</b>																													
<b>6.</b>	<p><b>Shareholders</b></p> <p>A licensed physician and surgeon must own at least 51% of the outstanding shares of a professional medical corporation. The remaining 49% may be owned by licensed podiatrists, licensed psychologists, registered nurses, licensed optometrists, licensed marriage and family therapists, licensed clinical social workers, licensed physician assistants, licensed chiropractors, or licensed acupuncturists. The number of these licensed persons cannot exceed the number of physicians and cannot exceed a combined share total of 49%.</p> <p><b>A lay (unlicensed) person cannot own any shares in a professional medical corporation in California.</b></p>																												
<b>6a.</b>	<p><b>If all shareholders are physicians, complete this section. If there are non-physician shareholders, proceed to 6b.</b></p> <table border="1" style="width: 100%; border-collapse: collapse;"> <thead> <tr> <th rowspan="2" style="width: 55%;">Name (attach additional sheet(s) if necessary)</th> <th rowspan="2" style="width: 15%;">Medical License No.</th> <th colspan="2" style="text-align: center;">Shareholder</th> </tr> <tr> <th style="width: 10%;">Yes</th> <th style="width: 10%;">No</th> </tr> </thead> <tbody> <tr><td> </td><td> </td><td> </td><td> </td></tr> </tbody> </table>			Name (attach additional sheet(s) if necessary)	Medical License No.	Shareholder		Yes	No																				
Name (attach additional sheet(s) if necessary)	Medical License No.	Shareholder																											
		Yes	No																										
<b>6b.</b>	<p><b>If ownership includes non-physicians, complete this section.</b></p> <table border="1" style="width: 100%; border-collapse: collapse;"> <thead> <tr> <th style="width: 45%;">Names of all shareholders (attach additional sheet(s) if necessary)</th> <th style="width: 15%;">License No.</th> <th style="width: 15%;">% of Shares</th> <th style="width: 25%;">Profession</th> </tr> </thead> <tbody> <tr><td> </td><td> </td><td> </td><td> </td></tr> </tbody> </table>			Names of all shareholders (attach additional sheet(s) if necessary)	License No.	% of Shares	Profession																						
Names of all shareholders (attach additional sheet(s) if necessary)	License No.	% of Shares	Profession																										
<b>7.</b>	<p><b>Corporation</b></p> <table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 60%;">Complete Name of Corporation</td> <td style="width: 40%;">Corporation #</td> </tr> </table> <p>I certify at least 51% of said corporation's shares are owned by a licensed physician and surgeon or podiatrist and as such make this declaration for and on behalf of said corporation. I have read the foregoing application and all attachments thereto and know the contents thereof, and the same are true of my own knowledge.</p> <p>I declare under penalty of perjury under the laws of the State of California that I am a <b>licensed physician or podiatrist</b> and have the legal authority to act on behalf of said corporation and that the information contained in this application and all attachments thereto is true and correct.</p> <p>Executed at _____, California, this _____ day of _____, _____ year  <small style="margin-left: 100px;">city</small> <small style="margin-left: 150px;">day</small> <small style="margin-left: 100px;">month</small> <small style="margin-left: 100px;">year</small></p> <p>By: _____  <small style="margin-left: 20px;">type/print name</small> <small style="margin-left: 300px;">corporate title</small></p> <p>Signature: _____</p>			Complete Name of Corporation	Corporation #																								
Complete Name of Corporation	Corporation #																												

**Visit the Medical Board of California web site at [www.mbc.ca.gov](http://www.mbc.ca.gov) to download confirmation information.**

The Information Practices Act, Section 1798.17 Civil Code, requires the following information to be provided when collecting information from individuals. Agency Name: Medical Board of California, Licensing Program, 2005 Evergreen Street, Suite 1200, Sacramento, CA 95815-3831; Telephone (916) 263-2382. The official responsible for information maintenance is the Program Manager for Licensing Operations. The authority which authorizes the maintenance of the information is the Business and Professions Code. Publ.L 94-445(42 U.S.C.A.405c(2)(C)) authorizes collection of your social security number (SSN) and/or federal employer identification number (FEIN). Your SSN and/or FEIN will be used exclusively for tax enforcement purposes and for purposes of compliance with any judgment or order for family support in accordance with Section 11350.6 of the Welfare & Institutions Code. If you fail to disclose your SSN or FEIN, you will be reported to the Franchise Tax Board, which may assess a \$100.00 penalty against you. Failure to provide all or any part of the requested information will result in this form being rejected as incomplete. The principal purpose(s) for which the information is to be used is to determine your eligibility for a Fictitious Name Permit pursuant to Section 2415 of the Business and Professions Code. Any known or foreseeable interagency or intergovernmental transfer that may be made of the information, when necessary, is to other federal, state and local law enforcement agencies. Each individual has the right to review the files or records maintained on him or her by the agency, except for information exempt from disclosure pursuant to Section 6254 of the Government Code or Section 1798.40 of the Civil Code.

Section 2415 of the Business and Professions Code states in pertinent part:

(a) Any physician and surgeon or any doctor of podiatric medicine, as the case may be, who as a sole proprietor, or in a partnership, group, or professional corporation, desires to practice under any name that would otherwise be a violation of Section 2285 may practice under that name if the proprietor, partnership, group, or corporation obtains and maintains in current status a fictitious name permit issued by the Division of Licensing, or, in the case of doctors of podiatric medicine, the California Board of Podiatric Medicine, under the provisions of this section.

(b) The division or the board shall issue a fictitious name permit authorizing the holder thereof to use the name specified in the permit in connection with his, her, or its practice if the division or the board finds to its satisfaction that:

- (1) The applicant or applicants or shareholders of the professional corporation hold valid and current licenses as physicians and surgeons or doctors of podiatric medicine, as the case may be.
- (2) The professional practice of the applicant or applicants is wholly owned and entirely controlled by the applicant or applicants.
- (3) The name under which the applicant or applicants propose to practice is not deceptive, misleading, or confusing.

indicated in the form, accompanied by a \$50 fee and a copy of the articles of incorporation of the professional medical corporation. The form is available online at <http://www.medbd.ca.gov/forms/fnp-001.pdf>.

Applications for fictitious name permits are reviewed in the order they are received, with an approximate processing time of 8 to 10 weeks. After review, the permit is approved or a letter of deficiency is mailed to the applicant explaining the specific problems. The applicant is provided with an opportunity to correct any deficiency.

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**Source:** Business Law/Selecting and Forming Business Entities/10 Professional Corporations/§10.79 E. Stock Purchase Agreement

### **§10.79 E. Stock Purchase Agreement**

A stock purchase agreement dealing with the disposition of the shares of a deceased or withdrawing shareholder is almost a necessity for a professional corporation because of statutory stock purchase requirements relating to professional corporations. Such an agreement may also control in the event of a marital dissolution. See *Marriage of Nichols* (1994) 27 CA4th 661, 33 CR2d 13.

The following forms in §§10.80-10.87 do not represent a complete stock purchase agreement. The clauses are samples of clauses in a medical corporation stock purchase agreement that relate directly to the professional nature of the corporation. For more extensive discussion of corporate buy-out agreements, see *Business Buy-Sell Agreements*, chap 3 (Cal CEB 1991).

These clauses appear in many agreements, but additional clauses tailored to the needs of a client in a particular profession must also be included. Special attention must be paid to the statutory provisions governing professional corporations and to regulations, applicable to the profession, restricting ownership and management of the corporation.

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**Source:** Business Law/Selecting and Forming Business Entities/10 Professional Corporations/§10.80 1. Form: Intent to Comply With Law and Regulations

## **§10.80 1. Form: Intent to Comply With Law and Regulations**

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §10.80 and ends in §10.87

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10.80-1 Intent to comply with law and regulations

**A. *Intent to Comply With Applicable Law and Regulations.*** It is the intention of all parties to this agreement that it shall comply with the provisions of the California Business and Professions Code and the California Corporations Code regulating professional corporations and with the regulations authorized under them.

*Comment:* This clause is desirable because of strict limitations on ownership, management, and transfers of stock imposed on professional corporations by the codes and regulations. See, e.g., Corp C §13407; Bus & P C §§2508 (medical or podiatric), 6165 (law). A "blanket intent" clause may eliminate legal problems in resolution of ambiguities.

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## §10.81 2. Form: Purchase Agreement

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §10.80 and ends in §10.87

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10.81-1 Purchase agreement

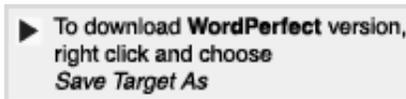
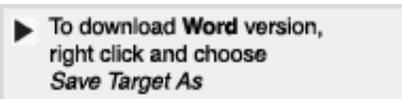
**B. Purchase Agreement.** If a shareholder's employment with the corporation is terminated for any reason, including death or permanent disability, or if a shareholder ceases to be an eligible shareholder or becomes a disqualified person as defined by Corporations Code §13401(e) for a period exceeding 90 days, the Corporation shall purchase his or her shares and the shareholder or his or her personal representative or other successor in interest shall sell his or her shares to the Corporation according to the terms of this agreement.

*Comment:* This clause requires the corporation to purchase shares of a terminated, ineligible, or disqualified shareholder. This clause is more restrictive than medical and dental rule requirements, which allow these shares to be sold to the corporation or to another eligible person. See 16 Cal Code Regs §1345. See also Law Corp R IV(C)(2). In addition, a legal guardian or executor may hold a dentist's shares for a period of up to 12 months (if certain conditions are satisfied) on the incapacity or death of a dentist who is the sole shareholder of the dental corporation. Bus & P C §§1625.3-1625.5; Corp C §13407. See §10.5. The statutory restrictions on a corporation's reacquisition of its shares may require modification of this clause. See Corp C §§500-511.

As an alternative to requiring the corporation to purchase the shares of a withdrawing shareholder, it may be desirable in some circumstances (e.g., on termination of employment) to provide that the corporation may have an option to purchase the shares, and, if the option is not exercised, that the shareholders may agree to vote that the corporation be promptly dissolved in accordance with the Corporations Code. A professional corporation may purchase its own shares without regard to any restrictions provided by law on repurchase of shares if at least one share remains issued and outstanding. Corp C §13407.

### §10.82 3. Form: Purchase Price

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §10.80 and ends in §10.87



10.82-1 Purchase price

**C. Purchase Price.** The purchase price for the shares to be purchased by the Corporation or the remaining shareholders shall be determined as follows: \_\_[specify formula]\_\_\_. No income attributable to services rendered by the Corporation after the shareholder becomes a disqualified person shall be considered in determining the value of the shareholder's stock.

*Comment:* Determining the purchase price of the shares is one of the most difficult problems in preparation of the stock purchase agreement. See Business Buy-Sell Agreements, chap 5 (Cal CEB 1991). One important question is whether the purchase price of the shares should include the value of the withdrawing shareholder's prorata share of the uncollected accounts receivable (and work in process). Frequently, receivables are not reflected in the purchase price of the shares but are taken into account by providing in the employment agreement for termination payments that are equivalent to the withdrawing shareholder-employee's prorata share of receivables. The manner in which unrealized receivables are handled has tax and cash-flow implications for both shareholder and corporation.

If the value of the unrealized receivables is included in the purchase price of the shares, the corporation will have to pay taxes on the receivables as they are collected, but the stock purchase payments will be nondeductible. The withdrawing shareholder's gain on the sale will generally be taxed as capital gain. See IRC §§1(h), 1221-1222.

If the value of unrealized receivables is taken into account by providing for termination pay under the employment agreement, the shareholder-employee will recognize ordinary income on receipt of the payments and the corporation probably will be entitled to a deduction for payments to the former shareholder. The payments to the shareholder-employee may be subject to wage withholding and employment taxes, and any such termination pay should be designed to comply with the timing and payment requirements of IRC §409A, dealing with nonqualified deferred compensation. There is also some risk that the Internal Revenue Service might assert that the alleged deferred compensation payments are in fact a redemption payment for the shareholder's interest and therefore nondeductible. See Treas Reg §1.162-7(b)(1). Regardless of the method of handling unrealized receivables, consideration should be given to adjusting the value of receivables to reflect estimated write-offs and expenses of collection.

Income attributable to services rendered while a shareholder is a disqualified person may not in any manner accrue to the shareholder's benefit. Bus & P C §§6166; Law Corp R IV(C)(5).

Another important question in determining the purchase price of shares is whether goodwill exists, and, if so, whether it should be taken into account. For discussion of corporate valuation problems relating to goodwill, see Buy-Sell Agreements §§5.12, 5.32.

**Source:** Business Law/Selecting and Forming Business Entities/10 Professional Corporations/§10.83 4. Form: Time for Completion of Sale or Transfer

#### §10.83 4. Form: Time for Completion of Sale or Transfer

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §10.80 and ends in §10.87

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10.83-1 Time for completion of sale or transfer

*[Add one of the following alternatives]*

*[Alternative 1: Completion after purchase price determined]*

**D. Close of Sale.** The sale shall be closed as soon as possible after the purchase price has been determined but no later than the time indicated. The price shall be paid as follows: \_\_ *[insert schedule]* \_\_.

*[Alternative 2: Completion after death of shareholder]*

**D. Close of Sale.** The sale shall be closed as soon as possible after the purchase price has been determined but no later than the time indicated. The price shall be paid as follows: \_\_ *[insert schedule]* \_\_. If the sale is being made because of the shareholder's death, the sale shall be closed as soon as possible after the purchase price has been determined but no later than six (6) months after the shareholder's death.

*[Alternative 3: Completion following ineligibility or disqualification of shareholder]*

**D. Close of Sale.** If the sale is being made because the shareholder ceases to be an eligible shareholder (other than by death) or becomes a disqualified person as defined by Corporations Code §13401(e) for a period exceeding 90 days, the sale shall be closed and the transfer completed as soon as possible after the purchase price has been determined but no later than 90 days after the seller ceases to be an eligible shareholder or becomes a disqualified person.

*Comment:* Shares of deceased persons must be sold or transferred to the corporation, other shareholders, or other eligible persons (not applicable to law corporations) within 6 months after death, except in the case of certain dental corporations (see Bus & P C §§1625.3-1625.5; see §10.5). Corp C §13407; Law Corp R IV(C)(2); 16 Cal Code Regs §§1345(a). If the purchase price is substantial, it may be desirable to provide for an immediate closing with payments to be made in installments over an extended period of time. This option should be evaluated under the tax rates and installment sales rules of IRC §§1, 453, and 1274.

**Source:** Business Law/Selecting and Forming Business Entities/10 Professional Corporations/§10.84 5. Form: Repurchase by Reinstated Employee

## §10.84 5. Form: Repurchase by Reinstated Employee

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §10.80 and ends in §10.87

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10.84-1 Repurchase by reinstated employee

**E. Repurchase by Reinstated Employee.** If shares have been sold to the Corporation or its shareholders because of the seller's disqualification or ineligibility, and, within one (1) year after the sale, the seller again becomes an eligible shareholder and is not a disqualified person, he or she may repurchase, and the Corporation or other shareholders shall sell, the shares, at a price calculated in the same way that the original buy-out price was calculated.

*Comment:* A corporation and its shareholders may agree that shares sold to it by a person who becomes a disqualified person, except by disbarment as an attorney, may be resold to that person if and when he or she again becomes an eligible shareholder. Law Corp R IV(C)(3); 16 Cal Code Regs §1345(b).

The shares may be resold at the buy-out price. If the shares are of greater value because of retained earnings, doing so may be a disguised way of permitting a disqualified shareholder to benefit from income attributable to services rendered while the shareholder is a disqualified person, which is forbidden. See Bus & P C §6166.

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**Source:** Business Law/Selecting and Forming Business Entities/10 Professional Corporations/§10.85 6. Form: Sale of Shares to Eligible Employee

## §10.85 6. Form: Sale of Shares to Eligible Employee

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §10.80 and ends in §10.87

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10.85-1 Sale of shares to eligible employee

**F. Eligibility to Become Shareholder.** On completion of one year as an employee of the Corporation, a physician shall be eligible to become a shareholder, on approval of all the then shareholders, at a price determined as if that physician were then terminating as a shareholder.

*Comment:* Care must be taken in determining the price for the sale of shares to an employee. If the shares are sold at a price less than the shares' fair market value, the employee may recognize income on the purchase of the discounted shares under the rules of IRC §83.

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**Source:** Business Law/Selecting and Forming Business Entities/10 Professional Corporations/§10.86 7. Form: Change of Corporation's Name

## §10.86 7. Form: Change of Corporation's Name

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §10.80 and ends in §10.87

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10.86-1 Change of corporation's name

**G. Change of Name.** On termination of employment of any person or on his or her ceasing to be a shareholder of the Corporation, the Corporation may, at its option, change the Corporation's name to omit that person's name.

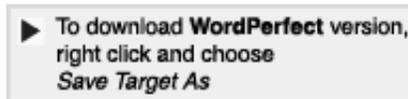
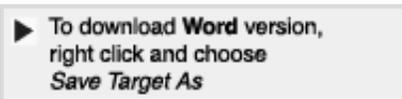
*Comment:* For discussion of corporate name restrictions, see §10.21.

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**Source:** Business Law/Selecting and Forming Business Entities/10 Professional Corporations/§10.87 8. Form: Restrictions on Certificate

## §10.87 8. Form: Restrictions on Certificate

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §10.80 and ends in §10.87



10.87-1 Restrictions on certificate

**H. Restrictions on Certificate.** On execution of this agreement, the parties shall cause the certificates representing the Corporation's shares of common stock owned by the shareholders who are the parties to be endorsed as follows:

(1) Notice is hereby given that the sale, assignment, transfer, pledge, or other disposition of the shares of common stock represented by this certificate are subject to a restrictive agreement dated \_\_[date]\_\_, between \_\_[list names]\_\_. A copy of the agreement is on file in the office of the Corporation's Secretary.

(2) Shares of this Corporation may be owned only by this Corporation or by \_\_[type of licensed professional, e.g., licensed dentists]\_\_ (Eligible Shareholders).

(3) When a shareholder of this Corporation dies, ceases to be an eligible shareholder, or becomes a disqualified person as defined by Corporations Code §13401(e) for a period exceeding 90 days, his or her shares shall be sold and transferred to the Corporation or to the remaining shareholders in accordance with the agreement referred to in subparagraph (1) of this section H.

The parties agree that all the Corporation's shares of stock issued to the shareholders after the above date shall be subject to the terms of this agreement and that the certificates representing any such shares shall be endorsed with the appropriate notice contained in this section H.

No additional shares of the Corporation's stock shall be issued without the written consent of all the parties.

*Comment:* Share certificates should contain a legend setting forth these restrictions. See 16 Cal Code Regs §1345(c); Law Corp R IV(C)(4).

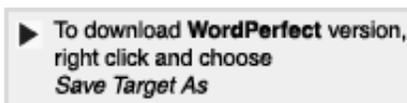
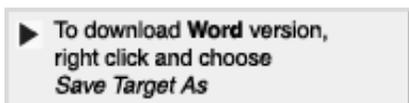
## **F. Employment Agreement**

### **§10.88 1. Nature of Agreement**

An employment agreement is a formal instrument that sets out in detail the employment relationship. Use of written employment agreements is recommended for all professional corporations. Besides fixing compensation, these agreements cover many matters that normally are found in a professional partnership agreement. The employment agreement should be coordinated with the stock purchase agreement to provide for termination and death benefits.

In preparing any employment agreement between professionals and a professional corporation, attention must be paid to all statutes and regulations relevant to the profession practiced by the corporation, income tax consequences to the corporation, and income and estate tax consequences to the employee. The employment agreement in §10.89 is designed for a small medical or law corporation with more than two professional employees. The agreement is presented with few annotations and should not be used as a model or prototype; rather, it is included merely to indicate the type of provisions that might be included in such an agreement. The tax consequences of the various provisions included in the agreement must be carefully analyzed.

§10.89 2. Form: Employment Agreement



10.89-1 Employment agreement

\_\_ *[Name of professional corporation]* \_\_ Employment Agreement

**A. Recitals.** This Agreement is between the following parties:

**Employer:** \_\_ *[Name of professional corporation]* \_\_ ("Employer")

**Professional:** \_\_ *[Name and address of professional employee]* \_\_ ("Professional")

This Agreement is effective as of \_\_ *[date]* \_\_.

Professional is a \_\_ *[physician/attorney]* \_\_ licensed to practice \_\_ *[medicine/law]* \_\_ by the State of California. Professional desires to practice \_\_ *[medicine/law]* \_\_ as an employee of Employer, and Employer desires to employ Professional under the terms and conditions of this Agreement.

**A. Term of Employment.** Subject to earlier termination as provided in this Agreement, Professional shall be employed for the following term: \_\_ *[specify starting and termination dates]* \_\_. This term shall be automatically renewed on expiration for successive periods of \_\_ *[number]* \_\_ year(s), subject to the same conditions, unless Professional is notified to the contrary as provided in this Agreement.

**B. Employee's Services.**

1. During the employment term, Professional agrees to devote \_\_ *[his/her]* \_\_ full working time and attention to the practice of \_\_ *[medicine/law]* \_\_ for Employer and shall not, without Employer's prior written consent, otherwise render \_\_ *[medical/legal]* \_\_ services for compensation.

2. Professional agrees to perform the duties and undertake the responsibilities prescribed by Employer's Board of Directors. Professional acknowledges that Employer's Board of Directors has the sole authority to assign Professional work among its employees.

**C. Salary.** Employer shall pay Professional in equal monthly installments the following basic annual salary: \$ \_\_ *[amount]* \_\_.

**D. Bonus.** In addition to the basic annual salary provided for above, Employer may, at its discretion, pay to Professional an annual bonus that the Board of Directors determines is proper in relation to the income generated or services performed by Professional for Employer.

**E. Benefits.** During the employment term, Professional shall be entitled to receive, when Professional becomes eligible for them, all other benefits of employment, including but not necessarily limited to \_\_ *[e.g., group health insurance benefits, sick leave]* \_\_ that are generally available to Employer's other employees and not inconsistent with other provisions of this Agreement.

**F. Reimbursement for Expenses.** During the employment term, Employer may, at the discretion of Employer's Board of Directors, reimburse Professional for reasonable out-of-pocket expenses incurred in connection with Employer's business, including but not necessarily limited to professional license fees, dues to professional societies, expenses, and food and lodging while away from home.

**G. Vacation.** Professional shall be entitled to \_\_ *[number]* \_\_ weeks of paid vacation a year.

**H. Malpractice Insurance.** Employer shall purchase and maintain during Professional's employment under this Agreement malpractice insurance, if available, in an amount of not less than \$ \_ [amount] \_ that insures Employer and its professional employees (including but not necessarily limited to Professional) against all liabilities, costs, damages, expenses, and attorney fees attributable to the acts or omissions of Employer or its professional employees.

**I. Disability Insurance.** Employer has advised Professional that it currently maintains group disability insurance for its employees. During the term of this Agreement, Employer agrees to maintain disability insurance covering Professional on terms and conditions no less favorable than the terms and conditions of the group disability insurance policy in effect on the date of this Agreement.

**J. Life Insurance.** Employer may insure Professional's life with one or more policies of insurance the proceeds of which are payable to Employer and in which Professional shall have no ownership or beneficial rights. Professional shall cooperate in good faith in obtaining such insurance and shall submit to any required medical examinations.

**K. Events Terminating Employment.** Professional's employment under this Agreement shall terminate when any of the following occurs:

1. Employer determines that it is not appropriate to continue to employ Professional because of \_ [his/her] \_ loss of any government license or professional standing, either temporarily or permanently, reasonably considered by Employer to be essential to the performance of Professional's duties.

2. Employer determines that it is not appropriate to continue to employ Professional because Professional has either committed a material act of dishonesty, disclosed confidential information, committed gross carelessness or misconduct, unjustifiably neglected employment duties, or acted in a way that has had a direct, substantial, and adverse effect on Employer's reputation.

3. Professional fails to rectify a breach of any of the terms, covenants, and conditions of this Agreement within 30 days after written notice from Employer to cure the breach.

4. Employer and Professional mutually agree in writing to terminate the Agreement.

5. Professional is unable because of physical or mental illness or injury to perform \_ [his/her] \_ duties in a normal and regular manner for a period of \_ [number] \_ months. The termination shall be effective as of the end of the calendar month in which the disability period ends.

6. Professional voluntarily retires. Professional's voluntary retirement shall be effective on the last day of the fiscal year in which Professional reaches the voluntary retirement age specified below, provided that Professional has given Employer prior written notice, in the period specified below, of Professional's election to retire.

Voluntary retirement age: \_ [specify] \_

Notice period: \_ [specify] \_

7. Professional's death. If Professional dies during the term of this Agreement, this Agreement shall terminate on the last day of the calendar month in which \_ [his/her] \_ death occurred.

*[If applicable, add one or more of the following options]*

*[Option 1: Termination payments]*

**L. Termination Payments.** If Professional's employment terminates because of \_ [describe termination events, e.g., resignation, retirement, death, disability] \_ , Employer shall pay to Professional or, if appropriate, to \_ [his/her] \_ designated beneficiaries or estate \_ [specify form and amounts of payments] \_ .

*[Option 2: Death benefit]*

**[M.] Death Benefit.** If Professional dies during the term of this Agreement, Employer shall pay within 90 days after \_ [his/her] \_ death the sum of \$ \_ [amount] \_ , in addition to any other amounts owed under this



company status from attaching to the professional corporation. See IRC §543(a)(7); Treas Reg §1.543-1.

The termination payments described in paragraph 8 should be coordinated with the death benefit and disability benefit provisions of the agreement and also with benefits under the corporation's retirement or other employee benefit plans that cover the professional employee. All termination pay arrangements and any provisions for the payment of deferred compensation (apart from payments under qualified retirement plans) must be carefully drafted to comply with the timing and payment requirements of IRC §409A, which deals with nonqualified deferred compensation.

For compensation and bonuses payable to employees and independent contractors of professional medical corporations, the compensation structure and allocation of overhead may need to be structured to comply with the federal anti-kickback law (42 USC §§1320a-7b), the federal physician self-referral law (42 USC §1395nn) (known as the Stark law), and related regulations and similar California laws which govern arrangements between physicians and the entities to which they refer, under certain circumstances. See Bus & P C §§650, 650.01, 650.02; Welf & I C §14107.2; Lab C §§139.3, 139.31.

On who should sign for the corporation, see Corp C §313.

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11

Limited Liability Companies

Charles E. McKee

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.1 I. SCOPE OF CHAPTER

§11.1 I. SCOPE OF CHAPTER

This chapter provides an overview of issues that the practitioner must consider in forming a limited liability company (LLC). It discusses the definition of an LLC, the governing law, tax considerations, election of tax classification, and securities laws. See [§§11.2-11.11](#). It also touches on operating considerations, such as members' rights, management, officers, allocations and distributions, and records. See [§§11.12-11.25](#). The chapter discusses briefly dissolution and foreign LLCs (see [§§11.26-11.27](#)) and also addresses various formation issues, as well as providing checklists of formation considerations. See [§§11.28-11.37](#). Secretary of State forms relevant to LLC formation are reproduced in [§§11.38-11.47](#). The chapter also includes a detailed, long-form LLC operating agreement. See [§§11.48-11.233](#).

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## II. INTRODUCTION

### §11.2 A. What is a Limited Liability Company?

A limited liability company (LLC) is one of the newer forms of business entities available to the business practitioner. An LLC is the entity favored by many attorneys because it combines the limited liability attribute of a corporation with the favorable taxation treatment and structural flexibility attributes of a partnership. An LLC has the rights, powers, and obligations given by the laws of the state under which it is organized. Since it is a separate entity, it may sue and be sued in its own name. Depending on the desires of its owners, called members, an LLC may be structured to resemble a sole proprietorship, a partnership, a corporation, or an amalgam of the attributes of each.

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/ B. Governing Law/  
§11.3 1. California Law

B. Governing Law

§11.3 1. California Law

In California, LLCs are governed by the Beverly-Killea Limited Liability Company Act (Corp C §§17000-17656).

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§11.4 2. Tax Laws

The discussion of federal and California tax laws in §§11.5-11.6 is intended as an overview, as a detailed discussion is beyond the scope of this chapter. For a summary of federal income taxation of LLCs, see §§2.145-2.148. For a comprehensive discussion, see Forming and Operating California Limited Liability Companies, chap 5 (2d ed Cal CEB 2007). See also Friedland & Petersen, *California Partnerships and Proprietorships: Practice and Compliance Guide* (1992); McKee, Nelson & Whitmire, *Federal Taxation of Partnerships and Partners* (4th ed 2007); and Willis, Pennell & Postlewaite, *Partnership Taxation* (6th ed 1997).

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.5 a. Tax Classification Under Federal Law

§11.5 a. Tax Classification Under Federal Law

LLCs may elect to be classified as a partnership or as a corporation for income tax purposes. See [§11.6](#). Usually, LLCs elect classification as a partnership in order to be a pass-through entity for income tax purposes. As a pass-through entity, an LLC is not subject to income tax at the entity level. IRC §701. Instead, LLC members report their respective distributive shares of LLC income, gain, loss, deduction, and credit on their individual federal income tax returns. IRC §702(a). Although an LLC classified as a partnership is not a separate tax-paying entity, its taxable income is computed at the entity level. IRC §703. An LLC must report its taxable income on an annual information return, which also reflects the members' distributive shares. IRC §6031(a). See IRS Form 1065 and Schedule K-1 (1065).

Pass-through tax treatment often makes the LLC a more attractive form of entity than a C corporation, which is taxed at both the entity level and the shareholder level. See [§2.121](#). In addition, LLCs are not subject to the restrictions placed on S corporations by the tax laws, such as limitations on the number and type of shareholders and limitation to only one type of shares. See [§§2.128-2.129](#).

However, an LLC may elect to be taxed as a C corporation. If it so elects, the LLC will report and pay taxes on its income, and its members will report as income and pay taxes on only actual distributions from the LLC. Because this results in taxation on both the LLC and its members, LLCs generally do not elect this type of tax treatment.

**NOTE:** If an LLC has only one member, it may elect to be taxed like a C corporation or it may elect to be disregarded as a taxable entity, similar to a sole proprietorship or a division of a larger company. However, a single-member LLC in California must still file FTB Form 568. See [§11.7](#).

The election by an LLC to adopt pass-through tax treatment, which is an election to be disregarded as a taxable entity, has no effect on the legal status of the ownership of assets by the LLC. *Gilliam v Speier (In re KRSM Props., LLC)* (9th Cir BAP 2004) 318 BR 712, 719. Effective January 1, 2009, the sole owner of a single-member LLC that elects to be disregarded as a taxable entity is no longer liable for the LLC's unpaid employer taxes and employee tax withholdings (but the sole owner will be liable for unpaid self-employment taxes). Treas Reg §301.7701-2(c)(iv). Prior to January 1, 2009, the sole owner of a single-member LLC was liable for the LLC's unpaid employer taxes and employee tax withholdings because as a disregarded entity, the IRS treated the sole owner and not the LLC as the employer. *McNamee v Department of the Treasury* (2d Cir 2007) 488 F3d 100.

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.6 b. Making Federal Tax Classification Election

§11.6 b. Making Federal Tax Classification Election

The IRS "check-the-box" regulations allow an LLC to choose to be taxed as a partnership, taxed as a C corporation, or to be treated as a disregarded entity if the LLC is a single-member entity. See Treas Reg §§301.7701-1—301.7701-3. For an LLC with two or more members, the default election (if no filing is made) is partnership-type tax treatment; if an LLC has only one member, the default election is to be disregarded as a tax entity. Treas Reg §301.7701-3(b)(1)(ii). California law generally conforms to federal law. See 18 Cal Code Regs §§23038(b)-1—23038(b)-3. For more details on the election, see [§2.117](#).

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.7 c. California Income Tax, Franchise Tax, and Annual Fee

§11.7 c. California Income Tax, Franchise Tax, and Annual Fee

California law generally conforms to federal law with respect to the income taxation of LLCs. Rev & T C §§17851-17851.5. However, California imposes on LLCs both an annual franchise tax and an annual fee based on the amount of the "total income" of the LLC derived from or attributable to California for the taxable year. Rev & T C §§17942-17943.

As with corporations, limited partnerships, and limited liability partnerships, each LLC organized, qualified, or doing business in California is subject to an annual \$800 franchise tax for the privilege of doing business in California. This tax is prepaid using FTB Form 3522 and is due and payable on or before the 15th day of the fourth month after the beginning of the taxable year of the LLC. Rev & T C §§17941(a)-(c), 23153(d)(1). The taxable year of a new LLC begins when it is organized.

For each taxable year, the LLC also must file FTB Form 568 and Schedule K-1 in a manner similar to IRS Form 1065, and report the "total income." The LLC must also pay the annual fee based on "total income" with the return. The return is due on or before the 15th day of the fourth month after the close of the taxable year of the LLC (Rev & T C §§17942(c), 18633.5), but the annual LLC fee must be estimated and paid on or before the 15th day of the sixth month of the current taxable year. Rev & T C §17942(d)(1). There is a penalty of 10 percent of the amount of any underpayment of the annual LLC fee, unless the estimated amount paid is at least equal to the total amount of the annual LLC fee for the prior taxable year. Rev & T C §17942(d)(2). "Total income" for these purposes means gross income plus the cost of goods sold that are paid or incurred in connection with the LLC's trade or business. For tax years beginning on or after January 1, 2007, "total income" includes only total income derived from or attributable to California, using the attribution rules in Rev & T C §§25135-25137. See Rev & T C §§17942(b)(1), 24271.

The annual fee is calculated as follows (Rev & T C §17942(a)):

Total income	Annual Fee
Less than \$250,000	\$0
\$250,000 to less than \$500,000	\$900
\$500,000 to less than \$1 million	\$2500
\$1 million to less than \$5 million	\$6000
\$5 million or more	\$11,790

Before January 1, 2007, "total income" included income earned in all states and was not apportioned based on the level of the LLC's activity in each state. The lack of apportionment was challenged, and the California Court of Appeal held that the California annual fee paid by LLCs (based on worldwide gross receipts) is unconstitutional under the commerce clause of the United States Constitution when paid by a foreign (non-California) LLC that did not conduct any business in California. Northwest Energetic Servs., LLC v California Franchise Tax Bd. (2008) 159 CA4th 841, 71 CR3d 642. In *Northwest*, the court ruled that the annual fee is actually a tax, and all taxes must be apportioned among the various states on a reasonable basis. Because the annual fee is not fairly apportioned to recognize the level of activity within California versus outside of California, the fee/tax is unconstitutional. In a second case, the Court of Appeal held that when a foreign (non-California) LLC conducts business both within and outside of California, the LLC is entitled to a refund not of the entire fee, but an amount apportioned based on the extent of out-of-state business conducted by the LLC. Ventas Fin. I, LLC v California Franchise Tax Bd. (2008) 165 CA4th 1207, 81 CR3d 823, cert denied (2009) US \_\_\_, 173 L Ed 2d 1076, 129 S Ct 1917.

Based on the *Ventas Finance* case, the FTB established procedures for submitting claims for the refund of previously paid fees. See FTB Notice 2009-04, available at [http://www.ftb.ca.gov/law/notices/2009/2009\\_4.pdf](http://www.ftb.ca.gov/law/notices/2009/2009_4.pdf). Refunds will be only for the amounts paid in excess of what would have been paid if the fee had been apportioned, not claims for the entire amount of the fee. The FTB will calculate the refund based on information contained in Schedule R included with the FTB Form 568, and will send the refund to the LLC. The FTB Notice makes no distinction between California and non-California LLCs with regards to claiming refunds, even though the *Ventas Finance* and *Northwest Energetic Services* cases were brought by foreign LLCs. The FTB established an alternative method to calculate the refund instead of using the information contained in Schedule R, but the deadline to file for this alternative method expired on August 20, 2009.

**PRACTICE TIP:** The practitioner should advise California LLCs that conducted business outside of California in years prior to January 1, 2007, to file refund claims as soon as possible, before the expiration of applicable statutes of limitations.

**CAUTION:** The FTB is implementing a program to suspend or forfeit the rights, powers, and privileges of LLCs that do not pay taxes or file returns. The suspension and forfeiture process is similar to that of corporations. The FTB will mail a notice to the LLC 60 days before the suspension or forfeiture. If the LLC does not timely file the delinquent returns and pay the taxes, penalties, and interest, the FTB will notify the Secretary of State, which will then suspend or forfeit the privileges of the LLC. Any contract of a suspended or forfeited LLC is voidable and a suspended or forfeited LLC cannot use the courts to enforce its rights. See the FTB announcement at <http://www.ftb.ca.gov/professionals/taxnews/2008/1008/1008.pdf>.

§11.8 3. Securities Laws

The discussion of federal and California securities laws in §§11.9-11.11 is intended as an overview, as a detailed discussion is beyond the scope of this chapter. For additional information about federal and California securities laws, see Forming and Operating California Limited Liability Companies, chap 12 (2d ed Cal CEB 2007); Financing and Protecting California Businesses, chap 6 (Cal CEB 2006); Guide to California Securities Law Practice (Cal State Bar 2003); and Marsh & Volk, Practice Under the California Securities Laws (rev ed 1973).

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/ a. Federal Securities Laws/§11.9 (1) Are LLC Membership Interests Securities?

a. Federal Securities Laws

§11.9 (1) Are LLC Membership Interests Securities?

The status of LLC membership interests as securities varies according to the individual LLC structure. A member-managed LLC whose operating agreement gives the members strong rights in the management and control of the LLC may be analogized to a general partnership, and the LLC interests are *not* securities. In a manager-managed LLC in which the non-manager members have limited or no rights to participate in management, the LLC interests *are* securities. For instances when the status is not clear, the better practice is to assume that LLC interests are securities.

The federal Securities Act of 1933 (15 USC §§77a-77aa) does not include LLC membership interests in its definition of securities. 15 USC §77b(a)(1). However, "investment contracts" are included in the definition of securities, and LLC interests may be considered investment contracts under most circumstances.

An investment contract is "a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party." *SEC v W. J. Howey Co.* (1946) 328 US 293, 298-99, 90 L Ed 1244, 66 S Ct 1100. The Ninth Circuit has interpreted "solely" to mean that the efforts of others must be the "undeniably significant ones, those essential managerial efforts which affect the failure or success of the enterprise." *SEC v Glenn W. Turner Enters., Inc.* (9th Cir 1973) 474 F2d 476, 482.

However, a general partnership interest is *not* a security under the Securities Act of 1933 if, under the partnership agreement, the general partners have the powers, whether or not exercised, to supervise and control the general partnership, to participate in the management of the general partnership, and to gain access to information. *Matek v Murat* (9th Cir 1988) 862 F2d 720, 729.

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.10 (2) Registration of Securities

§11.10 (2) Registration of Securities

While federal securities laws require the registration of any offering of securities, there are many exemptions from registration requirement. In almost all instances, a practitioner will use one of these exemptions.

One of the most common exemptions is under Section 4(2) of the Securities Act of 1933 (15 USC §77d(2)) for an offering by an issuer that is not a public offering. This exemption is self-executing and no filing is required. However, neither the Securities and Exchange Commission nor case law has provided clear guidelines on what constitutes a nonpublic offering. The offering should be made to only an extremely limited number of purchasers, generally five or fewer. In addition, the issuer should take reasonable measures to ensure that the initial purchasers hold the securities for a sufficient period of time to demonstrate that the purchasers did not acquire the securities with a view to distribution.

Because a nonpublic offering is ill-defined, the Securities and Exchange Commission has promulgated several "safe harbors" under Regulation D (17 CFR §§230.501-230.508). The two that are most used are Rule 504 (17 CFR §230.504) and Rule 506 (17 CFR §230.506). Rule 504 has a maximum aggregate offering limit of \$1,000,000. Rule 506 has no dollar limit, but limits the number of purchasers to 35, not including "accredited investors," and all purchasers (either alone or with a purchaser representative) must be knowledgeable and experienced investors. Regulation D requires substantial disclosure about the issuer and the offering to purchasers who are not accredited investors in an offering using Rule 506. However, Regulation D does not require the same disclosures in an offering using Rule 504, or in an offering using Rule 506 when all purchasers are accredited investors. Accordingly, many practitioners advise that when using Rule 506, securities be sold only to accredited investors. In general, an accredited investor is an entity with at least \$5,000,000 in assets, an individual with net worth of at least \$1,000,000, or an individual with income of at least \$200,000 (or joint income with spouse of at least \$300,000) in the last 2 years and a reasonable expectation of such income in the current year. Rule 501(a) (17 CFR §230.501(a)). An offering under Rule 506 to accredited investors only allows the issuer to take advantage of the preemption of many state securities law under §18(b)(4)(D) of the Securities Act of 1933 (15 USC §77r(b)(4)(D)). Under either Rule 504 or Rule 506, the issuer must file a Notice of Sale of Securities, Form D, with the Securities and Exchange Commission within 15 days after the first sale of securities, and must file an amendment to correct any material mistake of fact; or if the offering will last more than 1 year, on the anniversary of the first filing or the most recent amendment. Rule 503. All filings must be done electronically through the EDGAR system. There is no filing fee.

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.11 b. California Securities Laws

§11.11 b. California Securities Laws

The California Corporate Securities Law of 1968 (Corp C §§25000-25707) includes an LLC membership interest in the definition of a security, but further provides that an LLC membership interest is not a security when the LLC can prove that all of the members are actively engaged in the management of the LLC. Corp C §25019. Unlike the federal Securities Act of 1933 (15 USC §§77a-77aa), which only requires the operating agreement to give the members the power to participate in management so that a membership interest is not considered a security, California law requires that members actively participate.

California law requires any sale of securities by an issuer to be qualified (similar to a registration under federal law) or meet the requirements of an exemption from qualification. The transactional exemptions are found in Corp C §25102; the most commonly used exemption is the limited offering exemption provided by Corp C §25102(f). See also 10 Cal Code Regs §§260.102.12-260.102.15 (Rules of Commissioner of Corporations).

The limited offering exemption has no dollar limit, but limits the number of purchasers to 35 (Corp C §25102(f)(1)), excluding accredited investors and other excluded purchasers enumerated in 10 Cal Code Regs §260.102.13. Each purchaser must either have a preexisting personal or business relationship with the LLC or its managers, or (either alone or with a purchaser representative) must be a knowledgeable and experienced investor capable of protecting the purchaser's interests. Corp C §25102(f)(2). Each purchaser must represent that the purchaser is acquiring securities for the purchaser's own account and not in connection with a distribution of securities. Corp C §25102(f)(3). Finally, the issuer must file a Notice of Transaction with the Department of Corporations and pay the filing fee (based on the size of the offering) within 15 days after the first sale of securities in California. The filing must be done electronically at the Department of Corporations website. 10 Cal Code Regs §260.102.14. For the address of the website, see the Directory. Filing fees are paid by credit card.

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### III. LLC OPERATIONS

#### §11.12 A. Permissible Businesses

An LLC may engage in any business activity, whether for profit or not for profit, except the banking business, the business of issuing insurance policies, or the trust company business. Corp C §17002(a). Further, an LLC may not render professional services as defined in Corp C §§13401(a), 13401.3, Corp C §17375. Professional services are services that may be lawfully rendered only pursuant to a license, certification, or registration authorized under the Business and Professions Code, the Chiropractic Act, the Osteopathic Act, or the Yacht and Ship Brokers Act. Corp C §§13401(a) and 13401.3. Professional services do not include a business in which the services rendered require only a nonprofessional, occupational license under the Business and Professions Code. 87 Ops Cal Atty Gen 109 (2004).

**WARNING:** To date, there are no clear guidelines distinguishing which services requiring a license are professional and which are nonprofessional. Until further clarification is available, the practitioner is advised to proceed with caution.

An LLC's articles of organization may limit or restrict the business or businesses in which the LLC may engage. Corp C §17051(c)(1). Having such restrictions in the articles of organization or operating agreement may be beneficial when passive investors desire to restrict the management of the LLC from engaging in a new or different type of business than that engaged in by the LLC at the time when the investors contributed their money. In addition, such restrictions help the manager fulfill the manager's fiduciary duties and avoid a conflict of interest by reducing the number of potential activities that compete against the LLC's business. For example, in the real estate industry where promoters may establish a large number of LLCs, restricting the business of each LLC to the ownership of one parcel means that the promoter will not have to offer any new project to the existing LLCs.

An LLC may operate as a health care service plan licensed under the Health and Safety Code if the LLC is a subsidiary of a health care service plan licensed under the Health and Safety Code and the LLC is established to serve an existing line of business of the parent health care service plan. Corp C §17002(b). See Health & S C §§1340-1399.818 (health care service plans).

**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/ B. Membership Interests and Capital Contributions/§11.13 1. Membership Interests

B. Membership Interests and Capital Contributions

§11.13 1. Membership Interests

A membership interest is all of the rights of a member in an LLC, and includes the member's economic interest, the right to vote or participate in the management of the LLC, and the right to obtain information about the LLC and its business affairs. Corp C §17001(z). An economic interest is the right to receive allocations of income and loss from the LLC and to receive distributions of cash and property from the LLC, but does not include the right to vote or participate in the management of the LLC, and, except for certain limited rights set forth in Corp C §17106, does not include the right to obtain information about the LLC and its business affairs. Corp C §17001(n).

Membership interests are frequently denominated in percentages. This works well if there is a limited number of members and if the LLC is not expected to issue additional membership interests in the future. However, if an LLC intends to raise capital at several different times during the implementation of its business plan, or if the LLC intends to have an employee ownership plan for a number of employees, then the mathematics of working with percentages quickly becomes unworkable. In such situations, membership interests may be denominated in units or equity units, in the same manner as shares in a corporation. For a manager-managed LLC, the articles of organization or the operating agreement may set the maximum number of units that the managers may issue without the consent or approval of the members.

The articles of organization or the operating agreement may provide for different classes of members having different rights, powers, and duties, including rights, powers, and duties that are senior to those of other classes of members. Corp C §17102. In some instances, certain members may have superior voting rights, such as the sole right to elect and remove managers, or may have disproportionate distribution rights. Alternatively, if membership interests are denominated in units, then an LLC may have common equity units and preferred equity units, and the capital structure looks and feels very much like that of a corporation.

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.14 2. Capital Contributions

§11.14 2. Capital Contributions

A capital contribution to an LLC may be in the form of cash, property, or the obligation to render services. Corp C §17200(a). A member will receive a credit to the member's capital account for the net amount so contributed.

Unless the articles of organization or operating agreement provide otherwise, a member is not required to make any additional capital contribution. Corp C §17200(b). In certain circumstances, however, it may be advantageous for the members to commit to contribute additional capital. The articles of organization or operating agreement should state the trigger for additional capital contributions, which may be the occurrence of a specified event or the achievement of certain business milestones, or at the request of the manager or a majority in interest of the members. The articles of organization or operating agreement may specify the amount to be contributed, may provide the maximum amount to be contributed, or may allow for contribution of such amounts as are needed. In general, unless all members are actively involved in the management of the LLC, members usually prefer strict limits on additional capital contribution requirements.

The operating agreement may provide one or more remedies in the event that a member fails to make a required capital contribution. Remedies against the defaulting member may include (Corp C §17201(a)(3)):

- Reducing or eliminating the member's proportionate interest;
- Subordinating the member's interest to the interests of the other members;
- Allowing the forced sale of the member's interest;
- Allowing the other members to lend or contribute the amount needed;
- Adjusting the interest rates, rates of return, preferences, or priorities of the other members;
- Redemption or sale of the member's interest at a percentage of value, determined by appraisal or formula;
- Loss of voting rights; or
- Loss of ability to actively participate in the management or operations of the LLC.

**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.15 3. Tax Treatment of Capital Contributions

§11.15 3. Tax Treatment of Capital Contributions

In general, neither the member nor the LLC will recognize any gain or loss for the contribution of property as a capital contribution. IRC §721(a). However, there are a number of exceptions.

If a member contributes services, the member will usually recognize ordinary income equal to the value of the capital interest. Treas Reg §1.721-1(b)(1). If a member contributes property subject to a liability, or if the LLC assumes a member's liability in connection with contributed property, then the member is deemed to have received a distribution equal to the amount of the liability, and will recognize income to the extent that the deemed distribution is greater than the member's basis in the contributed property. IRC §§722, 731(a)(1), 752.

If a member receives cash or property from the LLC in addition to the membership interest, then the member is deemed to have received a distribution equal to the value of the cash or property received, the "boot," and will recognize income to the extent that the deemed distribution is greater than the member's basis in the contributed property. IRC §731(a)(1). Alternatively, the transaction may be deemed to be a "disguised sale," in which event the entire transaction will be deemed to be a taxable sale of the contributed property, and the member will recognize income to the extent that the value of the boot plus the value of the membership interest is greater than the member's basis in the contributed property. IRC §707(a)(2)(B).

The foregoing discussion is intended as an overview of the tax considerations of capital contributions, as a detailed discussion is beyond the scope of this chapter. For additional information, consult the references cited at the end of [§11.5](#).

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/ C. Management/§11.16

1. Management by Members or Managers

C. Management

§11.16 1. Management by Members or Managers

An LLC may be managed either by all of the members (a "member-managed LLC") or by one or more managers (a "manager-managed LLC"). The election is provided by Item 5 of the Secretary of State's form of articles of organization (Form LLC-1, see [§11.39](#)), which requires the LLC to state whether the LLC is managed by all of the members, one manager, or more than one manager.

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.17 2. Management by All Members

§11.17 2. Management by All Members

An LLC is managed by all of its members, unless the articles of organization provide for management by managers. Corp C §17150. Although member management is the statutory default, the Secretary of State's form of articles of organization requires each LLC to elect the form of management (see §11.16).

In a member-managed LLC, each member is an agent of the LLC, and any act of a member for the apparent purpose of carrying on in the usual way the affairs of the LLC binds the LLC. Corp C §17157(a). Any limitation on the ability of the members to bind the LLC, either generally or with respect to a particular matter, is not effective as to a third party unless the third party has actual knowledge that a member lacks authority to act on behalf of the LLC. Corp C §17157(a), (c). A limitation in the articles of organization does not provide constructive notice; a third person must receive actual notice. Corp C §17051(d).

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.18 3. Management by One or More Managers

§11.18 3. Management by One or More Managers

If an LLC is to be managed by one or more managers, then the articles of organization must state that the LLC is to be managed by one manager, or that the LLC is to be managed by more than one manager. Corp C §17151(b).

In a manager-managed LLC, no member, acting solely as a member, is an agent of the LLC and no member, acting solely as a member, has the authority to bind the LLC. Corp C §17157(b)(1). Instead, the manager, or each manager if there is more than one, is an agent of the LLC, and any act of a manager for the apparent purpose of carrying on in the usual way the affairs of the LLC binds the LLC. Corp C §17157(b)(2). Any limitation on the ability of a manager to bind the LLC, either generally or with respect to a particular matter, is not effective as to a third party unless the third party has actual knowledge that a manager lacks authority to act on behalf of the LLC. Corp C §17157(b)(2), (c). A limitation in the articles of organization does not provide constructive notice; a third person must receive actual notice. Corp C §17051(d). Further, any note or agreement signed by the manager if there is only one manager, or by two managers if there are more than one manager, is binding on the LLC unless a third party has actual knowledge that a manager lacks authority to act on behalf of the LLC. Corp C §17157(d).

If there are two or more managers, decisions are made by majority vote of the managers or by their unanimous written consent, unless the articles of organization or the operating agreement provide otherwise. Corp C §17156.

Managers do not have to be members or natural persons. Corp C §17151(c). Unless the articles of organization or the operating agreement provide otherwise, managers are elected by the affirmative vote of a majority in interest of the members, and one or more managers may be removed from office, with or without cause, by the affirmative vote of a majority in interest of the members at a meeting called expressly for such purpose. Corp C §17152(a)-(b). Note that "a majority in interest of the members," unless otherwise defined in the operating agreement, means more than 50 percent of the interests of members in the LLC's current profits. Corp C §17001(v). Managers hold office until the expiration of their term, or if no term is specified, then until their successors are elected. Corp C §17152(d).

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.19 4. Fiduciary Duties

§11.19 4. Fiduciary Duties

The members in a member-managed LLC have the same fiduciary duties as a manager in a manager-managed LLC. Corp C §17150. The manager in a manager-managed LLC has the same fiduciary duties to the LLC and its members as does a general partner to the partnership and its partners. Corp C §17153. These are the duty of loyalty and the duty of care. Corp C §16404(a). These duties may be modified only in a written operating agreement with the informed consent of the members (Corp C §17005(d)).

The three elements of the duty of loyalty are (Corp C §16404(b)(1)-(b)(3)):

- (1) The duty of the manager to account to the LLC for any property, profit, or benefit derived by the manager in the conduct and winding up of the LLC business or derived from the use by the manager of LLC property or information, including the appropriation of an LLC opportunity;
- (2) The duty of the manager to refrain from dealing with the LLC in the conduct or winding up of the LLC business as or on behalf of a party having an interest adverse to the LLC; and
- (3) The duty of the manager to refrain from competing with the LLC in the conduct of the LLC business before the dissolution of the LLC.

In the conduct and winding up of the LLC business, the duty of care of the manager is limited to refraining from engaging in grossly negligent or reckless conduct, intentional misconduct, or a knowing violation of law. Corp C §16404(c).

California law does not prescribe fiduciary duties for members of a manager-managed LLC who are not also managers. However, the courts have said that under certain circumstances, such as access to confidential information, a limited partner has fiduciary duties to the partnership. Tri-Growth Centre City Ltd. v Sillardorf, Burdman, Duignan & Eisenberg (1989) 216 CA3d 1139, 1150, 265 CR 330. By analogy, members of a manager-managed LLC may have similar fiduciary duties.

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§11.20 5. Officers

Although there is no requirement to do so, the operating agreement may provide for officers, including a chair, president, vice presidents, chief financial officer, assistant treasurers, secretary, assistant secretaries, and any other officers that the operating agreement provides. Corp C §17154(a), (c). The officers have the duties specified in the articles of organization, operating agreement, or as determined by the managers or members. Corp C §17154(a). An officer does not have to be a member, and a person may hold more than one officer position. Corp C §17154(a). Unless the operating agreement provides otherwise, officers are appointed by the managers and serve at the pleasure of the managers. Corp C §17154(b).

The LLC is bound by any note or agreement signed by the chair, president, or any vice president as one signatory and the chief financial officer, any assistant treasurer, the secretary, or any assistant secretary as the other signatory, unless a third party has actual knowledge that the signing officers did not have authority to sign the note or agreement. Corp C §17154(c).

**WARNING:** The managers should be careful to supervise the actions of the officers who are not also managers.

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/ D. Members' Rights and Liabilities/§11.21 1. Members' Rights

D. Members' Rights and Liabilities

§11.21 1. Members' Rights

In general, members have the flexibility to structure and organize the LLC as they may wish by means of a written operating agreement. Corp C §17005(a). However, there are a number of restrictions, including the following:

- A member must have the right to assert that a provision in the operating agreement governing the termination of that member's interest and the return of that member's contribution was unreasonable under the circumstances existing at the time the agreement was made. Corp C §§17005(b)(2), 17100(c).
- The articles of organization may be amended only with the vote or consent of a majority in interest of the members, although a written operating agreement may provide for a greater percentage. Corp C §§17005(b)(3), 17103(b). The operating agreement may be amended in the manner prescribed in its provisions, which may be by a majority interest or greater or lesser percentage. Corp C §17059. However, if the articles of organization or the operating agreement do not contain a voting provision for amendment, then the unanimous approval or consent of all members is required to amend the articles of organization or the operating agreement. Corp C §17103(a)(2).
- An LLC may be dissolved only with the vote or written consent of a majority in interest of the members, although a written operating agreement may provide for a greater percentage. Corp C §§17005(b)(3), 17103(c), 17350(b).
- A merger of an LLC with another business entity must be approved by the vote or written consent of a majority in interest of the members, although a written operating agreement may provide for a greater percentage. However, if the members become personally liable for the obligations of the LLC or other business entity as a result of the merger, then the merger must be approved by all members, unless the merger agreement provides for dissenters' rights. Corp C §§17005(b)(3), 17103(c), 17551(a). Likewise, the conversion of an LLC into another business entity must be approved by the vote or written consent of a majority in interest of the members, although a written operating agreement may provide for a greater percentage. However, if the members become personally liable for the obligations of the LLC or other business entity as a result of the merger, then the merger must be approved by all members, unless the merger agreement provides for dissenters' rights. Corp C §17540.3(b). See §§12.25, 12.28.
- A member, manager, or holder of an economic interest must have the right to receive certain financial and other information and to inspect the books and records relating to the LLC. Corp C §§17005(b)(4), 17106, 17453.
- The fiduciary duties of a manager to the LLC and its members may only be modified in a written operating agreement with the informed consent of the members. Corp C §17005(d). See §11.19.

Some provisions of the Beverly-Killea Limited Liability Company Act may be varied in the articles of organization or written operating agreement only to the extent expressly allowed in the statutes (Corp C §17005(c)). They include provisions concerning:

- Formation (Corp C §§17050-17062), including contents of the articles of organization (Corp C §17051);
- Dissolution (Corp C §§17350-17357);
- Foreign limited liability companies (Corp C §§17450-17457);
- Class actions and derivative actions (Corp C §§17500-17501);
- Mergers (Corp C §§17550-17556); and
- Dissenters' rights (Corp C §§17600-17613).

**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.22 2. Members' Liabilities

§11.22 2. Members' Liabilities

No member of an LLC is personally liable under any court judgment or in any other manner for any liability of the LLC, whether the liability arises in contract, tort, or otherwise, solely by reason of being a member of the LLC. Corp C §17101(a). In general, a member's exposure to loss is limited to the amount of the member's capital contribution.

A member may agree to guarantee or be obligated for a liability of the LLC under a written agreement. Corp C §17101(c)(2). For a small or start-up company, a landlord or lender will generally require a guarantee from one or more members. In addition, the articles of organization or a written operating agreement may provide that the members may agree to be personally obligated for some or all of the liabilities of the LLC if the provision expressly references Corp C §17101(e). Such a provision in a written operating agreement may be used to provide for indemnification or contribution if some or all of the members must perform on guarantees given to landlords, lenders, or others.

A member is personally liable for the obligations of the LLC under the alter ego doctrine to the same extent and under the same circumstances as a shareholder of a corporation would be personally liable for the obligations of a corporation. Corp C §17101(b). However, the failure to hold meetings of the members or managers or the failure to observe formalities in the calling or conduct of such meetings is not a factor to be used to establish liability under the alter ego doctrine. Corp C §17101(b). A member who participates in tortious conduct has personal liability. Corp C §17101(c)(1).

No manager or officer of an LLC is personally liable under any court judgment or in any other manner for any liability of the LLC, whether the liability arises in contract, tort, or otherwise, solely by reason of being a manager or officer of the LLC. Corp C §17158(a). However, the articles of organization or a written operating agreement may provide for such personal liability for a manager if the provision expressly references Corp C §17158(b)(1). A manager may agree in writing to guarantee or be obligated for a liability of the LLC. Corp C §17158(b)(2). In addition, a manager who participates in tortious conduct or criminal activity while performing managerial duties may be personally liable. People v Pacific Landmark (2005) 129 CA4th 1203, 1213, 29 CR3d 193.

Members and managers who approve distributions in violation of law may also be personally liable for the amount of the distribution that exceeds what could have been legally distributed. See §11.24.

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/ E. Allocations and Distributions/§11.23 1. Allocations

E. Allocations and Distributions

§11.23 1. Allocations

If an LLC elects pass-through tax treatment (see §§11.4-11.6), then each member will receive an allocation of a distributive share of the income, gain, loss, deduction, and credit of the LLC. IRC §702(a). Each member must report the distributive share on the member's personal income tax return for the year in which the LLC's taxable year ends, irrespective of whether the member receives a corresponding distribution of cash or property from the LLC. IRC §706(a).

The members have the flexibility in the operating agreement to determine each member's distributive share. IRC §704(a). Such allocations do not have to follow percentage interests, and many times some other method is used. If the operating agreement does not provide a method of allocation, California law provides that allocations will be in proportion to the members' capital contributions (Corp C §17202), while federal income tax law provides that allocations will be in accordance with a member's interest in the LLC (IRC §704(b)(1)).

**NOTE:** A member's interest in the LLC is not strictly analogous to a percentage interest. Instead, a member's interest in the LLC represents the manner in which the members have agreed to share the economic benefits and burdens of the LLC, taking into account such factors as the members' respective capital contributions, economic profits and losses (if different from taxable income and loss), cash flow, and liquidating and nonliquidating distributions. Treas Reg §1.704-1(b)(3). The application of this rule is uncertain and subjective.

While the members have a great deal of flexibility to determine each member's distributive share, there are certain limitations. The primary limitation is that the allocations must have substantial economic effect. IRC §704(b)(2). If allocations do not have substantial economic effect, then the IRS will reallocate income and loss, and the reallocation will likely not be in the manner that the members prefer. Under the IRS "safe harbor" rules, allocations have substantial economic effect if (Treas Reg §1.704-1(b)(2)):

- Allocations are reflected in capital accounts maintained according to the regulations;
- All liquidating distributions are made according to positive capital account balances (rather than percentage interests or some other means);
- If a member has a deficit capital account balance, the member is unconditionally obligated to restore the deficit on liquidation (although this is not preferred because the member becomes liable for obligations of the LLC; see §11.22), or in the alternative, the member is subject to a qualified income offset (generally, priority allocations of income until the deficit is restored); and
- The economic effect of the allocations is "substantial" (a reasonable probability that the allocation will substantially affect the member's economic interest in the LLC independent of the tax consequences).

§11.24 2. Distributions

The members have great flexibility in an operating agreement to determine how distributions will be apportioned among the members. Unless the operating agreement provides otherwise, the statutory default is that distributions that are a return of capital must be in proportion to the capital contributions made by each member, and distributions that are not a return of capital must be in proportion to the allocation of profits. Corp C §17250.

An LLC may not make a distribution if, after giving effect to the distribution, it would not be able to pay its debts as they become due in the usual course of business, or if total assets would be less than the sum of total liabilities plus the liquidation preference of any class of members that is senior to the members receiving the distribution. Corp C §17254(a). Any manager or member who votes for a distribution in violation of the law is personally liable for the amount of the distribution that exceeds what could have been legally distributed. Corp C §17255(a). Any member who receives a distribution with knowledge of the facts indicating that the distribution was in violation of the law may be compelled to return it. Corp C §§17254(e), 17255(b)(2). The statute of limitations for claims for improper distributions is 4 years. Corp C §§17254(f), 17255(c).

In general, distributions of cash are taxable only to the extent that the distributions exceed the adjusted basis of the member's LLC interest. IRC §731(a)(1). Therefore, distributions generally are not considered a taxable event.

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§11.25 F. Records

An LLC must have an office in California where the LLC must maintain certain records. Corp C §17057(a). These records include (Corp C §17058(a)-(b)):

- An alphabetical list of all members and holders of economic interests, including full name, residence or business address, capital contribution, and share of profits and losses;
- If the LLC is manager-managed, a list of the full names and residence or business addresses of all managers;
- A copy of the articles of organization and all amendments, together with all powers of attorney used to execute the articles of organization or any amendment;
- Copies of federal, state, and local income tax returns or information statements for the last 6 years;
- A copy of the operating agreement and all amendments, together with all powers of attorney used to execute the operating agreement or any amendment;
- Copies of the financial statements for the last 6 years;
- The books and records of the internal affairs of the LLC for the current year and the last 4 years; and
- If the LLC owns, claims, possesses, or controls real property, copies of records of the amount, cost, and value of all such real property.

Each manager, member, or holder of an economic interest for a purpose reasonably related to his or her interests as a manager, member, or holder of an economic interest, has the right to inspect and copy all of the records listed above, and to obtain a copy of the federal, state, and local income tax returns or information statements for each year. Corp C §17106(b). If the LLC has more than 35 members, then it must send each member an annual report with annual financial statements, and if three members or members holding at least 5 percent of the voting interests make a request, the LLC must send them quarterly balance sheet and income statements. Corp C §17106(c). Within 90 days after the end of each year, the LLC must provide all members and holders of economic interests with information to allow them to complete their individual income tax returns, and if the LLC has 35 or fewer members, it must also provide a copy of the LLC's federal, state, and local income tax returns or information statements for the year. Corp C §17106(e). These information rights may not be waived. Corp C §17106(h).

§11.26 G. Dissolution

While the focus of this chapter is on the formation of LLCs and not dissolution, some thought must be given to dissolution when forming an LLC. An LLC must be dissolved at the time set forth in the articles of organization, on the occurrence of an event set forth in the articles of organization or written operating agreement, by the vote of a majority in interest of the members (or a greater percentage set forth in the articles of organization or written operating agreement), or by judicial decree. Corp C §17350. Once the dissolution process has begun, the LLC must wind up its business and affairs and must give notice of the commencement of winding up to all known creditors. Corp C §17352(a).

When all known debts have been paid or adequately provided for, including debts owing to the members, the remaining assets of the LLC are to be distributed to the members. Unless the articles of organization or a written operating agreement provide otherwise, the assets are to be distributed first to the members for the return of their capital contribution, and then to the members in the proportion in which they share distributions. Corp C §17353(a). Generally, the operating agreement will provide that distributions be made in proportion to positive capital account balances so as to comply with IRS safe harbor allocation rules. See §11.23.

If an LLC has been in existence less than 12 months and has not conducted any business, it may use an abbreviated procedure to obtain a cancellation of the articles instead of a dissolution. Corp C §17350.5.

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.26A H. Asset Protection

§11.26A H. Asset Protection

If a creditor obtains a judgment against a member but not against the LLC, the creditor may not levy on the LLC's assets. The creditor's exclusive remedy against the member's interest in the LLC is to obtain a charging order against that interest. Corp C §17302(e). A charging order gives the creditor the right to receive all distributions and allocations of income from the member's interest. Corp C §17302(a). The charging order constitutes a lien on the member's interest, and a court may foreclose on the lien and order the interest sold. The purchaser at foreclosure has the status of an assignee. Corp C §17302(b). The debtor-member, the LLC, and the other members have the right to redeem the membership interest before foreclosure. Corp C §17302(c).

Placing assets in an LLC is a form of asset protection because the assets are generally beyond the reach of a member's creditors. However, the membership interest itself may be reached by creditors, which is likely to diminish the value of an LLC as an asset protection vehicle in many circumstances.

Limiting a creditor's remedies to actions against a member's interest protects the assets of the LLC and prevents interference with the LLC's operations that might harm the other members. For single-member LLCs, this underlying rationale does not apply, although the statute does not suggest that an exception applies to single-member LLCs. A California court has yet to rule on this issue.

A creditor may obtain a charging order only against an assignable membership interest. Corp C §17302(a). This is generally interpreted to mean the economic portion of the membership interest (the right to receive distributions and allocations of income and loss) and not the management or voting rights. However, the statutory reference to an assignable interest has led some to propose very aggressive asset protection strategies based on the concept that a charging order or foreclosure is an assignment. For example, an operating agreement might prohibit any assignment of an interest to a creditor without the consent of the manager and all non-assigning members, which would defeat any charging order or foreclosure since the consent would not be given. Other strategies include a "poison pill," allowing the other members to purchase for \$1 or other nominal consideration any membership interest that was assigned to a creditor or giving the manager discretionary authority to withhold distributions to interests assigned to creditors. No court has ruled on the enforceability of these provisions, and it seems unlikely that any would survive a challenge as a fraud against creditors. The statute gives a court the authority to issue all orders, directions, accounts, and inquiries "that the circumstances of the case may require." Corp C §17302(a). A court might use this authority to prevent fraud.

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.27 I. Foreign Limited Liability Companies

§11.27 I. Foreign Limited Liability Companies

A foreign LLC (organized under the laws of a state other than California or under the laws of a foreign country) that transacts intrastate business in California must register with the California Secretary of State. Corp C §17451(a). The foreign LLC files an Application for Registration as Foreign Limited Liability Company (Secretary of State Form LLC-5) (see §11.41) and pays the filing fee. The laws of the state or foreign country under which the foreign LLC is organized govern its internal affairs. Corp C §17450(a). A foreign LLC may not be denied registration because of any difference between the other state's or country's laws and California's laws. Corp C §17450(b).

A foreign LLC conducting intrastate business in California that does not register is subject to a penalty of \$20 per day up to a maximum of \$10,000, and the foreign LLC may not maintain any lawsuit until it is registered. Corp C §17456(a)-(b). The penalties for not registering are similar to those imposed on foreign corporations that do business in California without qualifying. See Corp C §2203. Failure to register does not make a foreign LLC's members liable for the obligations of the LLC. Corp C §17456(c).

A foreign LLC is subject to any licensing requirements imposed by California law. Corp C §17452(a). This prevents foreign LLCs from engaging in businesses that are prohibited to domestic LLCs (*e.g.*, the bank, insurance, or trust business) or the practice of any profession requiring a license (*e.g.*, medicine, dentistry, law, or accounting). See §11.12. On organizing an LLC in another state generally, see chap 4.

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/ IV. FORMATION/  
§11.28 A. Name of Limited Liability Company

IV. FORMATION

§11.28 A. Name of Limited Liability Company

The name of an LLC must contain the words "limited liability company" or the abbreviation "LLC" or "L.L.C." as the last words of the name. The words "limited" and "company" may be abbreviated as "ltd." and "co.," respectively. Corp C §17052(a).

The name may contain the name of one or more of the members. Corp C §17052(b).

The name may not contain the words "bank," "trust," "trustee," "incorporated," "inc.," "corporation," "corp.," "insurer," "insurance," or any other word that suggests that the LLC is in the business of issuing insurance policies or assuming insurance risks. Corp C §17052(d).

Generally, the name may not be one that the Secretary of State determines is likely to mislead the public and may not be the same as, or resemble closely, the name of another LLC. Corp C §17052(c). Therefore, before filing articles of organization, it is generally prudent to check with the Secretary of State's office on the availability of the proposed name for an LLC. If a name meets the statutory requirements, the name may be reserved with the Secretary of State for a period of 60 days. Corp C §17053. If an LLC will conduct business under a name other than the name stated in its articles of organization, the LLC must file a fictitious business name statement with the clerk of the county in which the LLC has its principal place of business. Bus & P C §17900(b)(5). For details on names, reserving a name with the Secretary of State, and filing a fictitious business name statement, see chap 3.

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/ B. Articles of Organization/§11.29 1. Contents of Articles

B. Articles of Organization

§11.29 1. Contents of Articles

The existence of an LLC begins when its articles of organization are filed with the Secretary of State. Corp C §17050(c). A copy of the articles of organization certified by the Secretary of State is conclusive evidence of the formation of an LLC and prima facie evidence of its existence. Corp C §17050(c).

The articles of organization must be filed using the Secretary of State's form, Limited Liability Company Articles of Organization (Form LLC-1; see form in §11.39). Corp C §17050(a). The articles of organization must provide (Corp C §17051(a)(1)-(5)):

- The name;
- The following statement: "The purpose of the limited liability company is to engage in any lawful act or activity for which a limited liability company may be organized under the Beverly-Killea Limited Liability Company Act."
- The name and address of the initial agent for services of process; and
- If the LLC will be manager-managed instead of member-managed, a statement that it will be managed by one manager or that it will be managed by more than one manager. (Note that Form LLC-1 requires the affirmative statement that the LLC be managed by all of the members, by one manager, or by more than one manager. See §§11.16, 11.39.)

The articles of organization may also provide the following:

- A provision limiting or restricting the business in which the LLC may engage and/or the powers that the LLC may exercise (Corp C §17051(c)(1));
- Provisions governing the admission of members (Corp C §17051(c)(2));
- The time at which the LLC is to dissolve (Corp C §17051(c)(3));
- Any event that will cause the dissolution of the LLC (Corp C §17051(c)(4));
- Any limitation on the authority of the managers or members to bind the LLC (Corp C §17051(c)(5));
- The names of the managers of the LLC (Corp C §17051(c)(6));
- An agreement for a member to be personally liable for the obligations of the LLC (Corp C §17101(e));
- If there are different classes of members, the different rights, preferences, and privileges between the classes (Corp C §17102);
- The titles, powers, and duties of officers (Corp C §17154(a));
- An agreement for a manager to be personally liable for the obligations of the LLC (Corp C §17158(b)(1));
- The amounts, times, and procedures for any mandatory additional capital contributions (Corp C §17200(b)); and
- The method of distributing assets remaining after the payment of debts on dissolution (Corp C §17353(a)).

Any permissible provisions included in the articles of organization must be set forth on separate pages and attached to the articles of organization. These provisions should be typed on one side of 8.5 by 11-inch paper.

**NOTE:** There are differing views as to the advisability of adding these permissible provisions to the articles of organization. The articles may be more difficult to amend than the operating agreement (especially if there is a super majority or unanimity voting requirement), so a provision in the articles may have more permanency than the same provision in the operating agreement. On the other hand, the articles are public record, and anyone who desires may obtain a copy. Any limitation on the power or authority of the members or the managers set forth in the articles does not provide constructive notice to a third party. Corp C §17051(d). See §§11.17-11.18. However, the restrictions in the articles will provide actual notice if a copy of the articles is given to a third party, as occurs in most significant transactions.

**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.30 2. Filing Articles of Organization

§11.30 2. Filing Articles of Organization

To form an LLC, one or more persons must complete and execute the articles of organization on Form LLC-1 (see §11.39) and file them with the Secretary of State. Corp C §17050(a). The person or persons who execute the articles of organization may, but need not, be members of the LLC. Corp C §17050(a). Frequently, either the attorney or a staff member will execute the articles of organization.

In addition to a signed original, the Secretary of State will accept a facsimile signature that is submitted by mail or in person. Corp C §17.1(c). The person who submits a facsimile signature must maintain the original signed document for at least 5 years from the date of filing. Corp C §17.1(d). Although the Secretary of State's office has the authority to adopt procedures for direct electronic or facsimile filing of documents (Corp C §17.1(e)), it has yet to do so.

**PRACTICE TIP:** Instead of using the mails, the practitioner may fax a document to a service company and have the service company file it over the counter. Alternatively, the practitioner may scan the signed document into a PDF file, e-mail it to a service company, and then have the service company file it over the counter.

If desired, articles of organization (or any document for an LLC) may receive a preclearance review from the Secretary of State to determine if the document conforms to law. The Secretary of State will send the response by facsimile, e-mail, overnight courier, or mail, as requested by the customer. The response times offered are 24 hours, 72 hours, 5 business days, or 10 business days for fees that are currently \$500, \$400, \$300, and \$250, respectively. 2 Cal Code Regs §21904. A specific filing date may be requested. See 2 Cal Code Regs §21905.5.

The filing fee for articles of organization is \$70. Corp C §12190(b). The Secretary of State also charges a \$15 fee for documents submitted over the counter. 2 Cal Code Regs §21903(c). Expedited service is offered with 4-hour (if precleared), same day, or 24-hour response times for documents submitted in person in the Sacramento office; current fees are \$500, \$750, and \$350, respectively. 2 Cal Code Regs §21905(e)-(f). For further information on preclearance review and expedited filing, consult the Secretary of State's website at <http://www.sos.ca.gov/business/precexp.htm>.

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/ C. Operating Agreement/§11.31 1. Statutory Requirements

C. Operating Agreement

§11.31 1. Statutory Requirements

An LLC is not formed until both the articles of organization are filed and the members have entered into an operating agreement. Corp C §17050(a). An operating agreement is an agreement among the members as to the affairs of the LLC and the conduct of its business. Corp C §17001(ab). An operating agreement may be oral or in writing. Corp C §17001(ab).

Because the law does not prescribe any particular form, an operating agreement may be in any format. An operating agreement is not filed with the Secretary of State, but, if it is in writing, the LLC must maintain a copy at its designated office, in addition to any powers of attorney under which the operating agreement or any amendment was signed. Corp C §17058(a)(5).

Although an operating agreement may be oral, the better practice is to have a written agreement. A written agreement provides these advantages:

- Clear documentation of the terms to which the members have agreed. Over time, members may have difficulty remembering even simple terms of an oral agreement. An oral agreement may lead to misunderstandings and difficulty of proof. A complex oral agreement may be a lawsuit waiting to happen.
- Variation from statutory provisions. Many provisions of the Beverly-Killea Limited Liability Company Act (Corp C §§17000-17656) may be varied only in a written operating agreement. This allows the members to customize the structure and terms of the LLC to reflect their goals and agreements. See §11.34.
- Provides evidence of a formal structure to the LLC. This is useful when a third party is making an alter ego claim against the members of an LLC, especially a single-member LLC. A written operating agreement that provides structure to the entity helps demonstrate that the entity is separate and apart from the member/owner. The corporate analogy is to bylaws and minutes for a corporation that has one shareholder, who is the sole director and fills all three statutorily required officer positions.

**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.32 2. Variation From Statutory Provisions

§11.32 2. Variation From Statutory Provisions

The Beverly-Killea Limited Liability Company Act (Corp C §§17000-17656) contains specific provisions that govern the rights, duties, and obligations of the members of an LLC. Except for certain provisions, the members have a great deal of flexibility to vary the provisions of the Act in an operating agreement. Corp C §17005(a)-(d). The practitioner should consider the following restrictions and conditions when drafting an operating agreement:

- The operating agreement may not be inconsistent with the articles of organization. Corp C §17001(ab). If there is a conflict, the articles of organization control. Corp C §17005(f).
- Neither the operating agreement nor the articles of organization may:
- Vary the definitions in Corp C §17001, except as specifically provided in each definition in that section (Corp C §17005(b)(1));
- Eliminate the right of a member under Corp C §17100(c) to assert that a provision in the operating agreement governing the termination of the member's interest and the return of the member's capital contribution was unreasonable (Corp C §17005(b)(2));
- Vary the voting requirements or voting rights set forth in Corp C §17103(b)-(c) with respect to amendment of the articles of organization and voting on dissolution or merger (Corp C §17005(b)(3)); or
- Vary a member's rights under Corp C §§17106 and 17453 with respect to the rights to obtain information and inspect records for domestic and foreign LLCs (Corp C §17005(b)(4)).
- The provisions of the Act with respect to formation (Corp C §§17050-17062), dissolution (Corp C §§17350-17357), foreign limited liability companies (Corp C §§17450-17457), class actions and derivative actions (Corp C §§17500-17501), mergers (Corp C §§17550-17556), and dissenters' rights (Corp C §§17600-17613) may be varied in a written operating agreement only to the extent expressly allowed in such provisions. Corp C §17005(c).
- The provisions of Corp C §17059 (the power to adopt or amend the operating agreement), §17103 (voting rights), §17104 (members' meetings), §17152 (election and removal of managers), §17154 (appointment of officers), and §17155 (indemnification) may only be varied in a written operating agreement. Corp C §17005(b). These provisions may not be modified by an oral agreement.
- The fiduciary duties of a manager in a manager-managed LLC or the members in a member-managed LLC may be modified only in a written operating agreement with the informed consent of the members. Corp C §17005(d). The fiduciary duties may not be modified by an oral agreement.

All other provisions of the Act may be varied by a written operating agreement. Corp C §17005(a)-(b). Although certain provisions of the Act expressly allow for modification by using the phrase "unless otherwise provided" in the operating agreement, the absence of such phrase does not imply that other provisions may not be varied by an operating agreement. Corp C §17005(e).

**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/ D. Additional Filings/  
§11.33 1. Statement of Information

D. Additional Filings

§11.33 1. Statement of Information

Every LLC, within 90 days after filing its articles of organization, must file a Statement of Information (Secretary of State Form LLC-12, see form in [§11.46](#)) with the Secretary of State. [Corp C §17060\(a\)](#). The Secretary of State will normally send the form with the filed articles of organization.

Every second year, in the calendar month in which the articles of organization were filed, every LLC must file a Statement of Information Renewal (Secretary of State Form LLC-12R) (see form in [§11.47](#)) with the Secretary of State. [Corp C §17060\(a\)](#), (c). An LLC may file a Statement of Information at any time to report changes in the information contained in any previously filed Statement of Information. There is no filing fee for reporting changed information.

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.34 2. Federal Employer Identification Number

§11.34 2. Federal Employer Identification Number

Because an LLC is a separate entity for tax purposes, it must obtain a federal employer identification number (FEIN). A FEIN will be required on tax returns and other statements, for withholding and paying wages, and when opening bank accounts.

The practitioner may obtain a FEIN for an LLC by completing and filing an Application for Employer Identification Number (IRS Form SS-4). See form in [§2.207](#). On completing Form SS-4 and the methods for filing it, see [§2.200](#).

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.35 3. Licensing and Other Filings

§11.35 3. Licensing and Other Filings

A new business that has employees is required to register with the California Employment Development Department, and it may also need to obtain a seller's permit from the California Board of Equalization (BOE). See [§§2.201, 2.208](#).

The practitioner should carefully review the client's proposed business activities to determine the applicable licenses and permits particular to the business, including city and local permits. For resources to obtain more information, see [§2.203](#).

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## V. CHECKLISTS

### §11.36 A. Preformation Checklist

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This checklist is a guide to information needed to form an LLC and prepare the operating agreement. It may also serve as an agenda for the initial client meeting.

The items on the checklist correspond to the discussions in §§11.2-11.35 and the applicable provisions in the form of operating agreement set out in §§11.48-11.233. Certain items will also be used to complete the articles of organization and other documents on behalf of the LLC.

**NOTE:** This checklist and the formation checklist in §11.37 are not exhaustive. Each should be used only as a guide to identify issues that regularly arise when forming an LLC and drafting an operating agreement.

- Name of the LLC, including alternate choices of name (see §§11.28, 11.47, 11.63, 11.93; see also chap 3).
- Street address and telephone number of the LLC's principal office in California (see §11.94) and any other business address.
- Fictitious business names (see §11.28; see also §§3.8-3.12).
- Management by managers or all of the members (see §§11.16-11.18).
- If managed by managers, number of managers.
- Name, address, and marital status of each member, manager, and officer (see §§11.95, 11.233).
- The business or businesses in which the LLC will engage (see §§11.12, 11.96).
- Any limitations or restrictions on the business or businesses of the LLC (see §11.96).
- Type of ownership interests, percentage interests, or units (see §§11.13, 11.102).
- Different classes of ownership interests (see §11.13).
- Members' respective ownership interests in the LLC (see §11.233).
- Initial capital contributions of each member (see §§11.14-11.15, 11.97, 11.233).
- Additional capital contributions (mandatory, permissive, not allowed) (see §§11.14, 11.98).
- Terms for admitting additional members (see §11.104).
- Rights and obligations of the members (see §§11.21-11.22).
- Voting rights; super majority required to approve certain events (see §11.110).
- Right to reimbursement of expenses incurred in connection with the LLC's business (see §11.108).
- Obligation, if any, of members or managers to devote all their business time to the LLC's business (see §11.120).
- Right, if any, of members or managers to engage in any business that competes or conflicts with the LLC's business (see §§11.106, 11.121).
- Appointment and removal of managers (see §§11.76, 11.117-11.123).
- Compensation of managers or members (see §§11.108, 11.123).
- Officers (President, Vice President, Chief Financial Officer, Secretary, others) (see §11.124).
- Interest and preferred returns (see §11.140).
- Return of capital (see §11.145).
- Manner and priority of distributions (percentage of income, to pay taxes, as manager or members may

determine) (see §11.145).

- Restrictions on member's ability to transfer or encumber LLC interests (see §§11.146-11.147).
- First negotiation rights (see §11.152).
- First refusal rights (see §11.153).
- Mandatory purchase and sale rights (drag-along and tag-along) (see §11.154).
- Other provisions regarding transfer of membership interests, such as buy-sell or put-call (see §11.156).
- Classification of taxation, partnership or corporate (see §11.5).
- Tax year of the LLC (see §11.71).
- Method of accounting.
- Member's right to inspect and copy records (see §§11.25, 11.157).
- Events of dissolution (see §11.164).

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## §11.37 B. Formation Checklist

► To download **Word** version,  
right click and choose  
*Save Target As*

► To download **WordPerfect** version,  
right click and choose  
*Save Target As*

### LLC Name

- Contact the Secretary of State to ascertain the availability of the proposed LLC name (see §3.5).
- If the Secretary of State rejects the proposed LLC name on grounds that it is too similar to name of an existing LLC, obtain the consent of the existing LLC to use the proposed LLC name (see form in §3.34).
- Conduct a search for conflicts with existing fictitious business names, unregistered users, and registered trademarks, trade names, and service names (see §§3.8-3.12, 3.13, 3.16-3.17).
- Reserve the name with the Secretary of State (see §3.15).
- If the LLC will conduct business under a name other than the name reflected in the articles of organization, file a fictitious business name statement in each county in which the LLC will conduct its business (see §§3.9, 11.28;).
- Apply to register the LLC's name as a trademark, trade name, or service name (see §§3.13, 3.16-3.17).

### Articles of Organization

- File the Articles of Organization (Secretary of State Form LLC-1) with the Secretary of State (see §§11.29-11.30, form in §11.39).

### Operating Agreement

- Prepare and execute the written operating agreement (see §§11.31-11.32, 11.48-11.233).

### Additional Filings

- File a Statement of Information (Secretary of State Form LLC-12) with the Secretary of State (see §11.33, form in §11.46).
- Obtain an FEIN from Internal Revenue Service (see §§2.200, 2.207, 11.34).
- File tax classification election (partnership or corporation) with the Internal Revenue Service (see §11.6).
- If the LLC will have employees, register with the Economic Development Department (see §§2.201, 2.208, 11.35).
- If required, obtain a seller's permit from the Board of Equalization (see §§2.202, 11.35).
- If required, obtain licenses and permits (see §§2.203, 11.35).
- If required, file for registration, qualification, or exemption under the securities laws (see §§11.9-11.11).

**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.38 VI. FORMS

§11.38 VI. FORMS

All forms are available from the Secretary of State's website and may be downloaded or completed online and printed out. The address of the website is [http://www.sos.ca.gov/business/bpd\\_forms.htm#llc](http://www.sos.ca.gov/business/bpd_forms.htm#llc).

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.39 A. Form: Articles of Organization (Secretary of State Form LLC-1)

**§11.39 A. Form: Articles of Organization (Secretary of State Form LLC-1)**





State of California Secretary of State

LLC-1

File #

LIMITED LIABILITY COMPANY ARTICLES OF ORGANIZATION

A \$70.00 filing fee must accompany this form.

IMPORTANT - Read instructions before completing this form.

This Space For Filing Use Only

ENTITY NAME (End the name with the words "Limited Liability Company," or the abbreviations "LLC" or "L.L.C." The words "Limited" and "Company" may be abbreviated to "Ltd." and "Co.," respectively.)

1. NAME OF LIMITED LIABILITY COMPANY

PURPOSE (The following statement is required by statute and should not be altered.)

2. THE PURPOSE OF THE LIMITED LIABILITY COMPANY IS TO ENGAGE IN ANY LAWFUL ACT OR ACTIVITY FOR WHICH A LIMITED LIABILITY COMPANY MAY BE ORGANIZED UNDER THE BEVERLY-KILLEA LIMITED LIABILITY COMPANY ACT.

INITIAL AGENT FOR SERVICE OF PROCESS (If the agent is an individual, the agent must reside in California and both Items 3 and 4 must be completed. If the agent is a corporation, the agent must have on file with the California Secretary of State a certificate pursuant to Corporations Code section 1505 and Item 3 must be completed (leave Item 4 blank).

3. NAME OF INITIAL AGENT FOR SERVICE OF PROCESS

4. IF AN INDIVIDUAL, ADDRESS OF INITIAL AGENT FOR SERVICE OF PROCESS IN CALIFORNIA CITY STATE ZIP CODE CA

MANAGEMENT (Check only one)

5. THE LIMITED LIABILITY COMPANY WILL BE MANAGED BY:

- ONE MANAGER
MORE THAN ONE MANAGER
ALL LIMITED LIABILITY COMPANY MEMBER(S)

ADDITIONAL INFORMATION

6. ADDITIONAL INFORMATION SET FORTH ON THE ATTACHED PAGES, IF ANY, IS INCORPORATED HEREIN BY THIS REFERENCE AND MADE A PART OF THIS CERTIFICATE.

EXECUTION

7. I DECLARE I AM THE PERSON WHO EXECUTED THIS INSTRUMENT, WHICH EXECUTION IS MY ACT AND DEED.

DATE

SIGNATURE OF ORGANIZER

TYPE OR PRINT NAME OF ORGANIZER

## INSTRUCTIONS FOR COMPLETING THE ARTICLES OF ORGANIZATION (FORM LLC-1)

For easier completion, this form is available on the Secretary of State's website at <http://www.sos.ca.gov/business/> and can be viewed, filled in and printed from your computer. The completed form along with the applicable fees can be mailed to Secretary of State, Document Filing Support Unit, P.O. Box 944228, Sacramento, CA 94244-2280 or delivered in person to the Sacramento office, 1500 11th Street, 3rd Floor, Sacramento, CA 95814. If you are not completing this form online, please type or legibly print in black or blue ink. This form is filed only in the Sacramento office.

Statutory filing requirements are found in California Corporations Code sections 17051 and 17052. All statutory references are to the California Corporations Code, unless otherwise stated.

**FEES:** The fee for filing Form LLC-1 is \$70.00. There is an additional \$15.00 special handling fee for processing a document delivered in person to the Sacramento office. The special handling fee must be remitted by separate check for each submittal and will be retained whether the document is filed or rejected. The preclearance and/or expedited filing of a document within a guaranteed time frame can be requested for an additional fee (in lieu of the special handling fee). Please refer to the Secretary of State's website at <http://www.sos.ca.gov/business/preceexp.htm> for detailed information regarding preclearance and expedited filing services. The special handling fee or preclearance and expedited filing services are not applicable to documents submitted by mail. Check(s) should be made payable to the Secretary of State.

**COPIES:** The Secretary of State will certify two copies of the filed document(s) without charge, provided that the copies are submitted to the Secretary of State with the document(s) to be filed. Any additional copies submitted will be certified upon request and payment of the \$8.00 per copy certification fee.

Pursuant to Section 17375, a domestic limited liability company may not render professional services, as defined in Sections 13401(a) and 13401.3. Professional services are defined as any type of professional services that may be lawfully rendered only pursuant to a license, certification, or registration authorized by the Business and Professions Code, the Chiropractic Act, the Osteopathic Act or the Yacht and Ship Brokers Act. If your business is required to be licensed, certified or registered, it is recommended that you contact the appropriate licensing authority before filing with the Secretary of State's office in order to determine whether your services are considered professional.

Filing this document shall obligate most limited liability companies to pay an annual minimum tax of \$800.00 to the Franchise Tax Board pursuant to Revenue and Taxation Code section 17941.

### Complete the Articles of Organization (Form LLC-1) as follows:

**Item 1.** Enter the name of the limited liability company. The name must end with the words "Limited Liability Company," or the abbreviations "LLC" or "L.L.C." The words "Limited" and "Company" may be abbreviated to "Ltd." and "Co.," respectively. The name of the limited liability company may not contain the words "bank," "trust," "trustee," "incorporated," "inc.," "corporation," or "corp.," and must not contain the words "insurer" or "insurance company" or any other words suggesting that it is in the business of issuing policies of insurance and assuming insurance risks.

**Item 2.** This statement is required by statute and should not be altered. Provisions limiting or restricting the business of the limited liability company may be included as an attachment.

**Items 3 & 4** Enter the name of the agent for service of process in California. An agent is an individual, whether or not affiliated with the limited liability company, who resides in California or a corporation designated to accept service of process if the company is sued. The agent should agree to accept service of process on behalf of the limited liability company prior to designation.

If a corporation is designated as agent, that corporation must have previously filed with the Secretary of State, a certificate pursuant to Corporations Code section 1505. Note, a **limited liability company cannot act as its own agent** and no domestic or foreign corporation may file pursuant to Section 1505 unless the corporation is currently authorized to engage in business in California and is in good standing on the records of the Secretary of State.

If an individual is designated as agent, complete Items 3 and 4. If a corporation is designated as agent, complete Item 3 and proceed to Item 5 (do not complete Item 4).

**Item 5.** Check the appropriate provision indicating whether the limited liability company is to be managed by one manager, more than one manager or all limited liability company members. Only one box may be checked.

**Item 6.** Attach any other information to be included in Form LLC-1, provided that the information is not inconsistent with law.

**Item 7.** Form LLC-1 must be signed by the organizer. The person signing Form LLC-1 need not be a member or manager of the limited liability company.

- If Form LLC-1 is signed by an attorney-in-fact, the signature should be followed by the words "Attorney-in-fact for (name of person)."
- If Form LLC-1 is signed by an entity, the person who signs on behalf of the entity should note their name and position/title and the entity name. Example: If a limited liability company ("Smith LLC") is the organizer, the signature of the person signing on behalf of the Smith LLC should be reflected as Joe Smith, Manager of Smith LLC, Organizer.
- If Form LLC-1 is signed by a trust, the trustee should sign as follows: \_\_\_\_\_, trustee for \_\_\_\_\_ trust (including the date of the trust, if applicable). Example: Mary Todd, trustee of the Lincoln Family Trust (U/T 5-1-94).

Any attachments to Form LLC-1 are incorporated by reference. All attachments should be 8 ½" x 11", one-sided and legible.

*Comment:* This form is available at the Secretary of State's website, <http://www.sos.ca.gov/business/llc/forms/llc->

1.pdf.

The California Secretary of State has preclearance and expedited services for all business entity documents filed with the Secretary of State under the California Corporations Code. "Preclearance service" allows a customer to submit a business entity document in person at the Sacramento office before filing to determine if the document conforms to law and to receive a preclearance response within a guaranteed time frame. Only one copy of the document need be submitted. "Expedited filing" allows a customer to submit a business entity document in person in the Sacramento office and receive a filing response within a guaranteed time frame. For further information, consult the website at <http://www.sos.ca.gov/business/precexp.htm>.

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§11.40 B. Form: Certificate of Amendment (Articles of Organization) (Secretary of State Form LLC-2)



 <p><b>State of California</b> <b>Secretary of State</b></p> <p><b>LIMITED LIABILITY COMPANY CERTIFICATE OF AMENDMENT</b></p> <p>A \$30.00 filing fee must accompany this form.</p> <p><b>IMPORTANT – Read instructions before completing this form.</b></p>				
This Space For Filing Use Only				
1. SECRETARY OF STATE FILE NUMBER	2. NAME OF LIMITED LIABILITY COMPANY			
<p>3. COMPLETE ONLY THE SECTIONS WHERE INFORMATION IS BEING CHANGED. ADDITIONAL PAGES MAY BE ATTACHED IF NECESSARY.</p> <p><b>A. LIMITED LIABILITY COMPANY NAME</b> (END THE NAME WITH THE WORDS "LIMITED LIABILITY COMPANY," "LTD. LIABILITY CO." OR THE ABBREVIATIONS "LLC" OR "L.L.C.")</p> <p>_____</p> <p><b>B. THE LIMITED LIABILITY COMPANY WILL BE MANAGED BY (CHECK ONE):</b></p> <p><input type="checkbox"/> ONE MANAGER</p> <p><input type="checkbox"/> MORE THAN ONE MANAGER</p> <p><input type="checkbox"/> ALL LIMITED LIABILITY COMPANY MEMBER(S)</p> <p><b>C. AMENDMENT TO TEXT OF THE ARTICLES OF ORGANIZATION:</b></p> <p>_____</p> <p><b>D. OTHER MATTERS TO BE INCLUDED IN THIS CERTIFICATE MAY BE SET FORTH ON SEPARATE ATTACHED PAGES AND ARE MADE A PART OF THIS CERTIFICATE. OTHER MATTERS MAY INCLUDE A CHANGE IN THE LATEST DATE ON WHICH THE LIMITED LIABILITY COMPANY IS TO DISSOLVE OR ANY CHANGE IN THE EVENTS THAT WILL CAUSE THE DISSOLUTION.</b></p>				
4. FUTURE EFFECTIVE DATE, IF ANY:				
	<table style="width: 100%; border: none;"> <tr> <td style="width: 33%; border: none;">MONTH</td> <td style="width: 33%; border: none;">DAY</td> <td style="width: 33%; border: none;">YEAR</td> </tr> </table>	MONTH	DAY	YEAR
MONTH	DAY	YEAR		
5. NUMBER OF PAGES ATTACHED, IF ANY:				
6. IT IS HEREBY DECLARED THAT I AM THE PERSON WHO EXECUTED THIS INSTRUMENT, WHICH EXECUTION IS MY ACT AND DEED.				
SIGNATURE OF AUTHORIZED PERSON	DATE			
TYPE OR PRINT NAME AND TITLE OF AUTHORIZED PERSON				
7. RETURN TO:				
NAME FIRM ADDRESS CITY/STATE ZIP CODE	[ ] ]			

## INSTRUCTIONS FOR COMPLETING THE CERTIFICATE OF AMENDMENT (LLC-2)

For easier completion, this form is available in a "fillable" version online at the Secretary of State's website at <http://www.ss.ca.gov/business/business.htm>. The form can be filled in on your computer, printed and mailed to the Secretary of State, Document Filing Support Unit, P O Box 944228, Sacramento, CA 94244-2280 or can be delivered in person to the Sacramento office, 1500 11<sup>th</sup> Street, 3<sup>rd</sup> Floor, Sacramento, CA 95814. If you are not completing this form online, please type or legibly print in black or blue ink.

**FILING FEE:** The filing fee is \$30.00. Make the check(s) payable to the Secretary of State and send the executed document and filing fee to the address stated above.

Statutory filing provisions can be found in California Corporations Code section 17054. All statutory references are to the California Corporations Code, unless otherwise stated.

- A Certificate of Amendment (LLC-2) shall be filed within thirty (30) days after any information set forth in the Articles of Organization (LLC-1) or a previously filed Certificate of Amendment (LLC-2) or Restated Articles of Organization (LLC-10), becomes inaccurate, or in order to add information to the Articles of Organization (LLC-1), a previously filed Certificate of Amendment (LLC-2) or a Restated Certificate of Articles of Organization (LLC-10).
- The Certificate of Amendment (LLC-2) may become effective not more than ninety (90) days after filing the Certificate of Amendment (LLC-2). (Section 17056 (c).)

### Complete the Certificate of Amendment (Form LLC-2) as follows:

- Item 1.** Enter the file number issued by the California Secretary of State.
- Item 2.** Enter the name of the limited liability company as filed with the California Secretary of State.
- Item 3.** Enter only the information which is being amended. Provide the text of each amendment adopted, using the A-D space provided or attaching additional pages.
- Item 4.** Enter the future effective date of the Certificate of Amendment (LLC-2), if any. If none is indicated, the amendment shall be effective upon filing with the California Secretary of State.
- Item 5.** Enter the number of pages attached, if any. All attachments should be 8 1/2" X 11", one-sided and legible.
- Item 6.** The Certificate of Amendment (LLC-2) shall be executed, with an original signature and title, of at least one manager unless a greater number is provided for in the Articles of Organization.

If an entity is designated as a manager or member, the person who signs for the entity must note the exact entity name, his/her name, and his/her position/title.

If a trust is designated as a manager or member, the certificate must be signed by a trustee as follows: \_\_\_\_\_, trustee for \_\_\_\_\_ trust (including the date of the trust, if applicable). Example: Mary Todd, trustee of the Lincoln Family Trust (U/T/A 5-1-94).

- Item 7.** Enter the name and address of the person or firm to whom a copy of the certificate should be returned.

- For further information contact the Business Filings Section at (916) 657-5448.

*Comment:* This form is available at the Secretary of State's website, <http://www.sos.ca.gov/business/llc/forms/llc-2.pdf>. For information on the Secretary of State's preclearance and expedited filing services, see Comment to the form in §11.39.

§11.41 C. Form: Application for Registration as Foreign Limited Liability Company (Secretary of State Form LLC-5)

Print



State of California  
Secretary of State

LLC-5 File # \_\_\_\_\_

LIMITED LIABILITY COMPANY  
APPLICATION FOR REGISTRATION

A \$70.00 filing fee AND a certificate of good standing from an authorized public official of the jurisdiction of formation must accompany this form.

IMPORTANT – Read instructions before completing this form.

This Space For Filing Use Only

**ENTITY NAME** (End the name in Item 1 with the words "Limited Liability Company," or the abbreviations "LLC" or "L.L.C." The words "Limited" and "Company" may be abbreviated to "Ltd." and "Co.," respectively.)

1. NAME UNDER WHICH THE FOREIGN LIMITED LIABILITY COMPANY PROPOSES TO REGISTER AND TRANSACT BUSINESS IN CALIFORNIA

2. NAME OF THE FOREIGN LIMITED LIABILITY COMPANY, IF DIFFERENT FROM THAT ENTERED IN ITEM 1 ABOVE

**DATE AND PLACE OF ORGANIZATION**

3. THIS FOREIGN LIMITED LIABILITY COMPANY WAS FORMED ON \_\_\_\_\_ IN \_\_\_\_\_  
(MONTH) (DAY) (YEAR) (STATE OR COUNTRY)

AND IS AUTHORIZED TO EXERCISE ITS POWERS AND PRIVILEGES IN THAT STATE OR COUNTRY.

**AGENT FOR SERVICE OF PROCESS** (If the agent is an individual, the agent must reside in California and both Items 4 and 5 must be completed. If the agent is a corporation, the agent must have on file with the California Secretary of State a certificate pursuant to Corporations Code section 1505 and Item 4 must be completed (leave Item 5 blank).)

4. NAME OF AGENT FOR SERVICE OF PROCESS

5. IF AN INDIVIDUAL, ADDRESS OF INITIAL AGENT FOR SERVICE OF PROCESS IN CALIFORNIA CITY STATE ZIP CODE  
CA

**APPOINTMENT** (The following statement is required by statute and should not be altered.)

6. IN THE EVENT THE ABOVE AGENT FOR SERVICE OF PROCESS RESIGNS AND IS NOT REPLACED, OR IF THE AGENT CANNOT BE FOUND OR SERVED WITH THE EXERCISE OF REASONABLE DILIGENCE, THE SECRETARY OF STATE OF THE STATE OF CALIFORNIA IS HEREBY APPOINTED AS THE AGENT FOR SERVICE OF PROCESS OF THIS FOREIGN LIMITED LIABILITY COMPANY.

**OFFICE ADDRESSES** (Do not abbreviate the name of the city.)

7. ADDRESS OF THE PRINCIPAL EXECUTIVE OFFICE CITY AND STATE ZIP CODE

8. ADDRESS OF THE PRINCIPAL OFFICE IN CALIFORNIA, IF ANY CITY STATE ZIP CODE  
CA

**EXECUTION**

9. I DECLARE I AM THE PERSON WHO EXECUTED THIS INSTRUMENT, WHICH EXECUTION IS MY ACT AND DEED.

DATE \_\_\_\_\_

SIGNATURE OF AUTHORIZED PERSON \_\_\_\_\_

TYPE OR PRINT NAME AND TITLE OF AUTHORIZED PERSON \_\_\_\_\_

## INSTRUCTIONS FOR COMPLETING THE APPLICATION FOR REGISTRATION (FORM LLC- 5)

For easier completion, this form is available on the Secretary of State's website at <http://www.sos.ca.gov/business/> and can be viewed, filled in and printed from your computer. The completed form along with the applicable fees can be mailed to Secretary of State, Document Filing Support Unit, P.O. Box 944228, Sacramento, CA 94244-2280 or delivered in person to the Sacramento office, 1500 11th Street, 3rd Floor, Sacramento, CA 95814. If you are not completing this form online, please type or legibly print in black or blue ink. This form is filed only in the Sacramento office.

Statutory filing requirements are found in California Corporations Code sections 17451 and 17452. All statutory references are to the California Corporations Code, unless otherwise stated.

- Attach a valid certificate of good standing from an authorized public official of the jurisdiction under which the foreign limited liability company is organized. If the issuance of such a certificate is not permissible in that jurisdiction, attach a statement by the foreign limited liability company indicating such.

**FEES:** The fee for filing Form LLC-5 is \$70.00. There is an additional \$15.00 special handling fee for processing a document delivered in person to the Sacramento office. The special handling fee must be remitted by separate check for each submittal and will be retained whether the document is filed or rejected. The preclearance and/or expedited filing of a document within a guaranteed time frame can be requested for an additional fee (in lieu of the special handling fee). Please refer to the Secretary of State's website at <http://www.sos.ca.gov/business/precexp.htm> for detailed information regarding preclearance and expedited filing services. The special handling fee or preclearance and expedited filing services are not applicable to documents submitted by mail. Check(s) should be made payable to the Secretary of State.

**COPIES:** The Secretary of State will certify two copies of the filed document(s) without charge, provided that the copies are submitted to the Secretary of State with the document(s) to be filed. Any additional copies submitted will be certified upon request and payment of the \$8.00 per copy certification fee.

Pursuant to Section 17375, a foreign limited liability company may not render professional services, as defined in Sections 13401(a) and 13401.3, in this state. Professional services are defined as any type of professional services that may be lawfully rendered only pursuant to a license, certification, or registration authorized by the Business and Professions Code, the Chiropractic Act, the Osteopathic Act or the Yacht and Ship Brokers Act. If your business is required to be licensed, certified or registered, it is recommended that you contact the appropriate licensing authority before filing with the Secretary of State's office in order to determine whether your services are considered professional.

Filing this document shall obligate most limited liability companies to pay an annual minimum tax of \$800.00 to the Franchise Tax Board pursuant to Revenue and Taxation Code section 17941.

### Complete the Application For Registration (Form LLC- 5) as follows:

- Item 1.** Enter the name under which the foreign limited liability company is to be registered and transact business in California. The name must end with the words "Limited Liability Company," or the abbreviations "LLC" or "L.L.C." The words "Limited" and "Company" may be abbreviated to "Ltd." and "Co.," respectively. The name of the limited liability company may not contain the words "bank," "trust," "trustee," "incorporated," "inc.," "corporation," or "corp.," and must not contain the words "insurer" or "insurance company" or any other words suggesting that it is in the business of issuing policies of insurance and assuming insurance risks.
- Item 2.** Enter the name of the foreign limited liability company as it appears on its articles of organization, if different from the name entered in Item 1. The name in Item 2 must agree exactly with the name on the certificate of good standing.
- Item 3.** Enter the date and state or country of formation and make the required statement concerning the authority of the limited liability company to exercise its powers and privileges in its state or country of formation.
- Items 4 & 5** Enter the name of the agent for service of process in California. An agent is an individual, whether or not affiliated with the limited liability company, who resides in California or a corporation designated to accept service of process if the company is sued. The agent should agree to accept service of process on behalf of the limited liability company prior to designation.
- If a corporation is designated as agent, that corporation must have previously filed with the Secretary of State, a certificate pursuant to Corporations Code section 1505. Note, a **limited liability company cannot act as its own agent** and no domestic or foreign corporation may file pursuant to Section 1505 unless the corporation is currently authorized to engage in business in California and is in good standing on the records of the Secretary of State.
- If an individual is designated as agent, complete Items 4 and 5. If a corporation is designated as agent, complete Item 4 and proceed to Item 6 (do not complete Item 5).
- Item 6.** This statement is required by statute and should not be altered.
- Item 7.** Enter the complete address, including the zip code, of the principal executive office of the foreign limited liability company. Please do not abbreviate the name of the city.
- Item 8.** Enter the complete address, including the zip code, of the principal office in California, if any. Please do not abbreviate the name of the city.
- Item 9.** Form LLC-5 must be signed by a person with authority to do so under the laws of the state of organization of the foreign limited liability company.

*Comment:* This form is available at the Secretary of State's website, <http://www.sos.ca.gov/business/llc/forms/llc-5.pdf>. For information on the Secretary of State's preclearance and expedited filing services, see Comment to the form in §11.39.



§11.42 D. Form: Certificate of Amendment to the Application for Registration [Foreign LLC] (Secretary of State Form LLC-6)

 Print



State of California  
Secretary of State

LIMITED LIABILITY COMPANY  
APPLICATION FOR REGISTRATION  
CERTIFICATE OF AMENDMENT

A \$30.00 filing fee must accompany this form  
IMPORTANT – Read instructions before completing this form.

This Space For Filing Use Only

1. Secretary of State File Number

2. Name under which this foreign limited liability company is conducting business in California:

3. COMPLETE ONLY THE SECTIONS WHERE INFORMATION IS BEING CHANGED. ADDITIONAL PAGES MAY BE ATTACHED, IF NECESSARY. CONSULT THE INSTRUCTIONS BEFORE COMPLETING THIS FORM.

A. The name under which this foreign limited liability company conducts business in California. (End the name with the words "Limited Liability Company," or "Ltd. Liability Co.," or the abbreviations "LLC" or "L.L.C.")

B. The name of the foreign limited liability company has been changed as follows and has been recorded in the home state or country:

C. State or country of formation of the foreign limited liability company, if false or erroneous at time of registration.

D. Date on which the foreign limited liability company was formed, if false or erroneous at time of registration.

E. Address of the principal executive office: City State Zip Code

F. Address of the principal office in California: City State CA Zip Code

4. Future effective date, if any: Month Day Year

5. Number of pages attached, if any:

6. Declaration: It is hereby declared that I am the person who executed this instrument, which execution is my act and deed.

\_\_\_\_\_  
Signature of Authorized Person

\_\_\_\_\_  
Type or Print Name and Title of Authorized Person

\_\_\_\_\_  
Date

RETURN TO:

NAME

FIRM

ADDRESS

CITY/STATE

ZIP CODE

**INSTRUCTIONS FOR COMPLETING THE CERTIFICATE OF AMENDMENT  
TO THE APPLICATION FOR REGISTRATION (LLC-6)**

- If any statement in the Application of Registration (LLC-5) was false when made or any statements made have become erroneous, the foreign limited liability company shall promptly file with the Secretary of State of California a Certificate of Amendment to the Application for Registration (LLC-6). (Section 17454.)
- The Certificate of Amendment to the Application for Registration (LLC-6) may become effective not more than ninety (90) days after filing the Certificate. If such future effective date is desired, indicate in a cover letter the month, day, and year upon which the Certificate of Amendment of the Application for Registration (LLC-6) is to become effective. (Section 17056(c)).

**DO NOT ALTER THIS FORM**

**Type or legibly print in black ink.**

- Attach the fee for filing the Certificate of Amendment to the Application for Registration (LLC-6) with the Secretary of State. The fee is thirty dollars (\$30).
- Make check(s) payable to the Secretary of State.
- Send the executed document and filing fee to:

California Secretary of State  
Document Filing Support Unit  
P.O. Box 944228  
Sacramento, CA 94244-2280

- Fill in the items as follows:

- Item 1.** Enter the file number issued by the California Secretary of State.
- Item 2.** Enter the name of the foreign limited liability company as registered with the California Secretary of State.
- Item 3.** Enter only the information which is being amended. Provide the text of each amendment adopted, using the A-F space provided and/or attaching additional pages.
- Item 4.** Enter the future effective date of the Certificate of Amendment to the Application for Registration (LLC-6), if any. If none is entered, the amendment shall be effective upon filing with the California Secretary of State.
- Item 5.** Enter the number of pages attached, if any. All attachments should be 8½" x 11", one-sided and legible.
- Item 6.** The Certificate of Amendment to the Application for Registration (LLC-6) shall be executed with an original signature and title.

If the Certificate of Amendment to the Application for Registration (LLC-6) is signed by an entity, the person who signs for the entity must note the exact entity name, his/her name and his/her position/title.

If the Certificate of Amendment to the Application for Registration (LLC-6) is signed by a trust, the certificate must be signed by a trustee as follows:

\_\_\_\_\_, trustee for \_\_\_\_\_ trust (including the date of the trust, if applicable). Example: Mary Todd, trustee of the Lincoln Family Trust (U/T/A 5/1/94).

- Item 7.** Enter the name and address of the person or firm to whom a copy of the filing should be mailed.
- Statutory provisions can be found in Section 17454 of the California Corporations Code, unless otherwise indicated.
  - For further information contact the Business Filings Section at (916) 657-5448.

*Comment:* This form is available at the Secretary of State's website, <http://www.sos.ca.gov/business/llc/forms/llc-6.pdf>. For information on the Secretary of State's preclearance and expedited filing services, see Comment to the form in §11.39.



§11.43 E. Form: Certificate of Continuation (Secretary of State Form LLC-8)

 Print



**State of California  
Secretary of State**

**LIMITED LIABILITY COMPANY  
CERTIFICATE OF CONTINUATION**

**A \$30.00 filing fee must accompany this form.  
IMPORTANT – Read instructions before completing this form.**

This Space For Filing Use Only

1. Secretary Of State file number:

2. Name of the limited liability company:

3. The grounds for filing this Certificate of Continuation for this limited liability company are:

- The business of the limited liability company is to be continued pursuant to unanimous vote of the remaining members.
- The dissolution of the limited liability company was by vote of the members pursuant to subdivision (c) of Section 17350 and each member who consented to the dissolution has agreed in writing to revoke his or her vote in favor of or consent to the dissolution.
- The limited liability company was not, in fact, dissolved.

4. **Declaration:** It is hereby declared that I am the person who executed this instrument, which execution is my act and deed.

\_\_\_\_\_  
Signature of Authorized Person

\_\_\_\_\_  
Type or Print Name and Title of Authorized Person

\_\_\_\_\_  
Date

5. RETURN TO:

NAME

FIRM

ADDRESS

CITY/STATE

ZIP CODE

## INSTRUCTIONS FOR COMPLETING THE CERTIFICATE OF CONTINUATION (LLC-8)

- Upon filing the Certificate of Continuation (LLC-8), the Certificate of Dissolution (LLC-3) will be of no effect from the time of the filing of the Certificate of Dissolution (LLC-3).
- The Certificate of Continuation (LLC-8) may become effective not more than ninety (90) days after filing the certificate. If such a future effective date is desired, indicate in a cover letter the month, day, and year upon which the Certificate is to become effective. (Section 17056(c)).

### DO NOT ALTER THIS FORM

Type or legibly print in black ink.

- Attach the fee for filing the Certificate of Continuation (LLC-8) with the Secretary of State. The fee is thirty dollars (\$30).
- Make check(s) payable to the Secretary of State.
- Send the executed document and filing fee to:

California Secretary of State  
Document Filing Support Unit  
P.O. Box 944228  
Sacramento, CA 94244-2280

- Fill in the items as follows:

- Item 1.** Enter the file number issued by the California Secretary of State.
- Item 2.** Enter the name of the limited liability company as filed with the California Secretary of State.
- Item 3.** Check the reason for the continuation of the limited liability company.
- Item 4.** The Certificate of Continuation (LLC-8) must be executed with an original signature.

If the Certificate of Continuation (LLC-8) is signed by an entity, the person who signs for the entity must note the exact entity name, his/her name and his/her position/title.

If an attorney-in-fact is signing the Certificate of Continuation (LLC-8), the signature must be followed by the words "Attorney-in-fact for (name of person)."

If the Certificate of Continuation (LLC-8) is signed by a trust, the certificate must be signed by a trustee as follows:

\_\_\_\_\_, trustee for \_\_\_\_\_ trust (including the date of the trust, if applicable). Example: Mary Todd, trustee of the Lincoln Family Trust (U/T/A 5/1/94).

- Item 5.** Enter the name and address of the person or firm to whom a copy of the filing should be mailed.
- Statutory provisions can be found in Section 17357 of the California Corporations Code, unless otherwise indicated.
  - For further information contact the Business Filings Section at (916) 657-5448.

*Comment:* This form is available at the Secretary of State's website, <http://www.sos.ca.gov/business/llc/forms/llc-8.pdf>. For information on the Secretary of State's preclearance and expedited filing services, see Comment to the form in §11.39.



## INSTRUCTIONS FOR COMPLETING RESTATED ARTICLES OF ORGANIZATION (LLC-10)

For easier completion, this form is available in a "fillable" version online at the Secretary of State's website at <http://www.ss.ca.gov/business/business.htm>. The form can be filled in on your computer, printed and mailed to the Secretary of State, Document Filing Support Unit, P O Box 944228, Sacramento, CA 94244-2280 or can be delivered in person to the Sacramento office, 1500 11th Street, 3rd Floor, Sacramento, CA 95814. If you are not completing this form online, please type or legibly print in black or blue ink.

**FILING FEE:** The filing fee is \$30.00. Make the check(s) payable to the Secretary of State and send the executed document and filing fee to the address stated above.

Statutory filing provisions can be found in California Corporations Code section 17054(f). All statutory references are to the California Corporations Code, unless otherwise stated.

### Complete the Restated Articles of Organization (Form LLC-10) as follows:

- Item 1.** Enter the file number issued by the California Secretary of State.
- Item 2.** Enter the name of the limited liability company as filed with the California Secretary of State.
- Item 3.** If the name of the limited liability company is being amended, the name shall contain the words "Limited Liability Company", "Ltd. Liability Co." or the abbreviation "LLC" or "L.L.C." at the end. The name of the limited liability company may not contain the words "bank," "trust," "trustee," "incorporated," "inc.," "corporation," or "corp.," and shall not contain the words "insurer" or "insurance company" or any other words suggesting that it is in the business of issuing policies of insurance and assuming insurance risks. (Section 17052.)
- Item 4.** Enter the future effective date of the Restated Articles of Organization (LLC-10), if any. If none is indicated, the Restated Articles of Organization (LLC-10) shall be effective upon filing with the California Secretary of State.
- Item 5.** Execution of this document confirms the following statement which has been preprinted on the form and may not be altered: "The purpose of the limited liability company is to engage in any lawful act or activity for which a limited liability company may be organized under the Beverly-Killea Limited Liability Company Act." Provisions limiting or restricting the business of the limited liability company may be included as an attachment.
- Item 6.** Enter the name of the agent for service of process in this state. Check the appropriate provision indicating whether the agent is an individual residing in California or a corporation which has filed a certificate pursuant to Section 1505 of the California Corporations Code. If an individual is designated as agent, proceed to item 7. If a corporation is designated, proceed to item 8.
- Item 7.** If an individual is designated as the agent for service of process, enter an address in California. Do not enter "in care of" (c/o) or abbreviate the name of the city. DO NOT enter an address if a corporation is designated as the agent for service of process.
- Item 8.** Check the appropriate provision indicating whether the limited liability company is to be managed by one manager, more than one manager, or all the limited liability company member(s). (Section 17051(a)(5).)
- Item 9.** The Restated Articles of Organization (LLC-10) may include other matters that the person filing the certificate determines to include. Other matters may include the latest date on which the limited liability company is to dissolve. If other matters are to be included, attach one or more pages setting forth the other matters.
- Item 10.** Enter the number of pages attached, if any. All attachments should be 8½" x 11", one-sided and legible.
- Item 11.** The Restated Articles of Organization shall be executed, with an original signature and title, of at least one manager unless a greater number is provided for in the Articles of Organization.

If the Restated Articles of Organization (LLC-10) are signed by an entity, the person who signs for the entity must note the exact entity name, his/her name, and his/her position/title.

If the Restated Articles of Organization (LLC-10) are signed by a trust, the certificate must be signed by a trustee as follows: \_\_\_\_\_, trustee for \_\_\_\_\_ trust (including the date of the trust, if applicable). Example: Mary Todd, trustee of the Lincoln Family Trust (U/T/A 5-1-94).

- Item 12.** Enter the name and address of the person or firm to whom a copy of the filing should be mailed.

- For further information contact the Business Filings Section at (916) 657-5448.



## **EXPANSION OF PRECLEARANCE AND EXPEDITED FILING SERVICES (Effective Monday, October 2, 2006)**

We are pleased to announce that our preclearance and expedited filing services have been expanded to include all business entity documents filed with the Secretary of State pursuant to the California Corporations Code, the California Financial Code or the California Insurance Code. These services, previously offered only for specified corporate documents, are now available for all corporate, limited liability company and limited partnership documents, including interspecies mergers and conversions, and for all other documents filed by other entity types. In addition, the number of copies required to be submitted for the preclearance service has been reduced from two to one.

Preclearance service provides a customer with the opportunity to submit a business entity document in person to the Secretary of State's Sacramento office prior to filing to determine if the document conforms to law and to receive a preclearance response within a guaranteed time frame.

Expedited filing service provides a customer with the opportunity to submit for filing a business entity document in person to the Secretary of State's Sacramento office and to receive a filing response within a guaranteed time frame.

Please refer to the Secretary of State's website at <http://www.ss.ca.gov/business/precexp.htm> for detailed information regarding the preclearance and expedited filing services.

Authority cited: Title 2, California Code of Regulations, sections 21904 and 21905; and Government Code section 12182.

PRECEXP NOTICE (10/2006)

*Comment:* This form is available at the Secretary of State's website, <http://www.sos.ca.gov/business/lc/forms/lc-10.pdf>. For information on the Secretary of State's preclearance and expedited filing services, see Comment to the form in §11.39.

§11.45 G. Form: Certificate of Correction (Secretary of State Form LLC-11)

Print

 <b>State of California</b> <b>Secretary of State</b>		LLC-11
<b>LIMITED LIABILITY COMPANY CERTIFICATE OF CORRECTION</b>		
A \$30.00 filing fee must accompany this form.		
<b>IMPORTANT – Read instructions before completing this form.</b>		This Space For Filing Use Only
<b>FILE NUMBER</b>	<b>ENTITY NAME</b> (Enter the exact name of the limited liability company.)	
1. SECRETARY OF STATE FILE NUMBER	2. NAME OF LIMITED LIABILITY COMPANY	
<b>DOCUMENT TITLE</b> (Enter the title of the document being corrected.)		
3. TITLE OF DOCUMENT BEING CORRECTED		
<b>PARTIES TO THE DOCUMENT</b> (Enter the name of each party to the document being corrected.)		
4. NAME OF EACH PARTY TO THE DOCUMENT BEING CORRECTED		
<b>DOCUMENT FILE DATE</b> (Enter the date the document being corrected was filed with the Secretary of State.)		
5. FILE DATE OF DOCUMENT BEING CORRECTED		
(MONTH) (DAY) (YEAR)		
<b>DOCUMENT PROVISION</b> (Item 6: Enter the provision in the document as previously filed and, if the execution of the document was defective, indicate the manner in which it was defective. Item 7: Enter the provision in the document as corrected. Attach additional pages if necessary. Additional information set forth on attached pages, if any, is incorporated herein by this reference and made a part of this certificate.)		
6. PROVISION IN DOCUMENT AS PREVIOUSLY FILED		
7. PROVISION IN DOCUMENT AS CORRECTED		
<b>EXECUTION</b> (Form LLC-11 must be executed in the same manner in which the document being corrected was required to be executed.)		
8. I CERTIFY UNDER PENALTY OF PERJURY UNDER THE LAWS OF THE STATE OF CALIFORNIA THAT THE FOREGOING IS TRUE AND CORRECT OF MY OWN KNOWLEDGE. I DECLARE I AM THE PERSON WHO EXECUTED THIS INSTRUMENT, WHICH EXECUTION IS MY ACT AND DEED.		
SIGNATURE OF AUTHORIZED PERSON	DATE	TYPE OR PRINT NAME AND TITLE OF AUTHORIZED PERSON
SIGNATURE OF AUTHORIZED PERSON	DATE	TYPE OR PRINT NAME AND TITLE OF AUTHORIZED PERSON
<b>RETURN TO</b> (Enter the name and the address of the person or firm to whom a copy of the filed document should be returned.)		
9. NAME [ ]		
FIRM (if any)		
ADDRESS		
CITY/STATE/ZIP [ ]		
LLC-11 (REV 10/2006)		APPROVED BY SECRETARY OF STATE

## INSTRUCTIONS FOR COMPLETING THE CERTIFICATE OF CORRECTION (FORM LLC-11)

For easier completion, this form is available on the Secretary of State's website at <http://www.ss.ca.gov/business> and can be viewed, filled in and printed from your computer. The completed form can be mailed to Secretary of State, Document Filing Support Unit, P.O. Box 944228, Sacramento, CA 94244-2280 or delivered in person to the Sacramento office, 1500 11<sup>th</sup> Street, 3<sup>rd</sup> Floor, Sacramento, CA 95814. If you are not completing this form online, please type or legibly print in black or blue ink. This form should not be altered. This form is only filed in the Sacramento office.

Statutory filing provisions are found in California Corporations Code section 17055. All statutory references are to the California Corporations Code, unless otherwise stated.

If any document filed with the Secretary of State under the Beverly-Killea Limited Liability Company Act contains any typographical error, error of transcription, other technical error, or has been defectively executed, the document may be corrected by filing Form LLC-11. Form LLC-11 may not be used to:

- make any other change or amendment that would not have complied in all respects with the requirements of the Beverly-Killea Limited Liability Company Act at the time of the document being corrected was filed; or
- change the effective date of the document being corrected; or
- affect any right or liability accrued or incurred before its filing, except that any right or liability accrued or incurred by reason of the error or defect being corrected shall be extinguished by the filing if the person having the right or to whom the liability is owed has not detrimentally relied on the original document.

**FEES:** The fee for filing Form LLC-11 is \$30.00. However, there is a \$15.00 special handling fee for processing a document delivered in person to the Sacramento office. The special handling fee must be remitted by separate check for each submittal and will be retained whether the document is filed or rejected. The preclearance and/or expedited filing of a document within a guaranteed time frame can be requested for an additional fee (in lieu of the special handling fee). Please refer to the Secretary of State's website at <http://www.ss.ca.gov/business/precexp.htm> for detailed information regarding preclearance and expedited filing services. The special handling fee or preclearance and expedited filing services are not applicable to documents submitted by mail. Check(s) should be made payable to the Secretary of State.

**COPIES:** The Secretary of State will certify two copies of the filed document(s) without charge, provided that the copies are submitted to the Secretary of State with the document(s) to be filed. Any additional copies submitted will be certified upon request and payment of the \$8.00 per copy certification fee.

### Complete Form LLC-11 as follows:

- Item 1.** Enter the file number issued to the limited liability company by the California Secretary of State.
- Item 2.** Enter the name of the limited liability company exactly as it is of record with the California Secretary of State, including the entity ending.
- Item 3.** Enter the title of the document being corrected.
- Item 4.** Enter the name of each party that signed the document being corrected. Note: If the document was signed by a person on behalf of the party to the document (e.g., attorney-in-fact), enter the name of that person and the capacity under which they signed the document (e.g., "(name of attorney-in fact), attorney-in-fact for (name of party to the document)").
- Item 5.** Enter the date (month/day/year) the document being corrected was filed with the California Secretary of State.
- Item 6.** Enter the provision in the document as previously filed. If the execution of the document was defective indicate the manner in which it was defective. Attach additional pages if necessary.
- Item 7.** Enter the provision in the document as corrected. Attach additional pages if necessary.
- Item 8.** Form LLC-11 must be executed in the same manner in which the document being corrected was required to be executed. If additional signature space is necessary, the signatures may be made on an attachment to the certificate.
- If Form LLC-11 is signed by an attorney-in-fact, the signature should be followed by the words "Attorney-in-fact for (name of person)."
  - If Form LLC-11 is signed by an entity, the person who signs on behalf of the entity should note their name and position/title, the exact entity name and the entity's relation to the limited liability company. Example: If a limited liability company ("Smith LLC") is the manager of the limited liability company named in Item 2, the signature of the person signing on behalf of Smith LLC should be reflected as Joe Smith, Manager of Smith LLC, Manager.
  - If Form LLC-11 is signed by a trust, the trustee should sign as follows: \_\_\_\_\_, trustee for \_\_\_\_\_ trust (including the date of the trust, if applicable). Example: Mary Todd, trustee of the Lincoln Family Trust (U/T/A 5-1-94).
- Item 9.** Enter the name and the address of the person or firm to whom a copy of the filed document should be returned.

*Comment:* This form is available at the Secretary of State's website, <http://www.sos.ca.gov/business/llc/forms/llc-11.pdf>. For information on the Secretary of State's preclearance and expedited filing services, see Comment to the form in §11.39.

§11.46 H. Form: Statement of Information—Limited Liability Company (Secretary of State Form LLC-12)

 Print



**State of California  
Secretary of State**

**L**

**STATEMENT OF INFORMATION  
(Limited Liability Company)**

**Filing Fee \$20.00. If amendment, see instructions.**

**IMPORTANT — READ INSTRUCTIONS BEFORE COMPLETING THIS FORM**

1. **LIMITED LIABILITY COMPANY NAME** (Please do not alter if name is preprinted.)

This Space For Filing Use Only

**DUE DATE:**

**FILE NUMBER AND STATE OR PLACE OF ORGANIZATION**

2. SECRETARY OF STATE FILE NUMBER

3. STATE OR PLACE OF ORGANIZATION

**COMPLETE ADDRESSES FOR THE FOLLOWING** (Do not abbreviate the name of the city. Items 4 and 5 cannot be P.O. Boxes.)

4. STREET ADDRESS OF PRINCIPAL EXECUTIVE OFFICE CITY AND STATE ZIP CODE

5. CALIFORNIA OFFICE WHERE RECORDS ARE MAINTAINED (DOMESTIC ONLY) CITY STATE ZIP CODE

**CA**

**NAME AND COMPLETE ADDRESS OF THE CHIEF EXECUTIVE OFFICER, IF ANY**

6. NAME ADDRESS CITY AND STATE ZIP CODE

**NAME AND COMPLETE ADDRESS OF ANY MANAGER OR MANAGERS, OR IF NONE HAVE BEEN APPOINTED OR ELECTED, PROVIDE THE NAME AND ADDRESS OF EACH MEMBER** (Attach additional pages, if necessary.)

7. NAME ADDRESS CITY AND STATE ZIP CODE

8. NAME ADDRESS CITY AND STATE ZIP CODE

9. NAME ADDRESS CITY AND STATE ZIP CODE

**AGENT FOR SERVICE OF PROCESS** (If the agent is an individual, the agent must reside in California and Item 11 must be completed with a California address. If the agent is a corporation, the agent must have on file with the California Secretary of State a certificate pursuant to Corporations Code section 1505 and Item 11 must be left blank.)

10. NAME OF AGENT FOR SERVICE OF PROCESS

11. ADDRESS OF AGENT FOR SERVICE OF PROCESS IN CALIFORNIA, IF AN INDIVIDUAL CITY STATE ZIP CODE

**CA**

**TYPE OF BUSINESS**

12. DESCRIBE THE TYPE OF BUSINESS OF THE LIMITED LIABILITY COMPANY

13. THE INFORMATION CONTAINED HEREIN IS TRUE AND CORRECT.

\_\_\_\_\_  
TYPE OR PRINT NAME OF PERSON COMPLETING THE FORM

\_\_\_\_\_  
SIGNATURE

\_\_\_\_\_  
TITLE

\_\_\_\_\_  
DATE

**INSTRUCTIONS FOR COMPLETING FORM LLC-12**

For easier completion, this form is available on the Secretary of State's website at <http://www.sos.ca.gov/business/> and can be viewed, filled in and printed from your computer. Completed forms along with the applicable fees can be mailed to Secretary of State, Statement of Information Unit, P.O. Box 944230, Sacramento, CA 94244-2300 or delivered in person to the Sacramento office, 1500 11<sup>th</sup> Street, 3<sup>rd</sup> Floor, Sacramento, CA 95814. If you are not completing this form online, please type or legibly print in black or blue ink. This form should not be altered.

Every domestic and registered foreign limited liability company shall file a Statement of Information with the Secretary of State, within 90 days after filing of its original Articles of Organization or Application for Registration, and biennially thereafter during the applicable filing period. The applicable filing period for a limited liability company is the calendar month during which its original Articles of Organization or Application for Registration were filed and the immediately preceding five calendar months. A limited liability company is required to file this statement even though it may not be actively engaged in business at the time this statement is due. Changes to information contained in a previously filed statement can be made by filing a new form, completed in its entirety.

Statutory filing provisions are found in California Corporations Code section 17060, unless otherwise indicated. Failure to file this Statement of Information by the due date will result in the assessment of a \$250.00 penalty. (Corporations Code sections 17651(b) and 17653; Revenue and Taxation Code section 19141)

**FILING FEES:** The fee for filing the initial or biennial Statement of Information is **\$20.00**. Checks should be made payable to the Secretary of State. If this statement is being filed to amend any information on a previously filed statement and is being filed outside the applicable filing period, as defined above, **no fee** is required.

**COPIES:** The Secretary of State will endorse file one copy of the statement if an exact copy is submitted along with the statement to be filed. Copies submitted with the statement to be filed can be certified upon request and payment of the \$8.00 per copy certification fee.

**Complete the Statement of Information (Form LLC-12) as follows:**

- Item 1.** Please do not alter the preprinted name. If the name is not correct, please attach a statement indicating the correct name and the date the name change amendment was filed with the Secretary of State. If blank, enter the name of the limited liability company **exactly** as it is of record with the California Secretary of State.
- Item 2.** Please do not alter the preprinted file number. If blank, enter the file number issued by the California Secretary of State.
- Item 3.** Please do not alter the preprinted jurisdiction. If blank, and the limited liability company is a registered foreign limited liability company (organized outside the state of California), enter the state or place under the laws of which the limited liability company is organized.
- Item 4.** Enter the complete street address, city and zip code of the limited liability company's principal executive office. Please do not enter a P.O. Box or abbreviate the name of the city. This address will be used for mailing purposes.
- Item 5.** If the limited liability company is formed under the laws of the state of California, enter the complete street address, city and zip code of the office required to be maintained pursuant to Corporations Code section 17057(a). Please do not enter a P.O. Box or abbreviate the name of the city.
- Item 6.** Enter the name and complete business or residential address of the chief executive officer, if any. Please do not abbreviate the name of the city.
- Items 7-9.** Enter the name and complete business or residential address of any manager or managers, appointed or elected in accordance with the Articles of Organization or Operating Agreement, or if no manager has been so elected or appointed, the name and business or residential address of each member. Attach additional pages, if necessary. Please do not abbreviate the name of the city.
- Item 10.** Enter the name of the agent for service of process in California. An agent is an individual (manager, member or any other person, whether or not affiliated with the company) who resides in California or a corporation designated to accept service of process if the company is sued. The agent **must** agree to accept service of process on behalf of the company prior to designation.  

If a corporation is designated as agent, that corporation must have previously filed with the Secretary of State, a certificate pursuant to Corporations Code section 1505. **Note, a limited liability company cannot act as its own agent** and no domestic or foreign corporation may file pursuant to section 1505 unless the corporation is currently authorized to engage in business in California and is in good standing on the records of the Secretary of State.

If an individual is designated as agent, complete Items 10 and 11. If a corporation is designated as agent, complete Item 10 and proceed to Item 12 (do not complete Item 11).
- Item 11.** If an individual is designated as agent for service of process, enter a business or residential address in California. Please do not enter "in care of" (c/o) or abbreviate the name of the city. Please do not enter an address if a corporation is designated as agent.
- Item 12.** Briefly describe the general type of business that constitutes the principal business activity of the limited liability company.
- Item 13.** Type or print the name and title of the person completing this form and enter the date this form was completed.

*Comment:* This form is available at the Secretary of State's website, <http://www.sos.ca.gov/business/llc/forms/llc-12.pdf>. For information on the Secretary of State's preclearance and expedited filing services, see Comment to the form in §11.39.



§11.47 I. Form: Statement of Information—Limited Liability Company (Renewal) (Secretary of State Form LLC-12R)

 Print



**State of California  
Secretary of State**

**L**

**STATEMENT OF INFORMATION  
(Limited Liability Company)**

Filing Fee \$20.00. If amendment, see instructions.

**IMPORTANT — READ INSTRUCTIONS BEFORE COMPLETING THIS FORM**

1. LIMITED LIABILITY COMPANY NAME (Please do not alter if name is preprinted.)

This Space For Filing Use Only

**DUE DATE:**

**FILE NUMBER AND STATE OR PLACE OF ORGANIZATION**

2. SECRETARY OF STATE FILE NUMBER

3. STATE OR PLACE OF ORGANIZATION

**NO CHANGE STATEMENT**

If there has been no change in any of the information contained in the last Statement of Information filed with the Secretary of State, check the box and proceed to Item 13.  
If there have been any changes to the information contained in the last Statement of Information filed, or no Statement of Information has been previously filed, this form must be completed in its entirety.

**COMPLETE ADDRESSES FOR THE FOLLOWING** (Do not abbreviate the name of the city. Items 4 and 5 cannot be P.O. Boxes.)

4. STREET ADDRESS OF PRINCIPAL EXECUTIVE OFFICE CITY AND STATE ZIP CODE

5. CALIFORNIA OFFICE WHERE RECORDS ARE MAINTAINED (DOMESTIC ONLY) CITY STATE ZIP CODE  
**CA**

**NAME AND COMPLETE ADDRESS OF THE CHIEF EXECUTIVE OFFICER, IF ANY**

6. NAME ADDRESS CITY AND STATE ZIP CODE

**NAME AND COMPLETE ADDRESS OF ANY MANAGER OR MANAGERS, OR IF NONE HAVE BEEN APPOINTED OR ELECTED, PROVIDE THE NAME AND ADDRESS OF EACH MEMBER** (Attach additional pages, if necessary.)

7. NAME ADDRESS CITY AND STATE ZIP CODE

8. NAME ADDRESS CITY AND STATE ZIP CODE

9. NAME ADDRESS CITY AND STATE ZIP CODE

**AGENT FOR SERVICE OF PROCESS** (If the agent is an individual, the agent must reside in California and Item 11 must be completed with a California address. If the agent is a corporation, the agent must have on file with the California Secretary of State a certificate pursuant to Corporations Code section 1505 and Item 11 must be left blank.)

10. NAME OF AGENT FOR SERVICE OF PROCESS

11. ADDRESS OF AGENT FOR SERVICE OF PROCESS IN CALIFORNIA, IF AN INDIVIDUAL CITY STATE ZIP CODE  
**CA**

**TYPE OF BUSINESS**

12. DESCRIBE THE TYPE OF BUSINESS OF THE LIMITED LIABILITY COMPANY

13. THE INFORMATION CONTAINED HEREIN IS TRUE AND CORRECT.

TYPE OR PRINT NAME OF PERSON COMPLETING THE FORM

SIGNATURE

TITLE

DATE

**INSTRUCTIONS FOR COMPLETING FORM LLC-12R**

For easier completion, this form is available on the Secretary of State's website at <http://www.sos.ca.gov/business/> and can be viewed, filled in and printed from your computer. Completed forms along with the applicable fees can be mailed to Secretary of State, Statement of Information Unit, P.O. Box 944230, Sacramento, CA 94244-2300 or delivered in person to the Sacramento office, 1500 11<sup>th</sup> Street, 3<sup>rd</sup> Floor, Sacramento, CA 95814. If you are not completing this form online, please type or legibly print in black or blue ink. This form should not be altered.

Every domestic and registered foreign limited liability company shall file a Statement of Information with the Secretary of State, within 90 days after filing of its original Articles of Organization or Application for Registration, and biennially thereafter during the applicable filing period. The applicable filing period for a limited liability company is the calendar month during which its original Articles of Organization or Application for Registration were filed and the immediately preceding five calendar months. A limited liability company is required to file this statement even though it may not be actively engaged in business at the time this statement is due. Changes to information contained in a previously filed statement can be made by filing a new form, completed in its entirety.

Statutory filing provisions are found in California Corporations Code section 17060, unless otherwise indicated. Failure to file this Statement of Information by the due date will result in the assessment of a \$250.00 penalty. (Corporations Code sections 17651(b) and 17653; Revenue and Taxation Code section 19141)

**FILING FEES:** The fee for filing the initial or biennial Statement of Information is **\$20.00**. Checks should be made payable to the Secretary of State. If this statement is being filed to amend any information on a previously filed statement and is being filed outside the applicable filing period, as defined above, **no fee** is required.

**COPIES:** The Secretary of State will endorse file one copy of the statement if an exact copy is submitted along with the statement to be filed. Copies submitted with the statement to be filed can be certified upon request and payment of the \$8.00 per copy certification fee.

**Complete the Statement of Information (Form LLC-12R) as follows:**

- Item 1.** Please do not alter the preprinted name. If the name is not correct, please attach a statement indicating the correct name and the date the name change amendment was filed with the Secretary of State. If blank, enter the name of the limited liability company **exactly** as it is of record with the California Secretary of State.
- Item 2.** Please do not alter the preprinted file number. If blank, enter the file number issued by the California Secretary of State.
- Item 3.** Please do not alter the preprinted jurisdiction. If blank, and the limited liability company is a registered foreign limited liability company (organized outside the state of California), enter the state or place under the laws of which the limited liability company is organized.
- No Change** If there has been any change to the last Statement of Information filed with the Secretary of State, including a change to any address, or no Statement of Information has ever been filed, complete this form in its entirety.  
If there has been no change in the information contained in the last Statement of Information filed with the Secretary of State, check the box and proceed to Item 13.
- Item 4.** Enter the complete street address, city and zip code of the limited liability company's principal executive office. Please do not enter a P.O. Box or abbreviate the name of the city. This address will be used for mailing purposes.
- Item 5.** If the limited liability company is formed under the laws of the state of California, enter the complete street address, city and zip code of the office required to be maintained pursuant to Corporations Code section 17057(a). Please do not enter a P.O. Box or abbreviate the name of the city.
- Item 6.** Enter the name and complete business or residential address of the chief executive officer, if any. Please do not abbreviate the name of the city.
- Items 7-9.** Enter the name and complete business or residential address of any manager or managers, appointed or elected in accordance with the Articles of Organization or Operating Agreement, or if no manager has been so elected or appointed, the name and business or residential address of each member. Attach additional pages, if necessary. Please do not abbreviate the name of the city.
- Item 10.** Enter the name of the agent for service of process in California. An agent is an individual (manager, member or any other person, whether or not affiliated with the company) who resides in California or a corporation designated to accept service of process if the company is sued. The agent **must** agree to accept service of process on behalf of the company prior to designation.  
If a corporation is designated as agent, that corporation must have previously filed with the Secretary of State, a certificate pursuant to Corporations Code section 1505. Note, a **limited liability company cannot act as its own agent** and no domestic or foreign corporation may file pursuant to section 1505 unless the corporation is currently authorized to engage in business in California and is in good standing on the records of the Secretary of State.  
If an individual is designated as agent, complete Items 10 and 11. If a corporation is designated as agent, complete Item 10 and proceed to Item 12 (do not complete Item 11).
- Item 11.** If an individual is designated as agent for service of process, enter a business or residential address in California. Please do not enter "in care of" (c/o) or abbreviate the name of the city. Please do not enter an address if a corporation is designated as agent.
- Item 12.** Briefly describe the general type of business that constitutes the principal business activity of the limited liability company.
- Item 13.** Type or print the name and title of the person completing this form and enter the date this form was completed.

*Comment:* This form is available at the Secretary of State's website, <http://www.sos.ca.gov/business/llc/forms/llc-12r.pdf>. For information on the Secretary of State's preclearance and expedited filing services, see Comment to the form in §11.39.



## VII. LONG-FORM LIMITED LIABILITY COMPANY OPERATING AGREEMENT

### §11.48 A. Form: Heading and Recitals

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §11.48 and ends in §11.233

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11.48-1 Heading and recitals

### OPERATING AGREEMENT

FOR

\_\_ [NAME] \_\_, LLC,

### A CALIFORNIA LIMITED LIABILITY COMPANY

This Operating Agreement is made as of \_\_ [date] \_\_, by and among the parties listed on the signature page (the "Initial Members"), with reference to the following facts:

**A. The Initial Members** \_\_ [formed/intend to form] \_\_ \_\_ [name] \_\_, LLC, a California limited liability company (the "Company"), by filing its Articles of Organization with the California Secretary of State on \_\_ [date] \_\_.

**B. The respective** \_\_ [percentage interests/number of Units] \_\_ and initial capital account balances of the Initial Members of the Company are set forth in Exhibit A, attached to this Agreement and incorporated by this reference.

**C. The Initial Members desire to adopt and approve an operating agreement for the Company.**

**NOW, THEREFORE, the parties by this Agreement set forth the operating agreement for the Company under the laws of the State of California on the terms and subject to the conditions of this Agreement.**

*Comment:* The operating agreement may be entered into before or after the articles of organization are filed with the Secretary of State. Corp C §17050(a).

The name of an LLC must contain the words "limited liability company" or the abbreviation "LLC" or "L.L.C." as the last words of the name. The words "limited" and "company" may be abbreviated as "ltd." and "co.," respectively. Corp C §17052(a). See §§3.29, 11.28.

A California LLC must have one or more members. Corporations Code §17050(b). Corp C §17001(t) defines a limited liability company as an entity having one or more members that is organized under the LLC Act and is subject to the provisions of Corp C §17101. A member is a "person" who has been admitted to the LLC in accordance with its articles of organization or operating agreement. Corp C §17001(x)(1). A "person" is an individual, partnership, limited partnership, trust, estate, association, corporation, limited liability company, or other entity, whether domestic or foreign. Corp C §17001(ae).

If there are too many members to list conveniently in the opening sentence of the agreement, the names can be listed in an exhibit that can be referred to in that sentence.

In general, this agreement is intended for LLCs with one manager, although certain provisions are included for LLCs with multiple managers and for member-managed LLCs. The drafter should modify the agreement as appropriate. This agreement is also intended for LLCs with more than one member. For a sample form of operating agreement more suitable for a single-member LLC, see Forming and Operating California Limited Liability Companies, chap 10 (2d ed Cal CEB 2007).

**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.49 B. Form: Definitions

## §11.49 B. Form: Definitions

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §11.48 and ends in §11.233

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11.49-1 Definitions

### ARTICLE I DEFINITIONS

**When used in this Agreement, the following terms shall have the meanings set forth below:**

*Comment:* Defined terms allow the use of short-form references for names, terms, and concepts in an agreement. They can save space, improve readability, and ensure consistency in the agreement. Grouping definitions at the beginning of an agreement is generally appropriate for terms that recur throughout the agreement. Definitions peculiar to a single article of an agreement may be defined in context in that article or grouped together in an introductory section of that article. See *Drafting Business Contracts: Principles, Techniques & Forms* §§5.23-5.35 (Cal CEB 1994).

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**§11.50 1. Form: The Act**

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11.50-1 The Act

**A. *The Act*. The Beverly-Killea Limited Liability Company Act, codified in Corporations Code §§17000-17656, as amended from time to time, and any succeeding law.**

*Comment:* The name of the Beverly-Killea Limited Liability Company Act is set forth in Corp C §17000.

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**§11.51 2. Form: Affiliate**

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11.51-1 Affiliate

**B. Affiliate.** An Affiliate of a Member or a Manager is any Person, directly or indirectly through one or more intermediaries, controlling, controlled by, or under common control with such Member or Manager. The term "control," as used in the immediately preceding sentence, shall mean with respect to a corporation or limited liability company the right to exercise, directly or indirectly, more than fifty percent (50%) of the voting rights attributable to the controlled corporation or limited liability company, and, with respect to any individual, partnership, trust, or other entity or association, the possession, directly or indirectly, of the power to direct or cause the direction of the management or policies of the controlled entity.

*Comment:* See Corp C §§150, 160.

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.52 3. Form: Agreement

**§11.52 3. Form: Agreement**

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11.52-1 Agreement

**C. Agreement.** This Operating Agreement, as originally executed and as amended from time to time.

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**§11.53 4. Form: Articles**

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11.53-1 Articles

**D. Articles. The Articles of Organization for the Company, as originally filed with the California Secretary of State and as amended from time to time.**

*Comment:* This definition is adapted from Corp C §17001(b).

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.54 5. Form: Assignee

## §11.54 5. Form: Assignee

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11.54-1 Assignee

**E. Assignee. A Person who has acquired an Economic Interest and who has not been admitted as a substitute Member in accordance with Section \_\_ [specify section of agreement; see §11.148] \_\_.**

*Comment:* The Beverly-Killea Limited Liability Company Act distinguishes between an "economic interest" (Corp C §17001(n)) and a "membership interest" Corp C §17001(z), which includes an economic interest as well as voting and other member rights. This definition, together with the definition of "transfer" (see §11.89), facilitates implementation of the transfer restrictions provided in §§11.146-11.156.

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.55 6. Form: Capital Account

## §11.55 6. Form: Capital Account

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11.55-1 Capital account

**F. *Capital Account.*** The capital account that the Company establishes and maintains for each Member pursuant to Section \_\_ *[specify section of agreement; see §11.99]* \_\_.

*Comment:* This definition is adapted from Corp C §17001(d). For the provisions regarding adjustments and special allocations, see §§11.129-11.135.

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.56 7. Form: Capital Contribution

## §11.56 7. Form: Capital Contribution

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11.56-1 Capital contribution

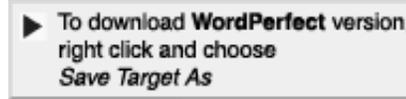
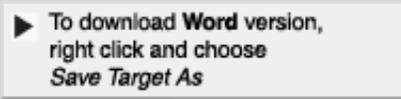
**G. *Capital Contribution.* The total amount of cash and the fair market value of property contributed to the Company by each Member.**

*Comment:* This definition is adapted from Corp C §17001(g) and follows Treas Reg §1.704-1(b)(2)(iv)(d). This provision may be modified if a member's capital contribution will be in the form of services rendered or to be rendered, which are permitted under the Beverly-Killea Limited Liability Company Act. See Corp C §§17001(g), 17200(a).

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**§11.57 8. Form: Capital Contribution Account**

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11.57-1 Capital contribution account

**H. Capital Contribution Account.** The tracking account that the Company establishes for each Member for distribution priority purposes only, which shall be credited with each Member's Capital Contributions and shall be debited with all distributions received by each Member pursuant to Section \_\_ [specify section of agreement; see §11.140]\_ \_.

*Comment:* A capital contribution account is a device that may be used when the members desire that distributions will initially be for the return of contributed capital, and when all contributed capital has been returned, then distributions will be allocated in a different manner, generally by percentage interests. This type of arrangement is common when some members contribute most of the capital and other members have the skill and business acumen but not the capital. The latter group participate in the earnings of the LLC only after the former group have received the return of their investment. Distributions that are debited to a capital contribution account should only be those that represent a return of a capital contribution, and not distributions for income taxes or a preferred return.

**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.58 9. Form: Common Equity Units

## §11.58 9. Form: Common Equity Units

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11.58-1 Common equity units

**I. Common Equity Units.** The meaning as set forth in Section \_\_ *[specify section of agreement; see §11.102]* \_\_.

*Comment:* This definition is used when membership interests are denominated in units rather than percentage interests, and the LLC will have two or more classes of units: common equity units and preferred equity units.

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.59 10. Form: Company

**§11.59 10. Form: Company**

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11.59-1 Company

**J. Company.** \_ \_[Name]\_ \_ , LLC, a California limited liability company.

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.60 11. Form: Company Accountants

## §11.60 11. Form: Company Accountants

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11.60-1 Company accountants

**K. *Company Accountants.*** The accountant or accountants most recently employed by the Company to prepare and advise the Company with respect to its financial statements and tax returns. If the accountant or accountants currently employed are unable or unwilling to act as required under this Agreement, then the \_\_[*Manager/Members*]\_\_ shall select a certified public accountant or firm of certified public accountants to act as the Company Accountants for the purposes of this Agreement.

*Comment:* The company accountants are used to make certain determinations with respect to the exercise of first refusal rights. See §11.153.

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.61 12. Form: Company Counsel

## §11.61 12. Form: Company Counsel

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11.61-1 Company counsel

**L. Company Counsel.** \_ \_[Name of law firm]\_ \_.

*Comment:* Company counsel is referred to in the section that specifies the client the attorney is representing. See §11.227.

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.62 13. Form: Company Minimum Gain

### §11.62 13. Form: Company Minimum Gain

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11.62-1 Company minimum gain

**M. *Company Minimum Gain.*** The same meaning as ascribed to the term "Partnership Minimum Gain" in Treasury Regulations §1.704-2(d)(1).

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.63 14. Form: Confidential Information

## §11.63 14. Form: Confidential Information

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11.63-1 Confidential information

**N. Confidential Information.** All business plans, financial information, results of operations, customer lists, marketing strategies, price lists, computer software, technical information, personnel information, customer information, trade secrets, and other confidential and proprietary information of the Company, whether in written, oral, or electronic form. Confidential Information includes all confidential information of the Company's customers and other third parties that the Company is obligated to keep confidential. Confidential Information shall not include information that is or becomes generally available to the public other than as a result of a disclosure by (1) a Member in violation of this Agreement, or (2) a non-Member who has a confidentiality obligation to the Company.

*Comment:* This definition is used in connection with the confidentiality provision in §11.114. The drafter may add additional items as needed.

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.64 15. Form: Corporations Code

**§11.64 15. Form: Corporations Code**

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11.64-1 Corporations Code

**O. Corporations Code.** The California Corporations Code, as amended from time to time, and any succeeding law.

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.65 16. Form: Distributable Cash

## §11.65 16. Form: Distributable Cash

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11.65-1 Distributable cash

**P. *Distributable Cash.*** The amount of cash that the Manager in good faith deems available for distribution to the Members, taking into account all debts, liabilities, and obligations of the Company then due, working capital requirements and other amounts that the Manager deems reasonably necessary for the Company's business or to place into reserves for customary and usual claims with respect to such business, the taxable income of the Company, and the income tax that the Members will have to pay on allocations of Net Profits.

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.66 17. Form: Economic Interest

## §11.66 17. Form: Economic Interest

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11.66-1 Economic interest

**Q. *Economic Interest.*** The right to share in the income, gains, losses, deductions, credits, and similar items of, and to receive distributions from the Company under this Agreement and the Act, but shall not include any other rights of a Member, including but not limited to the right to vote or participate in the management of the Company, or except as provided in Corporations Code §17106, any right to information concerning the business and affairs of the Company.

*Comment:* See Corp C §17001(n).

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.67 18. Form: Fiscal Year

**§11.67 18. Form: Fiscal Year**

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11.67-1 Fiscal year

**R. *Fiscal Year.* The Company's fiscal year, which shall be the calendar year.**

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.68 19. Form: Initial Member Loans

## §11.68 19. Form: Initial Member Loans

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11.68-1 Initial member loans

**S. Initial Member Loans.** The loans made to the Company by the Initial Member pursuant to Section \_\_[specify section of agreement; see §11.115]\_\_.

*Comment:* This definition is optional and should be used if the initial members are making loans to the LLC.

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.69 20. Form: Initial Members

**§11.69 20. Form: Initial Members**

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11.69-1 Initial members

**T. Initial Members.** \_ \_ [ *List names* ] \_ \_ / *Those Members listed on the signature page* \_ \_ .

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.70 21. Form: Interest

## §11.70 21. Form: Interest

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11.70-1 Interest

**U. *Interest*. A Membership Interest with respect to a Member or an Economic Interest with respect to an Assignee.**

*Comment:* This definition is generally not used when membership interests are denominated in units.

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.71 22. Form: Internal Revenue Code

## §11.71 22. Form: Internal Revenue Code

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11.71-1 Internal Revenue Code

**V. *Internal Revenue Code*.** The Internal Revenue Code of 1986, as amended from time to time, any succeeding law, and to the extent applicable, the Treasury Regulations.

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.72 23. Form: Majority Interest

## §11.72 23. Form: Majority Interest

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11.72-1 Majority interest

**W. Majority Interest.** Those Members who hold a majority of the \_\_ *[Percentage Interests that all Members hold/outstanding Units entitled to vote]* \_\_.

*Comment:* Corporations Code §17001(v) defines the term "majority in interest of the members" as "more than 50 percent of the interests of members in current profits," which definition may be changed in the operating agreement. The term "current profits" is not defined in the Beverly-Killea Limited Liability Company Act.

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.73 24. Form: Manager

**§11.73 24. Form: Manager**

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11.73-1      Manager

**X. *Manager.* \_ \_[Name]\_ \_ , and any Person that succeeds \_ \_[him/her/it]\_ \_ as the Manager of the Company.**

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.74 25. Form: Member

**§11.74 25. Form: Member**

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11.74-1 Member

**Y. Member.** Each Person who is an Initial Member, has been admitted to the Company as a Member in accordance with Section \_\_ *[specify section of agreement; see §11.104]* \_\_, or is an Assignee who has become a Member in accordance with Section \_\_ *[specify section of agreement; see §11.104]* \_\_, and has not ceased to be a Member for any reason.

*Comment:* See Corp C §17001(x).

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.75 26. Form: Member Nonrecourse Debt

## §11.75 26. Form: Member Nonrecourse Debt

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11.75-1 Member nonrecourse debt

**Z. Member Nonrecourse Debt.** The same meaning as ascribed to the term "Partner Nonrecourse Debt" in Treasury Regulations §1.704-2(b)(4).

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.76 27. Form: Member Nonrecourse Deductions

## §11.76 27. Form: Member Nonrecourse Deductions

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11.76-1 Member nonrecourse deductions

**AA. Member Nonrecourse Deductions.** The same meaning as ascribed to the term "Partner Nonrecourse Deductions" in Treasury Regulations §1.704-2(i).

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.77 28. Form: Membership Interest

## §11.77 28. Form: Membership Interest

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11.77-1 Membership interest

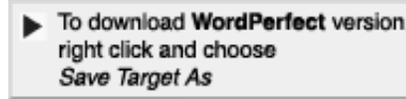
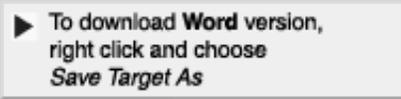
**BB. *Membership Interest.* A Member's entire interest in the Company, including the Member's Economic Interest, the right to vote on or participate in the management, and the right to receive information concerning the business and affairs of the Company. \_ \_ [*Membership Interests shall be divided into Units.*]\_ \_**

*Comment:* See Corp C §17001(z). The second sentence should be added if membership interests are denominated in units.

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**§11.78 29. Form: Net Profits and Net Losses**

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §11.48 and ends in §11.233



11.78-1 Net profits and net losses

**CC. Net Profits and Net Losses.** For each Fiscal Year or other applicable period, an amount equal to the Company's taxable income or loss for such year or period, determined in accordance with Internal Revenue Code §703(a), including all items of income, gain, loss, deduction, or credit required to be stated separately under Internal Revenue Code §703(a)(1), with the following adjustments:

- 1. Any income of the Company that is exempt from federal income tax and not otherwise taken into account in computing Net Profits or Net Losses shall be added to such taxable income or loss;**
- 2. Any expenditure of the Company described in Internal Revenue Code §705(a)(2)(B) or treated as an Internal Revenue Code §705(a)(2)(B) expenditure under Treasury Regulations §1.704-1(b)(2)(iv)(i) and not otherwise taken into account in computing Net Profits or Net Losses shall be subtracted from such taxable income or shall increase such loss; and**
- 3. Notwithstanding the foregoing provisions of this Section, any item of income, gain, loss, or deduction that is specially allocated under Sections \_\_[specify sections of agreement; see §§11.129-11.137]\_\_ shall not be taken into account in computing Net Profits or Net Losses.**

**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.79 30. Form: Nonrecourse Liability

### §11.79 30. Form: Nonrecourse Liability

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11.79-1 Nonrecourse liability

**DD. *Nonrecourse Liability*.** The meaning as set forth in Treasury Regulations §1.752-1(a)(2).

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**§11.80 31. Form: Percentage Interest**

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11.80-1 Percentage interest

*[Add one of the following alternatives]*

*[Alternative 1: Membership interests denominated in percentages]*

**EE. Percentage Interest.** Each Member's Membership Interest, expressed as a percentage, as set forth opposite the name of each Member under the column "Percentage Interest" in Exhibit A, as such percentage may be adjusted from time to time under the terms of this Agreement.

*[Alternative 2: Membership interests denominated in units]*

**EE. Percentage Interest.** At the time of computation, the percentage obtained by dividing the number of Units owned by a Member by the number of Units owned by all Members.

*[Alternative 3: Percentage interests based on capital account balances]*

**EE. Percentage Interest.** Each Member's Membership Interest, expressed as a percentage. At the time of computation, a Member's Percentage Interest shall be the percentage obtained by dividing the Capital Account balance of a Member by the total Capital Account balances of all Members. The Initial Members' respective initial Percentage Interests are set forth opposite the name of each Member under the column "Percentage Interest" in Exhibit A.

**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.81 32. Form: Person

**§11.81 32. Form: Person**

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11.81-1 Person

**FF. Person. Any individual, partnership, limited partnership, trust, estate, association, corporation, limited liability company, or any other entity.**

*Comment:* See Corp C §17001(ae).

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.82 33. Form: Preferred Equity Units

### §11.82 33. Form: Preferred Equity Units

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11.82-1 Preferred equity units

**GG. Preferred Equity Units.** The meaning as set forth in Section \_\_ *[specify section of agreement; see §11.102]*\_\_.

*Comment:* This definition is used when membership interests are denominated in units rather than percentage interests, and the LLC will have two or more classes of units: common equity units and preferred equity units.

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.83 34. Form: Securities Act

**§11.83 34. Form: Securities Act**

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11.83-1 Securities Act

**HH. *Securities Act*. The Securities Act of 1933, as amended from time to time, and any succeeding law.**

*Comment:* This definition, together with the definition of the securities laws (see §11.84), is used in connection with investment representations and warranties. See §§11.186-11.205.

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.84 35. Form: Securities Laws

**§11.84 35. Form: Securities Laws**

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11.84-1 Securities laws

**II. Securities Laws. The Securities Act, the rules and regulations thereunder, and the securities laws and regulations of each applicable state, all as amended from time to time.**

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.85 36. Form: Selling Member

**§11.85 36. Form: Selling Member**

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11.85-1 Selling member

**JJ. Selling Member. A Member who proposes to Transfer** \_\_ *[a Membership Interest/Units]* \_\_.

*Comment:* This definition is used in connection with first negotiation and first refusal rights on transfer. See §§11.152-11.153.

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.86 37. Form: Selling Member's Notice

**§11.86 37. Form: Selling Member's Notice**

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11.86-1 Selling member's notice

**KK. *Selling Member's Notice.* The written notice by a Selling Member concerning a proposed Transfer required by Section \_\_[specify section of agreement; see §11.153]\_\_.**

*Comment:* This definition is used in connection with first refusal rights on transfer. See §11.153.

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.87 38. Form: Super Majority Interest

**§11.87 38. Form: Super Majority Interest**

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11.87-1 Super majority interest

**LL. Super Majority Interest.** Those Members who hold at least \_\_ *[specify percent]* \_\_ percent of the \_\_ *[Percentage Interests that all Members hold/outstanding Units entitled to vote]* \_\_.

*Comment:* This definition is used when the members desire that the agreement of more than just a majority is required to approve certain matters.

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.88 39. Form: Tax Matters Member

**§11.88 39. Form: Tax Matters Member**

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11.88-1 Tax matters member

**MM. *Tax Matters Member*.** The same meaning as ascribed to the term "Tax Matters Partner" in Internal Revenue Code §6231(a)(7). The Tax Matters Member shall be \_\_ *[name]* \_\_, or as otherwise designated under Section \_\_ *[specify section of agreement; see §11.163]* \_\_.

*Comment:* See the Comment in §11.163.

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.89 40. Form: Transfer

**§11.89 40. Form: Transfer**

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11.89-1 Transfer

**NN. *Transfer* (including the past tense "Transferred" and the gerund "Transferring"). Any transfer, assignment, conveyance, sale, encumbrance, or other alienation of \_\_[a Membership Interest/Units]\_\_ or an Economic Interest, or any interest therein.**

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.90 41. Form: Treasury Regulations

## §11.90 41. Form: Treasury Regulations

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11.90-1 Treasury Regulations

**OO. *Treasury Regulations.*** The income tax regulations issued by the United States Department of Treasury pursuant to its authority under the Internal Revenue Code, as amended from time to time, and any succeeding regulations.

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**§11.91 42. Form: Units**

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11.91-1 Units

**PP. Units.** The meaning as set forth in Section \_\_ *[specify section of agreement; see §11.102]* \_\_.

*Comment:* This definition is used when membership interests are denominated in units.

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## **C. Organizational Matters**

### **§11.92 1. Form: Formation**

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11.92-1 Formation

## **ARTICLE II ORGANIZATIONAL MATTERS**

**A. Formation.** The Initial Members \_\_\_[*have formed/intend to form*]\_\_ a California limited liability company under the laws of the State of California by filing the Articles with the California Secretary of State and entering into this Agreement \_\_\_[, *which shall be deemed effective as of the date the Articles are so filed*]\_\_. The rights and liabilities of the Members shall be determined pursuant to the Act and this Agreement. To the extent that the rights or obligations of any Member are different by reason of any provision of this Agreement than they would be in the absence of such provision, this Agreement shall, to the extent permitted by the Act, control.

*Comment:* An LLC is formed when the articles of organization are filed with the Secretary of State and, either before or after the filing of the articles of organization, the members enter into an operating agreement. Corp C §17050(a). A copy of the articles of organization certified by the Secretary of State is conclusive evidence of the formation of an LLC. Corp C §17050(c). In any conflict between the provisions of the articles of organization and the provisions of the operating agreement, the articles of organization will control. Corp C §17005(f).

The provisions of the Beverly-Killea Limited Liability Company Act apply to an LLC and its members and managers unless a written operating agreement provides otherwise. While the Act gives the members significant flexibility to alter many of its provisions, there are certain provisions that may not be altered at all, and there are other provisions that may be varied only to the extent provided in such provisions. Corp C §17005(a)-(d). See §11.32.

If the operating agreement is to be signed before the articles of organization are filed, a good practice is to attach a draft of the articles of organization to the operating agreement. This may help eliminate any dispute over whether the organizer was authorized to execute and file the articles of organization.

§11.93 2. Form: Name

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11.93-1 Name

**B. Name.** The name of the Company shall be "  [Name]  , LLC." The Company may conduct business under that name or any other name approved by the Manager. The Manager shall file any fictitious name certificate or similar filing, and any amendment thereto, that the Manager considers appropriate or advisable.

*Comment:* The name of an LLC must contain the words "limited liability company" or the abbreviation "LLC" or "L.L.C." as the last words of the name. The words "limited" and "company" may be abbreviated as "ltd." and "co.," respectively. Corp C §17052(a). For further discussion on the name of an LLC, see §11.28. For information about fictitious names, see §§3.8-3.12.

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.94 3. Form: Office and Agent

### §11.94 3. Form: Office and Agent

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11.94-1 Office and agent

**C. Office and Agent.** The Company shall continuously maintain an office and a registered agent in the State of California. The principal office of the Company shall be located at \_\_[address]\_\_, or at such other location as the Manager may determine. The Company may also have such offices, anywhere within and without the State of California, as the Manager may determine from time to time, or the business of the Company may require. The registered agent shall be as stated in the Articles or as the Manager may otherwise determine.

*Comment:* An LLC must continuously maintain an office in California, where the records specified in Corp C §17058 must be kept, and an LLC must have a registered agent in California. Corp C §17057. The initial registered agent should be the same as stated in the articles of organization. Corp C §17051(a)(4).

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.95 4. Form: Addresses of Members and Manager

**§11.95 4. Form: Addresses of Members and Manager**

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11.95-1 Addresses

**D. *Addresses of Members and Manager.*** The respective addresses of the Members and the Manager are set forth in Exhibit \_\_ *[specify exhibit]* \_\_. A Member or Assignee may change address on notice to the Manager. The Manager may change address on notice to the Members.

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.96 5. Form: Purpose and Business of the Company

## §11.96 5. Form: Purpose and Business of the Company

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11.96-1 Purpose and business of the Company

[Add one of the following alternatives]

[Alternative 1: No limitation on business.]

**E. Purpose and Business of the Company. The purpose of the Company is to engage in any lawful act or activity for which a limited liability company may be organized under the Act.**

[Alternative 2: Limitation on business.]

**E. Purpose and Business of the Company. The purpose of the Company is to engage in any lawful act or activity for which a limited liability company may be organized under the Act. Notwithstanding the foregoing, the primary business of the Company shall be to \_\_[describe business of company]\_\_ and all other reasonably related activities. The Company shall not engage in any other business without the approval of a \_\_[Super]\_\_ Majority Interest.**

*Comment:* The articles of organization must contain the following language: "The purpose of the limited liability company is to engage in any lawful act or activity for which a limited liability company may be organized under the Beverly-Killea Limited Liability Company Act." Corp C §17051(a)(2). The Secretary of State's form of Articles of Organization (Form LLC-1; see form in §11.39) includes this sentence preprinted as the purpose of the LLC. Restrictions on the business of an LLC may be added to the articles by attaching a page containing the restrictions. See Corp C §17051(c)(1). To avoid conflicts, any limitations on the business of the LLC that are contained in the articles of incorporation should be included *verbatim* in the operating agreement. If there are no restrictions on the business or purpose of the LLC, alternative 1 of this form may be used, or this section may be omitted. See §11.29 (last paragraph).

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## **D. Capital Contributions**

### **§11.97 1. Form: Initial Capital Contributions**

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11.97-1 Initial capital contributions

## **ARTICLE III CAPITAL CONTRIBUTIONS**

**A. Initial Capital Contributions.** The Initial Members have contributed, or shall contribute, as their respective initial Capital Contributions the cash and property set forth in Exhibit A. The Members agree that the assets contributed by the Initial Members have a net fair market value in the amounts set forth in Exhibit A. The Initial Members shall receive a credit to their Capital Accounts equal to the respective amounts set forth on Exhibit A.

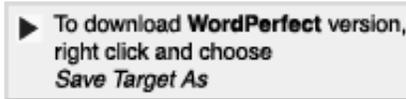
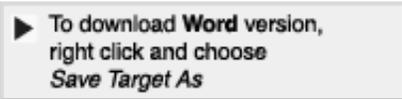
*Comment:* The members' initial capital contribution may be set forth in the body of the operating agreement, but it is generally easier to list the respective initial capital contributions, credits to capital accounts, and percentage interests or number of units issued in a separate exhibit. The exhibit should adequately describe non-cash property.

A capital contribution to an LLC may be in the form of cash, property, or services, or the obligation to contribute cash or property or to render services. Corp C §17200(a). For a further discussion about capital contributions, see §11.14. For information on the tax treatment of capital contributions, see §11.15.

Subject to the terms of the articles of organization or operating agreement, a member is not excused from making an agreed contribution because of death, disability, dissolution, or any other reason. Corp C §17201(a)(1). A member's contribution obligations may be compromised only by the unanimous vote of the members, unless otherwise provided in the operating agreement. Corp C §17201(b)(1). A compromise may not be effective with respect to a creditor who extended credit before the compromise. Corp C §17201(b)(2). If a member who is obligated to contribute property or services defaults in whole or in part, then the LLC may require the member to contribute cash in the amount of the fair market value (or the agreed value if set forth in the written operating agreement signed by the defaulting member) of the property or services not contributed. Corp C §17201(a)(2). The operating agreement may provide for the termination of the membership or economic interest of a member who fails to make a required capital contribution. See Corp C §17100(a)(3).

## §11.98 2. Form: Additional Capital Contributions

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §11.48 and ends in §11.233



11.98-1 Additional capital contributions

[Add one of the following alternatives]

[Alternative 1: No mandatory additional capital contributions]

**B. Additional Capital Contributions. No Member shall be required to make any additional Capital Contribution.**

[If applicable, add the following option to alternative 1]

[Option: Additional capital contributions authorized]

If the Manager \_\_ [and a \_\_ [Super Majority/Majority] \_\_ Interest] \_\_ determine(s) that additional capital is required, the Manager may request that the Members contribute additional capital to the Company \_\_ [and the price per Unit] \_\_. At the request of the Manager, each Member may, but is not obligated to do so, contribute additional capital as each Member may desire. The Company will adjust the Capital Accounts of the Members that contribute additional capital \_\_ [and will adjust the Percentage Interests of the Members based on respective \_\_ [Capital Account balances/Capital Contributions] \_\_ / and will issue additional Units to those Members] \_\_.

[Alternative 2: Mandatory additional capital contributions]

**B. Additional Capital Contributions. If the Manager \_\_ [and a \_\_ [Super Majority/Majority] \_\_ Interest] \_\_ determine(s) that additional capital is required, the Members shall contribute such additional capital in proportion to their respective Percentage Interests. On such a determination, the Manager shall give written notice to the Members, and each Member shall have \_\_ [specify number, e.g., 10] \_\_ days from the date the notice is given to contribute the Member's share of the additional capital to the Company. The Company shall adjust the Capital Accounts of the Members that contribute such additional capital. \_\_ [The maximum amount of additional Capital Contributions that a Member may be required to contribute shall be equal to \_\_ [specify percent] \_\_ of such Member's initial Capital Contribution as set forth in Exhibit A.] \_\_**

*Comment:* Unless the articles of organization or operating agreement provide otherwise, no member may be required to contribute additional capital. Corp C §17200(b). If additional capital contributions are authorized, the failure of a member to make additional capital contributions could constitute a breach and default. For enforcement provisions, see form in §11.101. For discussion of additional capital contributions, see §11.14.

In the first alternative, the optional provisions allow for a form of "preemptive" right if additional capital is required. If members are allowed to make optional additional capital contributions, the practitioner may wish to specify that percentage interests will be recalculated based on respective capital account balances, respective capital contributions, or some other method.

The last sentence in the second alternative provides for a limit on required additional capital contributions, which may be a percentage or a multiple of the initial capital contribution.

Mandatory additional capital contributions may be in proportion to the members' respective capital accounts instead of percentage interests. This may be useful when percentage interests are not proportionate with capital account balances, such as when one member or a group of members contribute most of the operating capital and another member or group of members contribute skills or know-how and are not given a significant credit to their capital accounts.

### §11.99 3. Form: Capital Accounts

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11.99-1 Capital accounts

[Add one of the following alternatives]

[Alternative 1: Short-form provision for capital accounts]

**C. Capital Accounts.** The Company shall establish and maintain an individual Capital Account for each Member in accordance with Treasury Regulation §704-1(b)(2)(iv). If a Member or Assignee Transfers \_\_[an Interest (or portion of an Interest)/any Units]\_\_ in accordance with this Agreement, the transferee of the \_\_[Interest or portion/Units]\_\_ shall succeed to the transferor's Capital Account attributable to the \_\_[Interest or portion/Units]\_\_ being transferred.

[Alternative 2: Long-form provision for capital accounts]

**C. Capital Accounts.** The Company shall establish and maintain an individual Capital Account for each Member in accordance with Treasury Regulation §1.704-1(b)(2)(iv), and adjusted in accordance with the following provisions:

1. A Member's Capital Account shall be increased by that Member's Capital Contributions, that Member's share of Net Profits, and any items in the nature of income or gain that are specially allocated to that Member pursuant to Sections \_\_[specify sections of agreement; see §§11.131-11.137]\_\_;

2. A Member's Capital Account shall be increased by the amount of any Company liabilities assumed by that Member subject to and in accordance with Treasury Regulation §1.704-1(b)(2)(iv)(c);

3. A Member's Capital Account shall be decreased by (a) the amount of cash distributed to that Member, (b) the value of any property distributed to that Member, net of liabilities that the Member is considered to assume or to be subject to, (c) that Member's share of Net Losses, and (d) the amount of any items in the nature of expenses or losses that are specially allocated to that Member under Sections \_\_[specify section of agreement; see §§11.131-11.137]\_\_;

4. A Member's Capital Account shall be reduced by the Member's share of any Company expenditures described in Internal Revenue Code §705(a)(2)(B) or that are treated as §705(a)(2)(B) expenditures under Treasury Regulations §1.704-1(b)(2)(iv)(i) (including syndication expenses and losses nondeductible under Internal Revenue Code §267(a)(1) or §707(b));

5. If a Member or Assignee Transfers \_\_[an Interest (or portion of an Interest)/any Units]\_\_ in accordance with this Agreement, the transferee of the \_\_[Interest or portion/Units]\_\_ shall succeed to the transferor's Capital Account attributable to the \_\_[Interest or portion/Units]\_\_;

6. The principal amount of a promissory note that is not readily traded on an established securities market and that is contributed to the Company by the maker of the note shall not be included in the Capital Account of any Member until the Company makes a taxable disposition of the note or until (and to the extent) principal payments are made on the note, all in accordance with Treasury Regulations §1.704-1(b)(2)(iv)(d)(2); and

7. Each Member's Capital Account shall be increased or decreased as necessary to reflect a revaluation of the Company's property assets in accordance with the requirements of Treasury Regulations §1.704-1(b)(2)(iv)(f)-(g), including the special rules under Treasury Regulations §1.701-1(b)(4), as applicable.

*Comment:* The long form in Alternative 2 mentions certain of the rules for maintaining capital accounts that are required by the Treasury Regulations.

The Beverly-Killea Limited Liability Company Act does not require that members have capital accounts. However, capital accounts must be maintained for federal income tax purposes if the LLC is to be classified as a partnership for taxation purposes. The basic rules for capital account maintenance are set forth in Treas Reg §1.704-1(b)(2)(iv). Internal Revenue Code §752 deals with increases and decreases in a partner's liabilities. Internal Revenue Code §705(a)(2)(B) refers to a partnership's expenditures that are not deductible in computing its taxable income and not properly chargeable to a partner's capital account.

The reference in subsection 7 of the long form to Treas Reg §1.704-1(b)(2)(iv)(f)-(g) is intended to be cautionary. Under that regulation and related regulations, great care must be taken if LLC property is reflected on the books at a value (book value) that is different from the adjusted tax basis of such property. Under such circumstances, capital accounts that are not adjusted as specified will not be considered to be determined and maintained in accordance with Treas Reg §1.704-1(b)(2)(iv) and, therefore, allocations of tax items to a member other than in accordance with the member's interest in the LLC will not have substantial economic effect, resulting in a possible reallocation for tax purposes.

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.100 4. Form: Withdrawal, Interest, Priority

#### §11.100 4. Form: Withdrawal, Interest, Priority

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §11.48 and ends in §11.233

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11.100-1 Withdrawal, interest, priority

**D. *Withdrawal, Interest, Priority.*** Except as otherwise provided in this Agreement, no Member or Assignee shall be entitled to (1) withdraw any part of his, her, or its Capital Account, (2) receive interest on his, her, or its Capital Contributions or Capital Account, or (3) a priority over any other Member or Assignee with respect to the return of a Capital Contribution, distributions, or allocations of income, gains, losses, deductions, credits, or related items.

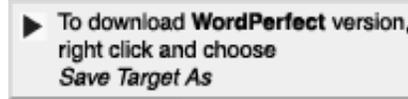
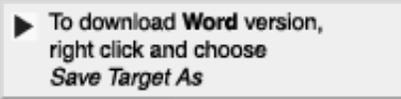
*Comment:* The operating agreement may provide that a member may withdraw from the LLC on the happening of specified events, or that the member shall not have the right to withdraw from the LLC. Corp C §17252(a). Despite any restriction on the right to withdraw, the member may withdraw from the LLC at any time by giving written notice to the other members, but the withdrawn member will have only the rights of a holder of an economic interest under the agreement. Corp C §17252(a). If the parties intend that a withdrawing member may withdraw his, her, or its capital, the agreement should specify this. In the absence of such a provision, the withdrawing member is not entitled to payment for his, her, or its interest. Corp C §17252(a). Any damages suffered by the LLC due to a withdrawal of a member in violation of the operating agreement may be offset against distributions payable with respect to the economic interest held by the withdrawn member. Corp C §17252(a).

Depending on the desires of the members, an operating agreement may provide for interest on capital contributions or the priority of certain members to allocations of profits and losses or distributions. See §§11.130, 11.140.

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## §11.101 5. Form: Failure to Make Capital Contributions

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11.101-1 Failure to make capital contributions

**E. Failure to Make Capital Contributions.** If a Member fails to contribute capital by the date established by the Manager for the contribution, that Member shall be deemed in default under this Agreement. In that event, the Manager shall give the defaulting Member written notice of the default, specifying the amount required to be paid, and allowing the Member fourteen (14) days from the date notice is given within which to pay the required capital contribution. If the defaulting Member fails to make the capital contribution by the end of the fourteen (14)-day period, then the Manager or those non-defaulting Members who hold a majority of the      *[Percentage Interests/Units]*      held by all non-defaulting Members may elect any one or more of the following remedies:

**1. Loan to Non-Defaulting Members.** The non-defaulting Members may advance funds to the Company to cover the amounts that the defaulting Member failed to contribute. Amounts that a non-defaulting Member so advances on behalf of the defaulting Member shall become a loan due and owing from the defaulting Member to the non-defaulting Member and shall bear interest at the rate of ten percent (10%) *per annum*, payable monthly. All cash distributions otherwise distributable to the defaulting Member under this Agreement shall instead be paid to the non-defaulting Members making the advances until the advances and interest on them are paid in full. In any event, any such advances shall be evidenced by a promissory note in a form reasonably acceptable to the Manager, and shall be due and payable by the defaulting Member one (1) year from the date that the advance was made. All amounts repaid shall first be applied to interest and thereafter to principal. Effective on a Member becoming a defaulting Member, each Member grants to the non-defaulting Members who advance funds under this paragraph a security interest in the defaulting Member's      *[Membership Interest/Units]*      to secure the defaulting Member's obligation to repay the advances, and agrees to execute and deliver a promissory note as described in this Agreement together with a security agreement in a form reasonably acceptable to the Manager and such assignment of certificates of      *[Membership Interest/Units]*      as the non-defaulting Members may reasonably request.

**2. Adjust Percentage Interests.** The Percentage Interests of all Members shall be adjusted, in which event each Member's Percentage Interest shall be a fraction, the numerator of which represents the amount of the Member's      *[Capital Account balance/total Capital Contributions]*      and the denominator of which represents the sum of all Members'      *[Capital Account balances/total Capital Contributions]*     .

**3. Dissolution.** The non-defaulting Members who hold a      *[majority/    specify fraction or percent, e.g., two-thirds or 75 percent]*      of the      *[Percentage Interests/Units]*      held by non-defaulting Members may dissolve the Company, in which event the Company shall be wound up, liquidated, and terminated under Sections      *[specify section of agreement; see §§11.164-11.172]*     .

**4. Purchase of      *[Membership Interest/Units]*     .** The Company or the non-defaulting Members may purchase the defaulting Member's      *[Membership Interest/Units]*     . The purchase price for such      *[Membership Interest/Units]*      shall be a sum equal to      *[specify percent, e.g., eighty percent (80%)]*      of the defaulting Member's Capital Account balance.

**5. Loss of Distributions.** The defaulting Member shall have no right to receive any distributions from the Company until the non-defaulting Members have first received distributions in an amount equal to the additional capital contributed by each non-defaulting Member to the Company plus a cumulative, non-compounded return thereon at the rate of ten percent (10%) per annum until such amount has been repaid to the non-defaulting Members in full.

**6. Loss of Vote.** The defaulting Member shall lose his, her, or its voting and approval rights under the Act, the Articles, and this Agreement      *[until such time as he, she, or it has cured the default]*     .

**7. Loss of Management Ability.** The defaulting Member shall lose his, her, or its ability (whether as a Member or a Manager) to participate in the management and operations of the Company \_\_ *[until such time as he, she, or it has cured the default]*\_\_.

Each Member acknowledges and agrees that (a) a default by any Member in making a required Capital Contribution will result in the Company and the non-defaulting Members incurring certain costs and other damages in an amount that would be extremely difficult or impractical to ascertain, and (b) the remedies described in this Section bear a reasonable relationship to the damages that the Members estimate may be suffered by the Company and the non-defaulting Members by reason of the failure of a defaulting Member to make any required Capital Contribution and the election of any or all of the above described remedies is not unreasonable under the circumstances existing as of the date of this Agreement.

The election of the Manager or non-defaulting Members, as applicable, to pursue one or more of the remedies provided in this Section shall not be a waiver or limitation of the right to pursue any additional or different remedy or remedies available under this Agreement or under law or equity with respect to any subsequent default.

*Comment:* Corp C §17201(a)(3) provides a wide variety of remedies in the event a member fails to make a required capital contribution, subject to that defaulting member's defense that a provision was unreasonable under the circumstances at the time the operating agreement was made.

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## E. Members

### §11.102 1. Form: Units

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11.102-1 Units

## ARTICLE IV MEMBERS

*[Add one of the following alternatives]*

*[Alternative 1: One class of units.]*

**A. Units.** The Membership Interests of the Company shall be divided into Units. Each Unit represents the same proportionate interest in the total Membership Interests of the Company for all purposes under this Agreement. Despite the foregoing, Units that have been converted to an Economic Interest under Section D of this Article IV, or that have been Transferred to a transferee that has not become a substitute Member under Section \_\_ *[specify section of agreement; see §11.148]* \_\_, shall continue to exist solely as an Economic Interest, and shall not have the right to vote or participate in the management of the Company or, except as provided in Corporations Code §17106, any right to information concerning the business and affairs of the Company. The Manager is authorized to issue \_\_ *[specify]* \_\_ Units to the Initial Members as set forth in Exhibit A without the approval of a Majority Interest. The Manager is also authorized to issue up to an additional \_\_ *[specify]* \_\_ Units, not including Units issued to the Initial Members, at such times and for such Capital Contributions as the Manager may determine from time to time without the approval of a Majority Interest. A Majority Interest may increase the number of Units that the Manager is authorized to issue without the approval of a Majority Interest.

*[Alternative 2: Common and preferred units]*

**A. Units.** The Membership Interests of the Company shall be divided into Units. There shall be two types of Units: Common Equity Units and Preferred Equity Units. Each Unit represents the same proportionate interest in the total Membership Interests of the Company of the same type and class of Units for the purposes of voting, allocations of Net Profits and Net Losses, distributions, and all other matters requiring the determination of the Percentage Interest of a Member under this Agreement. The Common Equity Units shall have the general and all residual rights to vote, to receive allocations of Net Profits and Net Losses, and to receive distributions. Preferred Equity Units shall be subdivided into separate classes, as determined by the Manager from time to time. Each class of Preferred Equity Units shall have such rights to vote, to receive allocations of Net Profits and Net Losses, to receive distributions, to be redeemed, and to be converted into Common Equity Units as \_\_ *[set forth in Exhibit B/determined by the Manager from time to time; such determination shall be in the form of a supplement that shall become part of this Agreement, which supplement requires only the approval of the Manager]* \_\_. Notwithstanding the foregoing, Units that have been converted to an Economic Interest under Section D of this Article IV or that have been Transferred to a transferee that has not become a substitute Member under Section \_\_ *[specify section of agreement; see §11.148]* \_\_, shall continue to exist solely as an Economic Interest, and shall not have the right to vote or participate in the management of the Company, or except as provided in Corporations Code §17106, any right to information concerning the business and affairs of the Company. The Manager is authorized to issue \_\_ *[specify]* \_\_ Common Equity Units and \_\_ *[specify]* \_\_ Preferred Equity Units to the Initial Members as set forth in Exhibit A without the approval of a Majority Interest. The Manager is also authorized to issue up to an additional \_\_ *[specify]* \_\_ Common Equity Units and \_\_ *[specify]* \_\_ Preferred Equity Units at such times and for such Capital Contributions as the Manager may determine from time to time without the approval of a Majority Interest. A Majority Interest may increase the number of Common Equity Units and/or Preferred Equity Units that the Manager is authorized to issue without the approval of a Majority Interest.

*Comment:* This provision is used only when membership interests are denominated in units rather than expressed in percentages. The intent is to copy the capital structure of a corporation that has shares of stock. The second alternative expands this concept with common and preferred units.

The articles of organization or an operating agreement may provide for the creation of classes of members who have the relative rights, powers, and duties that the articles of organization or operating agreement may provide, including rights, powers, and duties senior to other classes of members. Corp C §17102. The relative rights, powers, and duties of the members can be listed in the body of the operating agreement, but it may be easier to provide a detailed description in an exhibit. The alternative language gives the manager the power to determine the relative rights, powers, and duties of the members, similar to "blank check" preferred stock for a corporation. Because this determination must be set forth in the operating agreement (Corp C §17102), the manager is in effect amending the operating agreement. While Corp C §17059 vests the ability to amend the operating agreement in the members, it also provides that a written operating agreement may prescribe the manner in which the operating agreement may be altered or amended. If the manager is given the authority to determine the relative rights, powers, and duties of the members, under some circumstances it may be prudent to provide some limits to the manager's authority.

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.103 2. Form: Limited Liability

## §11.103 2. Form: Limited Liability

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11.103-1 Limited liability

**B. Limited Liability.** Except as expressly set forth in this Agreement or required by law, no Member shall be personally liable for any debt, obligation, or liability of the Company, whether that liability or obligation arises in contract, tort, or otherwise.

*Comment:* See Corp C §17101(a). In general, a member is personally liable to the same extent as a shareholder of a corporation. Corp C §17101(b). A member is also liable to restore unlawful distributions. Corp C §17254(e). For a discussion of the liability of members, see §11.22.

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### §11.104 3. Form: Admission of Additional Members

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11.104-1 Admission of Additional Members

**C. Admission of Additional Members.** *\_\_* *[Except as provided in Section A of this Article IV,]* *\_\_* **the Company may admit additional Members from time to time, with the consent of the Manager** *\_\_* *[and* *\_\_* *[a Super Majority Interest/a Majority Interest/all Members]* *\_\_* *\_\_* **. Each additional Member shall make a Capital Contribution in such amount and receive a** *\_\_* *[Percentage Interest/number of Units]* *\_\_* **, on such terms as the Manager** *\_\_* *[and* *\_\_* *[a Super Majority Interest/a Majority Interest/all Members]* *\_\_* *\_\_* **determine(s) to be appropriate based on the needs of the Company, the net value of the Company's assets, the Company's financial condition, and the benefits anticipated to be realized by the additional Member. The additional Member shall agree in writing to be bound by the terms of this Agreement. No additional Member shall be admitted if the effect of such admission would be to terminate the Company within the meaning of Internal Revenue Code §708(b). Despite the foregoing, Assignees may only be admitted as substitute Members in accordance with Section** *\_\_* *[specify section of agreement; see §11.148]* *\_\_* **.**

*Comment:* Corporations Code §17100(a)(1) provides that the approval of a majority in interest of the members is required to admit a new member, but that the articles of organization or the operating agreement may provide otherwise. The alternative language in this section provides sample provisions for both a more lenient admission procedure (approval of just the manager) and a more restrictive procedure (approval of a super majority or all of the members). The alternative phrase at the beginning of this section should be used when the operating agreement approves the issuance of membership interests or units for a capital-raising offering subsequent to the issuance to the initial members.

## §11.105 4. Form: Withdrawal

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §11.48 and ends in §11.233

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11.105-1 Withdrawal

**D. *Withdrawal.*** No Member may withdraw as a Member without the written consent of all other Members. A Member that withdraws with such written consent shall divest his, her, or its \_\_ *[entire Membership Interest/Units]* \_\_ before the effective date of withdrawal in accordance with the provisions of Section \_\_ *[specify section of agreement; see §§11.146-11.155]* \_\_. In the event a Member withdraws in violation of this Section, or Transfers his, her, or its \_\_ *[Membership Interest/ Units]* \_\_ in violation of \_\_ *[specify section of agreement]* \_\_, his, her, or its \_\_ *[Membership Interest/Units]* \_\_ shall be converted into an Economic Interest and thereafter that Member shall only have the rights of an Assignee. Each Member acknowledges and agrees that such conversion of \_\_ *[a Membership Interest/Units]* \_\_ on the occurrence of any of the foregoing events is not unreasonable under the circumstances existing as of the date of this Agreement. Whether with or without the written consent of the other Members, withdrawal shall not release a Member from any obligation or liability under this Agreement accrued or incurred before the effective date of withdrawal.

*Comment:* The articles of organization or a written operating agreement may provide the circumstances under which a member may withdraw (or resign or retire), or may provide that a member may not withdraw. Corp C §17252(a). Despite the articles of organization or the operating agreement, a member may withdraw by giving notice to the other members, but in that event the member's membership interest becomes an economic interest, and the withdrawing member is not entitled to payment for the membership interest. If a member withdraws in violation of the operating agreement, the LLC may offset any damages for breach of the operating agreement against distributions payable to the withdrawing member. Corp C §17252(a).

## §11.106 5. Form: Competing Activities

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §11.48 and ends in §11.233

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11.106-1 Competing activities

[Add one of the following alternatives]

[Alternative 1: Competing activities allowed]

**E. Competing Activities.** The Members and their officers, directors, shareholders, partners, members, managers, trustees, agents, employees, and Affiliates may engage or invest in, independently or with others, any business activity of any type or description, including those that might be the same as or similar to the Company's business and that might be in direct or indirect competition with the Company. Neither the Company nor any Member shall have any right in or to such other ventures or activities or to the income or proceeds derived from them. The Members shall not be obligated to present any investment opportunity or prospective economic advantage to the Company, even if the opportunity is of the character that, if presented to the Company, could be taken by the Company. The Members shall have the right to hold any investment opportunity or prospective economic advantage for their own account or to recommend such opportunity to Persons other than the Company. Each Member acknowledges that the other Members and their Affiliates may own or manage other businesses, including businesses that may compete with the Company. Each Member waives any and all rights and claims that he, she, or it may otherwise have against the other Members and their officers, directors, shareholders, partners, members, managers, agents, employees, and Affiliates as a result of any of such activities.

[Alternative 2: Competing activities not allowed]

**E. Competing Activities.** For as long as a Member is employed by the Company, he, she, or it shall not, directly or indirectly, plan, organize, or render services for, whether as an employee, consultant, or otherwise, invest in or become a shareholder, member, partner, creditor, officer, director, or owner in any business that the Company reasonably believes competes, directly or indirectly, with any business, activity, product, or service of the Company.

*Comment:* Because members have certain fiduciary duties to each other and to the LLC (see §11.19), it is better to state affirmatively what competing activities may be allowed rather than be silent as to this issue. The second alternative should be reserved for a member-managed LLC in which all members are employed by the LLC.

**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.107 6. Form: Transactions With the Company

## §11.107 6. Form: Transactions With the Company

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11.107-1 Transactions with the company

**F. *Transactions with the Company.* Subject to any limitations set forth in this Agreement and with the prior approval of the Manager \_\_[and a Majority Interest]\_\_, a Member may lend money to and transact other business with the Company. Subject to other applicable law, such Member has the same rights and obligations with respect thereto as a Person who is not a Member.**

*Comment:* The language in this form is adapted from Corp C §17004(a). The preference provisions of federal bankruptcy law with respect to insider transactions may affect any transaction between an LLC and a member.

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.108 7. Form: Remuneration to Members

## **§11.108 7. Form: Remuneration to Members**

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11.108-1 Remuneration to members

**G. *Remuneration to Members.* Except as otherwise authorized or specifically provided in this Agreement, no Member is entitled to remuneration for acting on the Company business.**

*Comment:* The language in this form is adapted from Corp C §17004(b).

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.109 8. Form: Members Are Not Agents

## §11.109 8. Form: Members Are Not Agents

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11.109-1 Members are not agents

**H. *Members Are Not Agents.*** Under Section \_\_ *[specify section of agreement]* \_\_ and the Articles, the management of the Company is vested in the Manager. The Members shall have no power to participate in the management of the Company except as expressly authorized by this Agreement or the Articles and except as expressly required by the Act. No Member, acting solely in the capacity of a Member, is an agent of the Company nor does any Member, unless expressly and duly authorized in writing to do so by the Manager, have any power or authority to bind or act on behalf of the Company in any way, to pledge its credit, to execute any instrument on its behalf, or to render it liable for any purpose.

*Comment:* The language in this form is adapted from Corp C §17157(b). The form should be used only for a manager-managed LLC. In a member-managed LLC, each member is the agent of the LLC and has the power to bind the LLC. Corp C §17157(a). See §§11.17-11.18.

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## §11.110 9. Form: Voting Rights

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### 11.110-1 Voting rights

**1. *Voting Rights.*** Members shall have only the voting, approval, and consent rights as required under the Act or as set forth in this Section. Except as otherwise provided, in all matters in which a vote, approval, or consent of the Members is required, a vote, consent, or approval of a Majority Interest shall be sufficient to authorize or approve such matter. Except as otherwise specifically provided in this Agreement, all votes, approvals, or consents of the Members may be given or withheld, conditioned, or delayed as the Members may determine in their sole and absolute discretion. The Members may vote, approve, or consent to the following:

1. To engage in any business other than as set forth in Section \_\_ *[specify section of agreement; see §11.96]* \_\_;
2. To approve additional Capital Contributions, under Section \_\_ *[specify section of agreement; see §11.98]* \_\_;
3. To elect remedies on the default of a Member to make a required Capital Contribution, under Section \_\_ *[specify section of agreement; see §11.101]* \_\_;
4. To increase the number of Units that the Manager may issue without the approval of a Majority Interest, under Section \_\_ *[specify section of agreement; see §11.102]* \_\_;
5. To admit a new Member, under Section \_\_ *[specify section of agreement; see §11.104]* \_\_;
6. To approve the withdrawal of a Member, under \_\_ *[specify section of agreement; see §11.105]* \_\_;
7. To approve any transaction between the Company and a Member, under Section \_\_ *[specify section of agreement; see §11.107]* \_\_;
8. To elect or remove the Manager, under Section \_\_ *[specify section of agreement; see §11.117]* \_\_;
9. To approve certain material Company events, under Section \_\_ *[specify section of agreement; see §11.118]* \_\_;
10. To approve transactions between the Company and the Manager or an Affiliate of the Manager, under Section \_\_ *[specify section of agreement; see §11.122]* \_\_;
11. To approve payments to the Manager, under Section \_\_ *[specify section of agreement; see §11.123]* \_\_;
12. To approve the Transfer of \_\_ *[a Membership Interest/Units]* \_\_ and the admission of the transferee as a Member, under Section \_\_ *[specify section of agreement; see §11.146]* \_\_;
13. To dissolve the Company, under Section \_\_ *[specify section of agreement; see §11.164]* \_\_;
14. To approve indemnification for a Manager, Member, or other Person, under Section \_\_ *[specify section of agreement; see §11.177]* \_\_;
15. To amend the Articles or this Agreement, under Section \_\_ *[specify section of agreement; see §11.207]* \_\_;
16. To compromise the obligation of a Member to return money or property paid or distributed in violation of the Act; and

**17. To approve any other matter described in this Agreement as requiring or allowing the approval, consent, or vote of the Members.**

*Comment:* This form should only be used for a manager-managed LLC. The drafter should add cross-references to other provisions in the agreement where member approval is required. If a super majority or unanimous vote is desired for any of these, then add an appropriate clause to the specific action, e.g. "which shall require the approval or consent of a Super Majority Interest." Certain of the voting rights listed in this section may be removed if the corresponding provision in the operating agreement does not require or allow the approval or consent of the members.

Although the Beverly-Killea Limited Liability Company Act requires that certain actions must be approved by the members, it does not require that the manager in a manager-managed LLC also approve such actions. If manager approval is desired in addition to member approval, then the operating agreement should affirmatively so provide.

The admission of a new member requires the approval of a majority in interest of the other members, unless the articles of organization or the operating agreement provide otherwise. Corp C §17100(a)(1).

The admission of a substitute member on the transfer of a membership interest requires the approval of a majority in interest of the other members, unless the articles of organization or the operating agreement provide otherwise. Corp C §17303(a).

The members may elect to dissolve an LLC on the approval of a majority in interest, or such greater percentage as may be provided in the articles of organization or in a written operating agreement. Corp C §17350(b). A vote of less than a majority in interest is not allowed, and the power of the members to dissolve an LLC may not be eliminated. Corp C §§17005(b)(3), 17103(c).

The power to amend the articles of organization or the operating agreement is vested in the members. Corp C §17059. An amendment of the articles of organization or the operating agreement requires the approval of all of the members, unless the articles of organization or a written operating agreement provide otherwise. Corp C §17103(a)(2). Despite such flexibility, an amendment to the articles of organization (but not the operating agreement) must be approved by at least a majority in interest of the members. Corp C §17103(b).

The compromise of an obligation of a member to return money or property paid or distributed in violation of the Act requires the approval of all of the members, unless the articles of organization or the operating agreement provide otherwise. Corp C §17201(b)(1).

**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.111 10. Form: Meetings of Members and Voting (Short Form)

## §11.111 10. Form: Meetings of Members and Voting (Short Form)

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §11.48 and ends in §11.233

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11.111-1 Meetings of members; voting (short form)

**J. Meetings of Members and Voting.** No annual or regular meetings of the Members are required to be held. However, if such meetings are held, they shall be noticed, held, and conducted under the Act. In any instance in which approvals are required under this Agreement, such approval may be obtained in any manner permitted by the Act. Except as otherwise provided in this Agreement, any action, approval, or consent by the Members shall require the concurrence of a Majority Interest. Except as otherwise provided in this Agreement, all votes, approvals, or consents of the Members may be given or withheld, conditioned, or delayed as the Members may determine in their sole and absolute discretion.

*Comment:* This short form may be used when protection of member rights is less of a concern, such as a member-managed LLC in which all members are active in management, or in a manager-managed LLC in which the members are managers, either directly or indirectly, as, for example, when an officer of a member that is an entity is a manager. The failure to hold annual meetings or the failure to observe formalities at any meetings may not be factors tending to establish alter ego or that the members have personal liability for the debts of the LLC. Corp C §17101(b).

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## §11.112 11. Form: Meetings of Members and Voting (Long Form)

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §11.48 and ends in §11.233

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### 11.112-1 Date, time, and place of meetings

#### J. Meetings of Members and Voting

[Add one of the following alternatives]

[Alternative 1: No mandatory meetings; LLC with officers]

**1. Date, Time, and Place of Meetings of Members.** Meetings of Members may be held at such date, time, and place within or without the State of California as the Manager may fix from time to time, or if there are two or more Managers and they are unable to agree to a date, time, and place, Members holding a Majority Interest shall determine the date, time, and place. No annual or regular meetings of Members are required. At any meeting of the Members, if neither the Chairman nor other officer is present to preside at the meeting, the Managers shall appoint a person to act as chair of the meeting, and if the Secretary is not present, the Managers shall appoint a person to act as secretary of the meeting.

[Alternative 2: No mandatory meetings; LLC without officers]

**1. Date, Time, and Place of Meetings of Members.** Meetings of Members may be held at such date, time, and place within or without the State of California as the Manager may fix from time to time, or if there are two or more Managers and they are unable to agree to a date, time, and place, Members holding a Majority Interest shall determine the date, time, and place. No annual or regular meetings of Members are required. At any meeting of the Members, the Manager shall preside at the meeting and shall appoint a person to act as secretary of the meeting, or if there are two or more Managers, they shall appoint a person to preside at the meeting and a person to act as secretary of the meeting. The secretary of the meeting shall prepare minutes of the meeting which shall be placed in the minute books of the Company.

[Alternative 3: Mandatory meetings]

**1. Date, Time, and Place of Meetings of Members.** The Members holding \_\_ [Membership Interests/Units] \_\_ entitled to vote shall hold at least one meeting annually for the purpose of the election of the Manager. Such annual meeting and all other meetings of Members shall be held at such date, time, and place within or without the State of California as the Manager may fix from time to time, or if there are two or more Managers and they are unable to agree to a date, time, and place, Members holding a Majority Interest shall determine the date, time, and place. At any meeting of the Members, the Manager shall preside at the meeting and shall appoint a person to act as secretary of the meeting, or if there are two or more Managers, they shall appoint a person to preside at the meeting and a person to act as secretary of the meeting. The secretary of the meeting shall prepare minutes of the meeting, which shall be placed in the minute books of the Company.

[Continue]

### 11.112-2 Power to call meetings

**2. Power to Call Meetings.** Meetings of the Members may be called by the Manager, or on written demand of Members holding more than ten percent (10%) of the outstanding \_\_ [Percentage Interests/Units] \_\_ entitled to vote, for the purpose of addressing any matters on which the Members may vote.

### 11.112-3 Notice of meeting

**3. Notice of Meeting.** Written notice of a meeting of Members shall be sent or otherwise given to each Member \_\_ [holding Units entitled to vote] \_\_ in accordance with this Section not less than ten (10) nor more than sixty (60) days before the date of the meeting. The notice shall specify 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 this meeting. On written request to the Manager by one or more Members entitled to call a meeting of Members, the Manager shall immediately cause notice to be given to the Members entitled to vote that a meeting will be held at a time requested by the person calling the meeting, not less than ten (10) days nor more than sixty (60) days after the receipt of the request. If the Manager does not give the notice within twenty (20) days after the receipt of the request, the Members entitled to call the meeting may give the notice.

11.112-4 Manner of giving notice

**4. *Manner of Giving Notice; Affidavit of Notice.*** Notice of any meeting of Members shall be given personally, by first-class mail or other written communication, or by electronic transmission that satisfies the requirements of Corporations Code §17001(o)(1) and the Electronic Signatures in Global and National Commerce Act (15 USC §7001(c)(1)), addressed to the Member at the address appearing on the books of the Company or given by the Member to the Company for the purpose of notice. If no such address appears on the Company's books or is given, notice shall be deemed to have been given if sent to that Member by first-class mail or other written communication to the Company's principal executive office, or if published at least once in a newspaper of general circulation in the county where that office is located. Notice shall be deemed to have been given at the time when delivered personally, deposited in the mail, or delivered by electronic transmission as set forth in this Section.

If any notice addressed to a Member at the address appearing on the books of the Company is returned to the Company by the United States Postal Service marked to indicate that the United States Postal Service is unable to deliver the notice to the Member at that address, all future notices or reports shall be deemed to have been duly given without further mailing if there shall be available to the Member on written demand of the Member at the principal executive office of the Company for a period of one (1) year from the date of the giving of the notice.

An affidavit of the mailing or other means of giving any notice of any meeting shall be executed by the Manager, any officer, or any transfer agent of the Company giving the notice, and shall be filed and maintained in the Company records.

11.112-5 Validity of action

**5. *Validity of Action.*** Any action approved at a meeting, other than by unanimous approval of all Members entitled to vote, shall be 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.

11.112-6 Quorum

**6. *Quorum.*** The presence in person or by proxy of a Majority Interest shall constitute a quorum at a meeting of Members. The Members present at a duly called or held meeting at which a quorum is present may continue to do business until adjournment, despite the loss of a quorum, if any action taken after loss of a quorum (other than adjournment) is approved by at least a Majority Interest.

11.112-7 Adjourned meeting; notice

**7. *Adjourned Meeting; Notice.*** Any meeting of Members, whether or not a quorum is present, may be adjourned from time to time by the vote of the majority of the \_\_ *[Membership Interests/Units entitled to vote]* \_\_ represented at that meeting, either in person or by proxy, but in the absence of a quorum, no other business may be transacted at that meeting, except as provided in paragraph 6 of this Section. When any meeting of Members is adjourned to another time or place, notice need not be given of the adjourned meeting if the time and place are announced at a meeting at which the adjournment is taken, unless a new record date for the adjourned meeting is subsequently fixed, or unless the adjournment is for more than forty-five (45) days from the date set for the original meeting, in which case the Manager shall set a new record date. At any adjourned meeting the Members may transact any business that might have been transacted at the original meeting.

11.112-8 Waiver of notice or consent

**8. *Waiver of Notice or Consent.*** The actions taken at any meeting of Members, however called and noticed, and wherever held, have the same validity as if taken at a meeting duly held after regular call and notice if a quorum is present either in person or by proxy, and if, either before or after the meeting, each of the Members entitled to vote, who was not present in person or by proxy, signs a written waiver of notice or consents to the holding of the meeting or approves the minutes of the meeting. The Manager or the Secretary, if any, shall file all such waivers, consents, or approvals in the Company records.

Attendance of a Member at a meeting shall constitute a waiver of notice of that meeting, except when the Member objects at the beginning of the meeting to the transaction of any business because the meeting is not lawfully called or convened, and except that attendance at a meeting is not a waiver of any right to object to the consideration of matters not included in the notice of the meeting if that objection is expressly made at the meeting. Neither the business to be transacted nor the purpose of any meeting of Members need be specified in any written waiver of notice except as provided in paragraph 5 of this Section.

11.112-9 Action by written consent without meeting

**9. Action by Written Consent Without Meeting.** Any action that may be taken at a meeting of Members \_\_\_\_, including the annual election of the Manager,]\_\_ may be taken without a meeting, if a consent in writing setting forth the action so taken is signed and delivered to the Company within sixty (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 meeting at which all Members entitled to vote on that action at a meeting were present and voted. All such consents shall be filed with the Manager or the Secretary, if any, and shall be maintained in the Company records. Any Member giving a written consent, or the Member's proxy holders, may revoke the consent by a writing received by the Manager or the Secretary, if any, before written consents of the number of votes required to authorize the proposed action have been filed.

*[Add one of the following alternatives]*

*[Alternative 1: When prior written notice of key events is desired]*

Unless the consents of all Members entitled to vote have been solicited in writing, the Manager shall give (a) notice of any amendment to the Articles or this Agreement, a dissolution of the Company, or a merger of the Company approved by Members without a meeting by less than unanimous written consent, to those Members entitled to vote who have not consented in writing at least ten (10) days before the consummation of the action authorized by such approval, or (b) prompt notice of the taking of any other action approved by Members without a meeting by less than unanimous written consent, to those Members entitled to vote who have not consented in writing.

*[Alternative 2: When prior written notice of key events not desired]*

Unless the consents of all Members entitled to vote have been solicited in writing, the Manager shall give prompt notice of the taking of any other action approved by Members without a meeting by less than unanimous written consent, to those Members entitled to vote who have not consented in writing.

*[Continue]*

11.112-10 Telephonic participation

**10. Telephonic Participation by Members at Meeting.** Members may participate in any meeting of Members through the use of any means of conference telephones or electronic video screen communication as long as all Members participating can hear one another, or by electronic transmission under Corporations Code §17001(o). A Member so participating is deemed to be present in person at the meeting.

11.112-11 Record date

**11. Record Date.** In order that the Company may determine the Members of record entitled to notices of any meeting or to vote, or entitled to receive any distribution or to exercise any rights in respect of any distribution or to exercise any rights in respect of any other lawful action, the Manager, or Members representing more than ten percent (10%) of the outstanding \_\_\_\_, *[Percentage Interests/Units entitled to vote]*\_\_, may fix, in advance, a record date that is not more than sixty (60) days nor less than ten (10) days prior to the date of the meeting and not more than sixty (60) days prior to any other action. If no record date is fixed:

(a) The record date for determining Members entitled to notice of or to vote at a meeting of Members shall be at the close of business on the business day next preceding the day on which notice is given or, if notice is waived, at the close of business on the business day next preceding the day on which the meeting is held;

(b) The record date for determining Members entitled to give consent to Company action in writing without a meeting shall be the day on which the first written consent is given;

(c) The record date for determining Members for any other purpose shall be at the close of business on the day on which the Manager adopts the resolution relating thereto, or the sixtieth (60th) day prior to the date of the other action, whichever is later; or

(d) The determination of Members of record entitled to notice of or to vote at a meeting of Members shall apply to any adjournment of the meeting unless the Manager or the Members who called the meeting fix a new record date for the adjourned meeting, but the Manager or the Members who called the meeting shall fix a new record date if the meeting is adjourned for more than forty-five (45) days from the date set for the original meeting.

11.112-12 Proxies

**12. Proxies.** Every Member entitled to vote for Manager or on any other matter shall have the right to do so

either in person or by one or more agents authorized by a written proxy signed by the person and filed with the Manager or the Secretary, if any. A proxy shall be deemed signed if the Member's name is placed on the proxy (whether by manual signature, typewriting, facsimile, or other electronic transmission or otherwise) by the Member or the Member's attorney in fact. A validly executed proxy that does not state that it is irrevocable shall continue in full force and effect unless revoked by the person executing it, before the vote under that proxy, by a writing delivered to the Company stating that the proxy is revoked, or by a subsequent proxy executed by, or attendance at the meeting and voting in person by, the person executing the proxy; or written notice of the death or incapacity of the maker of that proxy is received by the Company before the vote under that proxy is counted; provided, however, that no proxy shall be valid after the expiration of eleven (11) months from the date of the proxy, unless otherwise provided in the proxy. A proxy may not be transmitted orally.

11.112-13 Meetings by electronic transmission

**13. Meetings by Electronic Transmission.** A meeting of Members may be conducted, in whole or in part, by electronic transmission as set forth in Corporations Code §17001(o) or by electronic video screen communications if (a) the Company implements reasonable procedures to provide Members (in person or by proxy) a reasonable opportunity to participate in the meeting and to vote on matters submitted to the Members, including an opportunity to read or hear the proceedings of the meeting substantially concurrently with those proceedings, and (b) the Company maintains a record of any vote or other action taken by the Members at the meeting by means of by electronic transmission as set forth in Corporations Code §17001(o) or by electronic video screen communications.

*Comment:* Procedures for meetings of members and voting are provided in Corp C §17104. These procedures apply unless the articles of organization or a written operating provide otherwise. The provisions of this long form for meetings of members and voting follow the statutory procedures.

Meetings may be held at any place, within or without the state of California. The articles of organization or a written operating agreement may fix a place or may establish who may select the place. If the articles of organization or a written operating agreement do not provide, then meetings will be held at the principal executive office of the LLC. Corp C §17104(a). Annual meetings are not required. However, because the failure to hold meetings of the members or the failure to observe formalities in the calling or conduct of such meetings is not a factor to be used to establish liability under the alter ego doctrine (Corp C §17101(b)) care should be taken in providing for mandatory meetings.

In subsection 1, the provisions selecting a person to preside at the meeting and to act as secretary may be deleted if the operating agreement provides for officers who will perform such functions. See §11.124.

In subsection 9, the drafter should add the reference to the annual election of the manager only if the election is mandatory under the provisions of the operating agreement. See Corp C §17104(i).

Subparagraph 12 is based on Corp C §17104(j), which incorporates Corp C §§178 and 705. Corp Code §17001(ai) permits the oral transmission of a proxy, but oral transmission may lead to problems that are best avoided.

**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.113 12. Form: Certificate for Membership Interest or Units

## §11.113 12. Form: Certificate for Membership Interest or Units

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §11.48 and ends in §11.233

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11.113-1 Certificates

### **K. Certificate.**

**1. Form of Certificate.** \_\_ [A Membership Interest/Units]\_\_ \_\_ [may/shall]\_\_ be represented by a certificate. The exact contents of a certificate shall be determined by the Manager, but shall be issued substantially in conformity with the following requirements. The certificates shall be respectively numbered serially, as they are issued, shall be impressed with the Company seal or a facsimile of it, if any, and shall be signed by \_\_ [specify who will sign certificate, e.g., either the Chief Executive Officer or Vice President of the Company plus the Manager]\_\_ . Each certificate shall state the name of the Company, the fact that the Company is organized under the laws of the State of California as a limited liability company, the name of the Person to whom the certificate is issued, the date of issue, and the \_\_ [Percentage Interest/number and type of Units]\_\_ that it represents. Each certificate of membership shall be otherwise in the form determined by the Manager.

**2. Cancellation of Certificate.** The Company shall cancel all certificates surrendered for transfer, and the Company shall not issue any new certificate in lieu of a previously issued certificate until the former certificate for a like \_\_ [Membership Interest/number of Units]\_\_ shall have been surrendered and canceled, except as provided in this Section K, subsection 2 with respect to lost, stolen, or destroyed certificates.

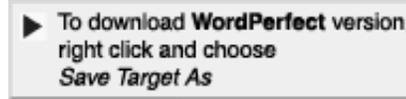
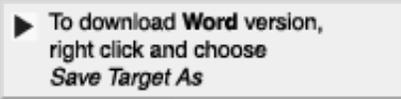
**3. Replacement of Lost, Stolen, or Destroyed Certificate.** Any Member claiming that his, her, or its \_\_ [certificate of Membership Interest/Unit certificate]\_\_ is lost, stolen, or destroyed may make an affidavit or affirmation of that fact and request a new certificate. On the giving of a satisfactory indemnity to the Company as the Manager may reasonably require, the giving of which indemnity may be waived, the Company shall issue a new certificate of the same tenor and representing the same \_\_ [Percentage Interest/number of Units]\_\_ as was represented by the certificate alleged to be lost, stolen, or destroyed.

*Comment:* Membership certificates are optional. See Corp C §17105. This section may be deleted if certificates are not desired. If membership interests are expressed in percentages and the percentage interest of a member may change from time to time under the operating agreement, the practitioner should be careful as to how the interest on the certificate is stated. In such a situation, it may be preferable to express membership interests in units.

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**§11.114 13. Form: Confidentiality**

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11.114-1 Confidentiality

**L. Confidentiality.** Each Member shall, while a Member, for a period of two (2) years after ceasing to be a Member, and as long thereafter as the Confidential Information shall retain a degree of confidentiality giving value to its protection from competitors, hold all Confidential Information in strict confidence and not disclose any Confidential Information to any other person, company, or entity. A Member may disclose Confidential Information to its officers, directors, managers, employees, and professional advisors if disclosure is required so that the recipient may advise or act on behalf of the disclosing Member and such recipient agrees in writing with terms similar to this Section L to protect the Confidential Information. If a Member is legally compelled to disclose any Confidential Information, the Member shall promptly notify the Company in writing in advance of such disclosure so that the Company may seek a protective order or other appropriate remedy and/or waive compliance with this Section L. In the event that such protective order or other remedy is not obtained, or if the Company waives compliance with the provisions of this Section L, the Member shall disclose only such Confidential Information that the Member's legal counsel advises is legally required to be disclosed, and will exercise the Member's best efforts to obtain assurance that confidential treatment will be accorded to any Confidential Information that is compelled to be disclosed.

*Comment:* This provision should be used only when all of the members will likely have access to confidential information.

## §11.115 14. Form: Initial Member Loans

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §11.48 and ends in §11.233

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11.115-1 Initial member loans

**M. Initial Member Loans.** The Initial Members may, but are not obligated to, make one or more Initial Member Loans to the Company to provide the Company with working capital to pay for \_\_ *[specify purpose of loans]* \_\_. Except for the initial Capital Contribution of the Initial Members as set forth in Exhibit A, and except as provided in Section \_\_ *[specify section of agreement; see §11.98]* \_\_, all advances made by an Initial Member to or on behalf of the Company shall be Initial Member Loans and shall not be deemed to be Capital Contributions. Initial Member Loans shall bear interest at the annual rate of \_\_ *[specify, e.g., ten percent (10.0%)]* \_\_ from the date of the loan until repaid. By signing this Agreement, each Member is deemed to have approved all Initial Member Loans.

*Comment:* This provision (and the related definition at §11.68) may be used when the members wish to voluntarily provide additional funding in the form of loans to the LLC, and wish to document that such advances will be recorded as loans and not capital contributions, especially when the loans are not likely to be evidenced by written promissory notes. This informal type of arrangement works best when all the members are active in the LLC, such as a member-managed LLC.

**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/ F. Management and Control of the Company/§11.116 1. Form: Management of the Company; Powers

## **F. Management and Control of the Company**

### **§11.116 1. Form: Management of the Company; Powers**

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11.116-1 Management of the company; powers

#### **ARTICLE V MANAGEMENT AND CONTROL OF THE COMPANY**

*[Add one of the following alternatives]*

*[Alternative 1: Member-managed LLC]*

**A. Management of the Company; Powers.** In entering into this Agreement, the intent of the Members is to actively engage in the management of the Company. Subject to the provisions of the Articles and this Agreement relating to actions required to be approved by the Members, each Member shall have full, complete, and exclusive authority, power, and discretion to manage and control the business, property, and affairs of the Company, to make all decisions regarding those matters, and to perform any and all other acts or activities customary or incident to the management of the Company's business, property, and affairs, including the power to exercise on behalf and in the name of the Company all of the powers described in Corporations Code §17003.

*[Alternative 2: Single-manager LLC]*

**A. Management of the Company by the Manager; Powers.** Subject to the provisions of the Articles and this Agreement relating to actions required to be approved by the Members, the Manager shall have full, complete, and exclusive authority, power, and discretion to manage and control the business, property, and affairs of the Company, to make all decisions regarding those matters, and to perform any and all other acts or activities customary or incident to the management of the Company's business, property, and affairs, including but not limited to the power to exercise on behalf and in the name of the Company all of the powers described in Corporations Code §17003. Subject to the limitations in Section \_\_ *[specify section of agreement; see §11.118]* \_\_, the Manager is authorized to

- 1. Manage the day-to-day affairs of the Company;**
- 2. Approve or perform any act that this Agreement authorizes the Manager to approve or perform;**
- 3. Endorse checks, drafts, and other evidences of indebtedness made payable to the order of the Company for the purpose of deposit into the Company's accounts;**
- 4. Sign all checks, drafts, and other instruments obligating the Company to pay money;**
- 5. Open bank accounts and designate who may sign checks, drafts, and other instruments obligating the Company to pay money, including dollar limits and signature requirements;**
- 6. Sign all contracts and obligations on behalf of the Company;**
- 7. Purchase or sell any assets, including but not limited to real estate; and**
- 8. Borrow money, sign promissory notes, loan agreements, and other loan documents on behalf of the Company, and encumber the Company's property with one or more deeds of trust, security agreements, or related documents for purposes of securing the Company's obligations.**

**A. Management of the Company by the Managers; Powers.**

**1. Exclusive Management by the Managers; Powers.** Subject to the provisions of the Articles and this Agreement relating to actions required to be approved by the Members, the Managers shall have full, complete, and exclusive authority, power, and discretion to manage and control the business, property, and affairs of the Company, to make all decisions regarding those matters, and to perform any and all other acts or activities customary or incident to the management of the Company's business, property, and affairs, including but not limited to the power to exercise on behalf and in the name of the Company all of the powers described in Corporations Code §17003. The concurrence of a majority of the Managers is required to authorize any act of the Managers, unless a majority of the Managers expressly authorize one Manager to act on behalf of the Company. For the purposes of organizing the Company, any of the initial Managers named in Section \_\_ [specify section of agreement; see §11.73] \_\_, acting alone, may open the Company's initial bank account and authorize signatories for such account.

**2. Agency Authority of the Managers.** Subject to the limitations in Section \_\_ [specify section of agreement; see §11.118] \_\_, the Managers are authorized to

- (a) Manage the day-to-day affairs of the Company;
- (b) Approve or perform any act that this Agreement authorizes the Managers to approve or perform;
- (c) Sign all checks, drafts, and other instruments obligating the Company to pay money;
- (d) Open bank accounts and designate who may sign checks, drafts, and other instruments obligating the Company to pay money, including dollar limits and signature requirements;
- (e) Sign all contracts and obligations on behalf of the Company;
- (f) Purchase or sell any assets, including but not limited to real estate; and
- (g) Borrow money, sign promissory notes, loan agreements, and other loan documents on behalf of the Company, and encumber the Company's property with one or more deeds of trust, security agreements, or related documents for purposes of securing the Company's obligations. Any Manager acting alone is authorized to endorse checks, drafts, and other evidences of indebtedness made payable to the order of the Company for the purpose of deposit into the Company's accounts.

**3. Meetings of the Managers.** \_\_ [Any Manager/The Chair, the Chief Executive Officer, the President, or any two (2) Managers] \_\_ may call meetings of the Managers. All meetings shall be held on four (4) days' notice by mail or one (1) day's notice (or on such shorter notice period if necessary under the circumstances) delivered personally or by telephone, facsimile, or electronic mail. A notice need not specify the purpose of any meeting. Notice of a meeting need not be given to any Manager who signs a waiver of notice or a consent to holding the meeting (which waiver or consent need not specify the purpose of the meeting) or an approval of the minutes thereof, whether before or after the meeting, or who attends the meeting without protesting, prior to its commencement, the lack of notice to such Manager. All such waivers, consents, and approvals shall be filed with the Company records or made a part of the minutes of the meeting. A majority of the Managers present, whether or not a quorum is present, may adjourn any meeting to another time and place. If the meeting is adjourned for more than twenty-four (24) hours, notice of any adjournment shall be given prior to the time of the adjourned meeting to the Managers who are not present at the time of the adjournment. Meetings of the Managers may be held at any place within or without the State of California that has been designated in the notice of the meeting or at such place as may be approved by the Managers. Managers may participate in a meeting through use of conference telephone or similar communications equipment, so long as all Managers participating in such meeting can hear one another. Participation in a meeting in such manner constitutes a presence in person at such meeting. A majority of the Managers constitutes a quorum of the Managers for the transaction of business. Except to the extent that this Agreement expressly requires the approval of all Managers, every act or decision done or made by a majority of the Managers present at a meeting duly held at which a quorum is present is the act of the Managers. A meeting at which a quorum is initially present may continue to transact business notwithstanding the withdrawal of Managers, if any action taken is approved by at least a majority of the required quorum for such meeting.

**4. Action by Written Consent.** Any action required or permitted to be taken by the Managers may be taken by the Managers without a meeting, if a majority of the Managers individually or collectively consent in writing to such action, unless the action requires the unanimous vote of the Managers, in which case all Managers must consent in writing. Such action by written consent shall have the same force and effect as a majority vote or unanimous vote, as applicable, of such Managers.

*Comment:* With respect to Alternative 2 of this form, the grant of powers to the manager is intended to be broad, and subject only to the limitation that certain actions require the approval of the members. The grant of powers to an LLC in Corp C §17003 is very broad and non-exclusive, so a detailed "laundry list" of powers is not necessary. Nevertheless, certain third parties such as banks, lenders, and title companies may unnecessarily insist on a specific recitation of manager power to act on behalf of the LLC in certain types of transactions.

With respect to subsection 2 of Alternative 3, the operating agreement may authorize any manager acting alone to sign checks up to a dollar limit, or may authorize the managers as a group to establish such dollar limits. If the LLC has officers who will run the day-to-day operations and the role of the managers is to supervise the officers, then certain of the powers that are normally exercised by officers may be removed from this subsection to avoid confusion and overlapping responsibilities. See the Comment in §11.116.

The Beverly-Killea Limited Liability Company Act does not contain procedures governing meetings of managers. The provision in subsection 3 of Alternative 3 follows Corp C §307 governing the meetings of corporate directors. The drafter may alter this provision to meet the needs of the members.

The last subsection in Alternative 3 alters Corp C §17156, which requires that action by written consent be unanimous.

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## §11.117 2. Form: Election of Manager

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §11.48 and ends in §11.233

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11.117-1 Election of manager

### B. Election of Manager.

**1. Number, Term, and Qualifications.** The Company shall have \_\_ [one (1) Manager/ three (3) Managers/a variable number of Managers between three (3) and nine (9), the exact number to be determined by the Managers. Until the Managers determine otherwise, the number of Managers shall be three (3)] \_\_. On the approval of a \_\_ [Super] \_\_ Majority Interest, the Members may change the number of Managers, provided that in no instance shall there be less than one Manager and provided further that if the number of Managers is increased to more than one, the Articles shall be amended to indicate that the Company has more than one Manager, and if the number of Managers is decreased to one, the Articles shall be amended to indicate that the Company has only one Manager. The Manager shall hold office until the Manager resigns or is removed. \_\_ [No regular or annual election of the Manager is required to be held/The Managers shall be elected annually by the affirmative vote or written consent of Members holding a Majority Interest.] \_\_ A Manager need not be a Member, individual, resident of the State of California, or citizen of the United States.

**2. Resignation.** A Manager may resign at any time by giving written notice to the Members and the other Managers, if any, without prejudice to the rights, if any, of the Company under any contract to which the Manager is a party. The resignation of a Manager shall take effect on receipt of that notice or at such later time as shall be specified in the notice. Unless otherwise specified in the notice, the acceptance of the resignation shall not be necessary to make it effective. The resignation of a Manager who is also a Member shall not affect the Manager's rights as a Member and shall not constitute a withdrawal of a Member.

**3. Removal.** A Manager may be removed at any time, with or without cause, by the affirmative vote of a Majority Interest at a meeting called expressly for that purpose, or by the written consent of a Majority Interest. Any removal shall be without prejudice to the rights, if any, of the Manager under any agreement with the Company. The removal of a Manager who is also a Member shall not affect the Manager's rights as a Member or constitute a withdrawal of a Member.

**4. Vacancies.** Any vacancy occurring for any reason in the number of Managers may be filled by \_\_ [the remaining Managers or] \_\_ the affirmative vote or written consent of a Majority Interest.

*Comment:* The articles of organization must be amended to increase the number of managers from one to more than one, and to decrease the number of managers from more than one to one. Corp C §17151(b). The percentage vote required should be the same as the vote required to amend the operating agreement as set forth in §11.207.

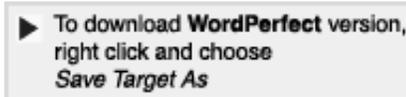
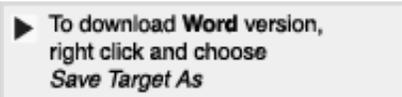
Care should be taken when mandating the annual election of managers or other formalities. Such a provision may act to negate the effect of Corp C §17101(b), which provides that the failure to hold annual meetings of the members or to observe formalities will not be considered a factor in piercing the "corporate" veil.

Removal of managers is covered by Corp C §17152(b). The operating agreement may prohibit the members from removing a manager, or may make removal of a manager more difficult by requiring unanimous or a super majority approval. The operating agreement may also provide that a manager may be removed by the other managers (assuming that the LLC has more than one manager) in the event of disability or cause, which should be detailed in this provision.

Resignation of managers is covered by Corp C §17152(c); vacancies in Corp C §17152(a).

### §11.118 3. Form: Limitations on Powers of Managers or Member-Managers

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §11.48 and ends in §11.233



11.118-1 Limitations on powers

[Add one of the following alternatives]

[Alternative 1: Manager-managed LLC]

**C. Limitations on Powers of Manager(s).** \_\_ [Any contract or liability of the Company in an amount in excess of \$ \_\_ [amount] \_\_ must be approved by the Managers.] \_\_ **The Manager(s) shall not have authority to cause the Company to engage in the following transactions without first obtaining the affirmative vote or written consent of a Majority Interest, or such greater percentage vote as may be required by the terms of this Agreement:**

[Alternative 2: Member-managed LLC]

**C. Limitations on the Powers of Members.** \_\_ [Any contract or liability of the Company in an amount in excess of \$ \_\_ [amount] \_\_ must be approved by the Members.] \_\_ **No Member shall have authority to cause the Company to engage in the following transactions without first obtaining the affirmative vote or written consent of a Majority Interest, or such greater percentage vote as may be required by the terms of this Agreement:**

[Continue]

**1. Sell, exchange, or otherwise dispose of substantially all of the Company's assets, occurring as part of a single transaction or plan, or in multiple transactions over a twelve (12)-month period, except in the orderly liquidation and winding up of the business of the Company on its duly authorized dissolution;**

**2. Merge the Company with another limited liability company or corporation, general partnership, limited partnership, or other entity (except that any act that would cause a Member to incur personal liability for the obligations of the Company or its successor shall also require the consent of such Member);**

**3. Except as set forth in Section \_\_ [specify section of agreement; see §11.102] \_\_, establish a different class of Members;**

**4. Confess a judgment against the Company \_\_ [in an amount in excess of \$ \_\_ [amount] \_\_] \_\_;**

**5. Undertake any act that would make it impossible to carry on the primary business of the Company;**

**6. File a bankruptcy petition on behalf of the Company; or**

**7. Undertake any other transaction described in this Agreement as requiring the approval, consent, or vote of the Members.**

*Comment:* Notwithstanding any limitations in the operating agreement, any note, mortgage, evidence of indebtedness, contract, certificate, statement, conveyance, or other instrument in writing executed or entered into by a manager-managed LLC when signed by two managers (or by one manager in the case of an LLC whose articles of organization provide for only one manager) is binding against the LLC, unless the other party has actual knowledge that the persons signing on behalf of the LLC had no authority to sign the document. Corp C §17157(d). See §11.18. Notwithstanding any limitations in the operating agreement, the act of any member in a member-managed LLC for the apparent purpose of carrying on the business or affairs of the LLC, including any agreement signed by a member, is binding against the LLC, unless the other party has actual knowledge that the person acting on behalf of the LLC had no authority to act. Corp C §17157(a). See §11.17.

The first sentence of Alternative 1 may be used where there is more than one manager in a manager-managed LLC

and it is desired to restrict the authority of any manager acting alone. In a member-managed LLC, the first sentence of Alternative 2 may be used when it is desired to restrict the authority of any member acting alone.

The practitioner may add or subtract from the list of items that require member approval. However, any merger of the LLC requires member approval (Corp C §17103(c)), and different classes of members may only be created by an amendment to the articles of organization or operating agreement (Corp C §17102).

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#### **§11.119 4. Form: Performance of Duties; Liability of a Manager**

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11.119-1 Performance of duties; liability of a manager

**D. Performance of Duties; Liability of a Manager.** A Manager shall not be liable to the Company or to any Member for any loss or damage sustained by the Company or any Member, unless the loss or damage shall have been the result of fraud, deceit, *gross negligence*, intentional misconduct, or a knowing violation of law by the Manager. A Manager shall perform managerial duties in good faith, in a manner the Manager reasonably believes to be in the best interests of the Company and its Members, and with such care, including reasonable inquiry, as an ordinarily prudent person in a like position would use under similar circumstances. A Manager who so performs the duties of Manager shall not have any liability by reason of being or having been a Manager of the Company.

When performing the duties of a Manager, a Manager shall be entitled to rely on information, opinions, reports, or statements, including financial statements and other financial data, of the following persons or groups unless the Manager has knowledge concerning the matter in question that would cause such reliance to be unwarranted and provided that the Manager acts in good faith and after reasonable inquiry when the need therefor is indicated by the circumstances:

1. One or more employees or other agents of the Company whom the Manager reasonably believes to be reliable and competent in the matters presented;
2. Any attorney, independent accountant, or other person as to matters that the Manager reasonably believes to be within such person's professional or expert competence; or
3. A committee on which the Manager does not serve, duly designated in accordance with a provisions in the Articles or this Agreement, as to matters within the designated authority of such committee, which committee the Manager reasonably believes to be competent.

*Comment:* See discussion in §11.19.

**§11.120 5. Form: Devotion of Time**

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11.120-1 Devotion of time

*[Add one of the following alternatives]*

*[Alternative 1: Manager-managed LLC]*

**E. Devotion of Time.** The Manager is not obligated to devote all of the Manager's time or business efforts to the affairs of the Company. The Manager shall devote whatever time, effort, and skill the Manager deems appropriate for the operation of the Company. Each Member acknowledges that the Manager may devote substantial time and effort to other business and non-business pursuits.

*[Alternative 2: Member-managed LLC]*

**E. Devotion of Time.** A Member is not obligated to devote all of the Member's time or business efforts to the affairs of the Company. The Member shall devote whatever time, effort, and skill as the Member deems appropriate for the operation of the Company. Each Member acknowledges that every other Member may devote substantial time and effort to other business and non business pursuits.

*Comment:* These provisions may be modified to reflect the amount of time that the members expect the manager (or members) to devote to the LLC, and may be tailored to provide different time requirements for different managers (or members).

## §11.121 6. Form: Competing Activities

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §11.48 and ends in §11.233

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11.121-1 Competing activities

[Add one of the following alternatives]

[Alternative 1: Competing activities allowed]

**F. Competing Activities.** The Manager and the Manager's agents, employees, and Affiliates, or if the Manager is an entity, then the Manager and its officers, directors, shareholders, partners, members, managers, trustees, agents, employees, and Affiliates (all of which are included in the term "Manager" for this Section), may engage or invest in, independently or with others, any business activity of any type or description, including those that might be the same as or similar to the Company's business and that might be in direct or indirect competition with the Company. Neither the Company nor any Member shall have any right in or to such other ventures or activities or to the income or proceeds derived from them. The Manager shall not be obligated to present any investment opportunity or prospective economic advantage to the Company, even if the opportunity is of the character that, if presented to the Company, could be taken by the Company. The Manager shall have the right to hold any investment opportunity or prospective economic advantage for the Manager's own account or to recommend such opportunity to Persons other than the Company. Each Member acknowledges that the Manager may own or manage other businesses, including businesses that may compete with the Company. Each Member waives any and all rights and claims that he, she, or it may otherwise have against the Manager as a result of any of such activities.

[Alternative 2: Competing activities not allowed]

**F. Competing Activities.** For as long as the Manager is serving as the Manager, the Manager shall not, directly or indirectly, plan, organize, or render services for, whether as an employee, consultant, or otherwise, invest in or become a shareholder, member, partner, creditor, officer, director, or owner in any business that the Company reasonably believes competes, directly or indirectly, with any business, activity, product, or service of the Company.

*Comment:* Because a manager owes a duty of loyalty to the members and to the LLC not to compete with the business of the LLC (see §11.19), the operating agreement must affirmatively state that competing activities are allowed. This is particularly important when the manager is serving on a part-time basis or is serving as the manager of a number of LLCs that are in the same line of business. Alternative 2 should be reserved for when the manager is to serve full-time and is not engaged in other activities.

## §11.122 7. Form: Transactions With the Company

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §11.48 and ends in §11.233

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11.122-1 Transactions with the company

[Add one of the following alternatives]

[Alternative 1: Manager-managed LLC]

**G. Transactions With the Company.** Notwithstanding that it may constitute a conflict of interest, the Manager may, and may cause the Manager's Affiliates to, engage in any transaction (including the purchase, sale, lease, or exchange of any property or the rendering of any service, or the establishment of any salary, other compensation, or other terms of employment) with the Company as long as the transaction is not expressly prohibited by this Agreement and as long as (1) the terms and conditions of such transaction, on an overall basis, are fair and reasonable to the Company, \_\_ [(2) the disinterested Managers who have no interest in the transaction (other than their interests as Members) affirmatively vote or consent in writing to approve the transaction and its terms, provided that the disinterested Managers comprise at least a quorum of the Managers,] \_\_ or (3) Members holding a majority of the \_\_ [Membership Interests/outstanding Units entitled to vote] \_\_ held by Members having no interest in such transaction (other than their interests as Members) affirmatively vote or consent in writing to approve the transaction and its terms. Nothing in this Section shall require a Manager to submit any such transaction to the Members for approval.

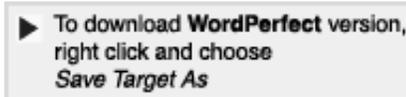
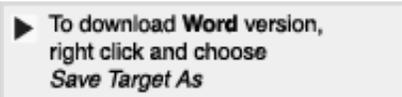
[Alternative 2: Member-managed LLC]

**G. Transactions With the Company.** Notwithstanding that it may constitute a conflict of interest, the Members may, and may cause their Affiliates to, engage in any transaction (including, without limitation, the purchase, sale, lease, or exchange of any property or the rendering of any service, or the establishment of any salary, other compensation, or other terms of employment) with the Company so long as such transaction is not expressly prohibited by this Agreement and as long as (1) the terms and conditions of such transaction, on an overall basis, are fair and reasonable to the Company, or (2) Members holding a majority of the \_\_ [Membership Interests/Units] \_\_ held by Members having no interest in such transaction (other than their interests as Members) affirmatively vote or consent in writing to approve the transaction and its terms. Nothing in this Section shall require a Member to submit any such transaction to the Members for approval.

*Comment:* This provision allows the managers, or the members in a member-managed LLC, the greatest latitude in entering into transactions with the LLC. The drafter may add greater restrictions if desired.

## §11.123 8. Form: Payments to the Manager

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §11.48 and ends in §11.233



11.123-1 Payments to the manager

**H. *Payments to the Manager.*** Except as specified in this Agreement, neither the Manager nor the Manager's Affiliates are entitled to remuneration for services rendered or goods provided to the Company. The Manager and the Manager's Affiliates shall be entitled to receive only the following:

**1. *Management Fee.*** The Company shall pay the Manager a monthly fee for services in connection with the management of the Company in the amount of \$ \_ \_ [amount] \_ \_ . Such fee may be changed from time to time as approved by the affirmative vote of a majority of the \_ \_ [Percentage Interests/Units] \_ \_ not held by the Manager. No Manager shall be prevented from receiving any fee because the Manager is also a Member.

**2. *Services Performed by the Manager.*** The Company shall pay the Manager and the Manager's Affiliates for services rendered to the Company in such amounts as may be approved by the affirmative vote of a majority of the \_ \_ [Percentage Interests/Units] \_ \_ not held by the Manager. No Manager shall be prevented from receiving any compensation because the Manager is also a Member.

**3. *Expenses.*** The Company shall reimburse the Manager and the Manager's Affiliates for the actual out-of-pocket costs of expenses reasonably incurred on behalf of the Company, including but not limited to the organizational expenses (including but not limited to legal and accounting fees and costs) incurred to form the Company and prepare and file the Articles and this Agreement, and for all other costs and expenses incurred on behalf of the Company. Except as otherwise provided in this Agreement, the Manager and the Manager's Affiliates shall not be entitled to reimbursement by the Company for the salaries, compensation, or fringe benefits of the employees of the Manager or the Manager's Affiliates, or the overhead expenses of the Manager or the Manager's Affiliates, including rent and general office expenses.

*Comment:* These provisions should be selected and modified as necessary to reflect the understanding of the members with respect to compensation and reimbursement of the manager. If there are multiple managers and if appropriate under the circumstances, manager compensation may be set by the managers. The operating agreement should authorize compensation for any manager that also is a member, since members may not receive compensation for acting on LLC business, except for winding up the LLC or as provided in an operating agreement. Corp C §17004(b).

## §11.124 9. Form: Officers

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11.124-1 Officers

[Add one of the following alternatives]

[Alternative 1: No officers]

I. **Officers.** The Company shall not have officers.

[Alternative 2: Officers]

I. **Officers.**

1. **Appointment of Officers.** The Company may have a Chair, a Chief Executive Officer, a President, a Chief Operating Officer, one or more Vice Presidents, a Chief Financial Officer, one or more Assistant Financial Officers, a Secretary, and one or more Assistant Secretaries. Such officers shall be appointed by and shall serve at the pleasure of the Manager, subject to the rights, if any, of an officer under any contract of employment. Any individual may hold any number of offices. No officer need be a resident of the State of California or a citizen of the United States. If a Manager is an individual, he or she may serve as an officer of the Company. If a Manager is not an individual, the Manager's officers may serve as officers of the Company if elected by the Manager. The officers shall exercise such powers and perform such duties as specified in this Agreement and as shall be determined from time to time by the Manager.

2. **Removal, Resignation, and Filling of Vacancy of Officers.**

(a) **Removal.** The Manager may remove any officer at any time, either with or without cause, subject to the rights, if any, of such officer under a contract of employment.

(b) **Resignation.** Any officer may resign at any time by giving written notice to the Manager. Any resignation shall take effect at the date of the receipt of that notice or at any later time specified in that notice; and, unless otherwise specified in that notice, the acceptance of the resignation shall not be necessary to make it effective. Any resignation is without prejudice to the rights, if any, of the Company under any contract to which the officer is a party.

(c) **Filling of Vacancy.** The Manager shall fill any vacancy in any office because of death, resignation, removal, disqualification, or any other cause.

3. **Salaries of Officers.** Subject to Sections \_\_ [specify sections of agreement; see §§11.122-11.123] \_\_, the Manager shall determine the salaries of all officers and agents of the Company.

[If applicable, add the following option]

[Option: Multiple managers for LLC]

4. **Duties and Powers of the Chair.** The Managers may, in their discretion, elect a Chair, who shall be a Manager. Unless otherwise determined by the Managers, the Chair shall preside at all meetings of the Members and the Managers, and shall exercise and perform such other powers and duties as may be from time to time assigned to the Chair by the Managers or prescribed by this Agreement.

[Continue]

5. **Duties and Powers of the Chief Executive Officer.** Subject to the supervision and control of the Manager, and such supervisory powers, if any, as the Manager may give to the Chair, the Chief Executive Officer shall

have general supervision, direction, and control of the business and affairs of the Company. In the absence of the Chair, the Chief Executive Officer shall preside at all meetings of the Members \_\_[and the Managers]\_\_. The Chief Executive Officer shall have general powers and duties of management usually vested in the office of chief executive officer of a corporation, and shall have such other powers and duties as the Manager or this Agreement may prescribe from time to time. The Chief Executive Officer shall be senior to the President.

**6. Duties and Powers of the President.** Subject to the supervision and control of the Manager and the Chief Executive Officer, the President shall be the general manager of the Company and shall have general supervision, direction, and control over the business and officers of the Company. In the absence of the Chair and the Chief Executive Officer, the President shall preside at all meetings of the Members \_\_[and the Managers]\_\_. The President shall have the general powers and duties of management usually vested in the office of president of a corporation, and shall have such other powers and duties as the Manager, the Chief Executive Officer, or this Agreement may prescribe from time to time. If the Company does not have a Chief Executive Officer, then the President shall exercise all powers and authority of the Chief Executive Officer.

**7. Duties and Powers of the Chief Operating Officer.** Subject to the supervision and control of the Chief Executive Officer and the President, the Chief Operating Officer shall have general and active management of the day-to-day operations of the Company. Except as otherwise specified or limited by the Manager, the Chief Executive Officer, or the President, the Chief Operating Officer shall have the general powers and duties of management usually vested in the office of a chief operating officer of a corporation, and shall have such other powers and duties as the Manager, the Chief Executive Officer, or the President may prescribe from time to time.

**8. Duties and Powers of the Vice President.** The Vice President, if there is one, or if there is more than one, the Vice Presidents in the order determined by the Manager, shall (a) in the absence or disability of the President, perform the duties and exercise the powers of the President, (b) in the absence or disability of the Chief Executive Officer and the President, perform the duties and exercise the powers of the Chief Executive Officer, and (c) perform such other duties and have such other powers as the Manager, the Chief Executive Officer, the President, or the Chief Operating Officer may prescribe from time to time.

**9. Duties and Powers of the Chief Financial Officer.** The Chief Financial Officer shall keep and maintain, or cause to be kept and maintained, adequate and correct books and records of accounts of the properties and business transactions of the Company, including accounts of its assets, liabilities, receipts, disbursements, gains, losses, capital, \_\_[Percentage Interests/Units,]\_\_ and Economic Interests. The books of account shall at all reasonable times be open to inspection by the Manager.

The Chief Financial Officer shall have the custody of the funds and securities of the Company, and shall keep full and accurate accounts of receipts and disbursements in the Company's books, and shall deposit all moneys and other valuable effects in the name and to the credit of the Company in such depositories as may be designated by the Manager.

The Chief Financial Officer shall disburse the funds of the Company as may be ordered by the Manager taking proper vouchers for such disbursements, and shall render to the Chief Executive Officer and the Manager an account of all such officer's transactions as Chief Financial Officer and of the financial condition of the Company.

The Chief Financial Officer shall have such other powers and duties as the Manager, the Chief Executive Officer, or the President may prescribe from time to time. Except as otherwise specified or limited by the Manager, the Chief Executive Officer, or the President, the Chief Financial Officer shall have the general duties, powers, and responsibility of a chief financial officer of a corporation, and shall be the chief financial and accounting officer of the Company.

If the Manager chooses to elect one or more assistant financial officers, the assistant financial officers in the order of their seniority shall, in the absence, disability, or inability to act of the Chief Financial Officer, perform the duties and exercise the powers of the Chief Financial Officer, and shall perform such other duties as the Manager, the Chief Executive Officer, the President, or the Chief Financial Officer may prescribe from time to time.

**10. Duties and Powers of the Secretary.** The Secretary shall attend all meetings of the Members \_\_[and the Managers]\_\_, and shall record all the proceedings of the meetings in a book to be kept for that purpose, and

shall perform like duties for the standing committees when required. The Secretary shall give, or cause to be given, notice of all meetings of the Members.

The Secretary shall keep, or cause to be kept, at the principal executive office or at the office of the Company's transfer agent or registrar, as determined by the Manager, a register, or a duplicate register, showing the names of all Members and their addresses, their Percentage Interests, \_\_[their number and type of Units,]\_\_ the number and date of certificates issued for the same, and the number and date of cancellation of every certificate surrendered for cancellation. The Secretary shall also keep all documents described in Section \_\_[specify section of agreement; see §11.157]\_\_ and such other documents as may be required under the Act. The Secretary shall have the general duties, powers, and responsibilities of a secretary of a corporation, and shall have such other powers and duties as the Manager, the Chief Executive Officer, or the President may prescribe from time to time.

If the Manager chooses to appoint one or more assistant secretaries, the assistant secretaries, in the order of their seniority, in the absence, disability, or inability to act of the Secretary, shall perform the duties and exercise the powers of the Secretary, and shall perform such other duties as the Manager, the Chief Executive Officer, the President, or the Secretary may prescribe from time to time.

**11. Signing Authority of the Officers.** Any officer is authorized to endorse checks, drafts, and other evidences of indebtedness made payable to the order of the Company for the purpose of deposit into the Company's accounts. The Manager shall, from time to time, designate the officers authorized to sign all checks, drafts, and other instruments obligating the Company to pay money. Subject to the restrictions in Section \_\_[specify section of agreement; see §11.118]\_\_ and any restrictions imposed by the Manager, all contracts and obligations on behalf of the Company shall be signed by the Chief Executive Officer, the President, or any Vice President, plus the Chief Financial Officer, the Secretary, or any Assistant Secretary, or by such other officer or officers that the Manager may, from time to time, designate.

*Comment:* A written operating agreement may provide for officers for either a manager-managed or a member-managed LLC. Corp C §17154. Notwithstanding any limitations in the operating agreement, any note, mortgage, evidence of indebtedness, contract, certificate, statement, conveyance, or other instrument in writing executed or entered into by an LLC when signed by the chair, the president, or any vice president and any secretary, any assistant secretary, the chief financial officer, or any assistant financial officer is binding against the LLC, unless the other party has actual knowledge that the persons signing on behalf of the LLC had no authority to sign the document. Corp C §17154(c).

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.125 10. Form: Limited Liability

## §11.125 10. Form: Limited Liability

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11.125-1 Limited liability

**J. *Limited Liability*.** No Manager or officer of the Company shall be personally liable for any debt, obligation, or liability of the Company, whether that liability or obligation arises in contract, tort, or otherwise, solely by reason of being a Manager or officer or both a Manager and an officer of the Company.

*Comment:* See Corp C §17158(a).

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.126 11. Form: Membership Interests or Units of Manager or Officer

**§11.126 11. Form: Membership Interests or Units of Manager or Officer**

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11.126-1 Membership interests or units of manager or officer

**K. \_\_[Membership Interests/Units]\_\_ of Manager or Officer. Except as otherwise provided in this Agreement, \_\_[Membership Interests/Units]\_\_ held by the Manager or officer as a Member shall entitle the Manager or officer to all the rights of a Member, including the economic, voting, information, and inspection rights of a Member.**

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## **G. Allocations of Net Profits and Net Losses and Distributions**

### **1. Allocations of Net Profits and Net Losses**

#### **§11.127 a. Form: Net Losses**

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11.127-1 Net losses

## **ARTICLE VI ALLOCATIONS OF NET PROFITS AND NET LOSSES AND DISTRIBUTIONS**

*[Add one of the following alternatives]*

*[Alternative 1: Short form of allocations of losses]*

**A. Net Losses.** All Net Losses shall be allocated to the Members in proportion to their respective Percentage Interests.

*[Alternative 2: Long form of allocations of losses]*

**A. Net Losses.** Net Losses shall be allocated to the Members as follows:

1. First, to the Members in proportion to their respective Percentage Interests, until each Member has been allocated Net Losses equal to the amount of Net Profits allocated to such Member under Section \_\_ *[specify section of agreement; see §11.128, alternative 2]* \_\_ (to the extent any allocation of Net Profits is offset under this Section, such Net Profits shall be disregarded for the purpose of computing subsequent allocations under this Section);

2. Second, to the Members in proportion to their respective positive Capital Account balances, until each of their Capital Account balances is reduced to zero; and

3. Thereafter, to the Members in proportion to their respective Percentage Interests.

*[Alternative 3: Priority in allocation of losses]*

**A. Net Losses.** Net Losses shall be allocated to the Members as follows:

1. First, to \_\_ *[names]* \_\_ in proportion to their respective percentages as set forth in Exhibit A \_\_ *[until* \_\_ *[describe contingency]* \_\_]; and

2. Thereafter, to the Members in proportion to their respective Percentage Interests.

## §11.128 b. Form: Net Profits

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11.128-2 Net profits

[Add one of the following alternatives]

[Alternative 1: Short form for net profits]

**B. Net Profits.** All Net Profits shall be allocated to the Members in proportion to their respective Percentage Interests.

[Alternative 2: Long form for net profits]

**B. Net Profits.** Net Profits shall be allocated to the Members as follows:

1. First, to the Members in proportion to their respective Percentage Interests, until each Member has been allocated Net Profits in an amount equal to the Net Losses allocated to such Member under Section \_\_ [specify section of agreement; see §11.127, alternative 2] \_\_ (to the extent any allocation of Net Losses is offset under this Section, such Net Losses shall be disregarded for the purpose of computing subsequent allocations under this Section);

2. Second, to the Members in proportion to their respective allocations of Net Losses previously allocated to such Member under Section \_\_ [specify section of agreement; see §11.127, alternative 2] \_\_, until each Member has been allocated Net Profits in an amount equal to the Net Losses allocated to such Member under that section (to the extent any allocation of Net Losses is offset under this Section, such Net Losses shall be disregarded for the purpose of computing subsequent allocations under this Section); and

3. Thereafter, to the Members in proportion to their respective Percentage Interests.

[Alternative 3: Priority in allocation of profits]

**B. Net Profits.** Net Profits shall be allocated to the Members as follows:

1. First, to \_\_ [names] \_\_ in proportion to their respective percentages as set forth in Exhibit A \_\_ [until \_\_ [describe contingency] \_\_]; and

2. Thereafter, to the Members in proportion to their respective Percentage Interests.

*Comment:* Corp C §17202 provides that profits and losses will be allocated among the members as set forth in the operating agreement. If the operating agreement is silent, then profits and losses will be allocated in proportion to the capital contributions of the members.

The provisions in §§11.127-11.128 may be modified to provide for preferential allocations of profits and losses to reflect the economic agreement among the members. For example, a member may wish to have a priority allocation of losses because the member's tax situation allows such member to benefit from the losses. Other members may want a priority allocation of profits because they believe that their contributions, or the timing of their contributions, entitle them to a priority. If certain members receive a priority allocation of profits, it may be advisable to place a limit on the priority allocations, such as until a certain date, until a milestone is reached, or until total aggregate priority allocations reach a stated amount. Alternatively, the priority allocations may be for a specific dollar amount or percentage of total profits each year, with the excess allocated in a non-priority manner.

The practitioner should examine the provisions regarding distributions so that allocations of net profits will correlate with distributions. See the form in §11.140 and the comments to the form.

Any allocation of profits and losses must have "substantive economic effect" under the IRS rules. See §11.23. If the practitioner is not an income tax expert, he or she should consult with a specialist.

**§11.129 c. Form: Loss Limitation**

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §11.48 and ends in §11.233

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11.129-1 Loss limitation

**C. Loss Limitation.** Despite Section \_\_ *[specify section of agreement; see §11.127]* \_\_, allocations of Net Losses to a Member shall be made only to the extent that such allocations will not create a deficit Capital Account balance for that Member in excess of an amount, if any, equal to the Member's share of Company Minimum Gain. Any Net Losses not allocated to a Member because of the foregoing provision shall be allocated to the other Members (to the extent the other Members are not limited in respect to the allocation of losses under this Section. Any Net Losses reallocated under this Section shall be taken into account in computing subsequent allocations of Net Profits and Net Losses under this Article VI, so that the net amount of any item so allocated and the Net Profits and Net Losses allocated to each Member under this Article VI, to the extent possible, shall be equal to the net amount that would have been allocated to each such Member under this Article VI if no reallocation of losses had occurred under this Section.

*Comment:* This provision, plus the "qualified income offset" provision in §11.136, are intended to comply with the alternative test for economic effect set forth in Treas Reg §1.704-1(b)(2), which is in lieu of the deficit restoration requirement. See §11.23.

**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.130 d. Form: Allocations Respecting Asset Distributions

### §11.130 d. Form: Allocations Respecting Asset Distributions

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §11.48 and ends in §11.233

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11.130-1 Allocations respecting asset distributions

**D. Allocations Respecting Asset Distributions.** Any unrealized appreciation or unrealized depreciation in the values of Company property distributed in kind to any of the Members shall be deemed to be Net Profits or Net Losses realized by the Company immediately prior to the distribution of the property, and the Company shall allocate such Net Profits or Net Losses as provided in this Section. Any property so distributed shall be treated as a distribution to the Members to the extent of the fair market value of the property, less the amount of any liability secured by and related to the property. Nothing contained in this Agreement is intended to treat or cause such distributions to be treated as sales for value. For the purposes of this Section, "unrealized appreciation" or "unrealized depreciation" shall mean the difference between the fair market value of such property and the Company's book basis for such property.

*Comment:* This provision is based on Treas Reg §§1.704-1(b)(2)(iv)(b) and 1.704-1(b)(2)(iv)(e).

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**§11.131 2. Form: Special Allocations**

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11.131-1 Special allocations

**E. *Special Allocations*. For the tax purposes only, the following provisions shall apply:**

*Comment:* If an LLC is classified as a partnership for income tax purposes (see §§11.5-11.6), nonrecourse deductions must be allocated among the members in accordance with their respective "interests in the LLC" as determined in Treas Reg §1.704-1(b), which is not strictly analogous to percentage interests. Treas Reg §1.704-2(b)(1). Allocations of nonrecourse deductions will be deemed in accordance with the members' interests in the LLC if (1) the operating agreement incorporates the "safe harbor" provisions of Treas Reg §1.704-1(b)(2), (2) allocations of nonrecourse deductions are reasonably consistent with allocations that have substantial economic effect of other significant LLC items attributable to property securing the nonrecourse liabilities, (3) the operating agreement contains a "minimum gain chargeback" provisions that complies with Treas Reg §1.704-2(f), and (4) all other material allocations and capital account adjustments are valid under Treas Reg §1.704-1(b). Treas Reg §1.704-2(e)(1). The provisions in §§11.130-11.134 are intended to comply with these requirements.

## §11.132 a. Form: Minimum Gain Chargeback

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §11.48 and ends in §11.233

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11.132-1 Minimum gain chargeback

**1. Minimum Gain Chargeback.** If there is a net decrease in Company Minimum Gain during any Fiscal Year, each Member shall be specially allocated items of Company income and gain for that Fiscal Year (and, if necessary, in subsequent fiscal years) in an amount equal to the portion of the Member's share of the net decrease in Company Minimum Gain that is allocable to the disposition of Company property subject to a Nonrecourse Liability, which share of such net decrease shall be determined in accordance with Treasury Regulations §1.704-2(g)(2). Allocations under this Section shall be made in proportion to the amounts required to be allocated to each Member under this Section. The items to be so allocated shall be determined in accordance with Treasury Regulations §1.704-2(f). This Section is intended to comply with the minimum gain chargeback requirement contained in Treasury Regulations §1.704-2(f) and shall be interpreted consistently with it.

*Comment:* Minimum gain is the amount of gain that would be realized by an LLC if it disposed of property subject to a nonrecourse liability for an amount equal to the outstanding balance of the nonrecourse liability. Treas Reg §1.704-2(d). Minimum gain increases as additional liability is incurred with respect to encumbered property, and as the adjusted basis of the property decreases, e.g., through depreciation. Treas Reg §1.704-2(b)(2). Minimum gain decreases when there is a decrease in the amount by which the nonrecourse liability exceeds the adjusted tax basis of the property encumbered by the liability. Treas Reg §1.704-2(b)(2). A minimum gain chargeback is an allocation of gain attributable to a decrease in partnership minimum gain. Allocations under a minimum gain chargeback must be made to the members that either were allocated nonrecourse deductions or received distributions of proceeds attributable to nonrecourse borrowing. Treas Reg §§1.704-2(b)(2), 1.704-2(f).

**§11.133 b. Form: Chargeback of Minimum Gain Attributable to Member Nonrecourse Debt**

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11.133-1 Chargeback of minimum gain

**2. Chargeback of Minimum Gain Attributable to Member Nonrecourse Debt.** If there is a net decrease in Company Minimum Gain attributable to a Member Nonrecourse Debt, during any Fiscal Year, each Member who has a share of the Company Minimum Gain attributable to such Member Nonrecourse Debt (which share shall be determined in accordance with Treasury Regulations §1.704-2(i)(5)) shall be specially allocated items of Company income and gain for such Fiscal Year (and, if necessary, in subsequent Fiscal Years) in an amount equal to that portion of such Member's share of the net decrease in Company Minimum Gain attributable to such Member Nonrecourse Debt that is allocable to the disposition of Company property subject to such Member Nonrecourse Debt (which share of such net decrease shall be determined in accordance with Treasury Regulations §1.704-2(i)(5)). Allocations under this Section shall be made in proportion to the amounts required to be allocated to each Member under this Section. The items to be so allocated shall be determined in accordance with Treasury Regulations §1.704-2(i)(4). This Section is intended to comply with the minimum gain chargeback requirement contained in Treasury Regulations §1.704-2(i)(4) and shall be interpreted consistently with it.

*Comment:* This provision applies when the LLC has nonrecourse debt, but a member bears the economic risk of the debt, such as when the member guarantees the debt. Only the member that bears the economic risk of a nonrecourse debt is subject to the "minimum gain chargeback." See Treas Reg §1.704-2(i)(4).

**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.134 c. Form: Nonrecourse Deductions

### §11.134 c. Form: Nonrecourse Deductions

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11.134-1 Nonrecourse deductions

**3. *Nonrecourse Deductions.* Any nonrecourse deduction (as defined in Treasury Regulations §1.704-2(b)(1)) for any Fiscal Year or other period shall be specially allocated to the Members in proportion to their respective allocation of Net Profits for such Fiscal Year.**

*Comment:* Nonrecourse deductions for the LLC are based on net increases in Company Minimum Gain (defined in §11.66).

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.135 d. Form: Member Nonrecourse Deductions

## **§11.135 d. Form: Member Nonrecourse Deductions**

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11.135-1 Member nonrecourse deductions

**4. Member Nonrecourse Deductions.** Those items of Company loss, deduction, or Internal Revenue Code §705(a)(2)(B) expenditures that are attributable to Member Nonrecourse Debt for any Fiscal Year or other period shall be specially allocated to the Member who bears the economic risk of loss with respect to the Member Nonrecourse Debt to which such items are attributable in accordance with Treasury Regulations §1.704-2(i).

*Comment:* See Comment in §11.131.

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## §11.136 e. Form: Qualified Income Offset

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11.136-1 Qualified income offset

**5. *Qualified Income Offset.*** If a Member unexpectedly receives any adjustment, allocation, or distribution described in Treasury Regulations §1.704-1(b)(2)(ii)(d)(4), (5), or (6), or any other event creates a deficit balance in such Member's Capital Account in excess of such Member's share of Company Minimum Gain, items of Company income and gain shall be specially allocated to such Member in an amount and manner sufficient to eliminate such excess deficit balance as quickly as possible. Any special allocations of items of income and gain under this Section shall be taken into account in computing subsequent allocations of income and gain under this Article VI so that the net amount of any item so allocated and the income, gain, and losses allocated to each Member under this Article VI to the extent possible, shall be equal to the net amount that would have been allocated to each such Member under the provisions of this Section if such unexpected adjustments, allocations, or distributions had not occurred.

*Comment:* This provision, plus the "loss limitation" provision in §11.129, are intended to comply with the alternative test for economic effect set forth in Treas Reg §1.704-1(b)(2), which is in lieu of the deficit restoration requirement. See §11.23.

### §11.137 3. Form: IRC §704(c) Allocations

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11.137-1 IRC §704(c) allocations

**F. Internal Revenue Code §704(c) Allocations.** Despite any other provision in this Article VI, in accordance with Internal Revenue Code §704(c) and the Treasury Regulations promulgated thereunder, all income, gain, loss, and deductions with respect to any property contributed to the capital of the Company shall, solely for tax purposes, be allocated among the Members so as to take account of any variation between the adjusted basis of such property to the Company for federal income tax purposes and its fair market value on the date of contribution. Allocations under this Section are solely for purposes of federal, state, and local taxes. As such, they shall not affect or in any way be taken into account in computing a Member's Capital Account or share of profits, losses, or other items of distributions under any provision of this Agreement.

*Comment:* For an LLC classified as a partnership for income tax purposes (see §§11.5-11.6), if members contribute assets that have a built-in gain or loss at the time of contribution, then the gain or loss with respect to such assets will be shared among the members so as to take into account the built-in gain or loss. IRC §704(c). The purpose is to prevent the shifting of tax consequences of such built-in gain or loss among the members. If the LLC sells the property with the built-in gain or loss, the gain or loss will be allocated to the member that contributed the property.

**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.138 4. Form: Allocation of Net Profits and Net Losses and Distributions in Respect of Transferred Interest

#### §11.138 4. Form: Allocation of Net Profits and Net Losses and Distributions in Respect of Transferred Interest

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11.138-1 Allocation of net profits and net losses and distributions in respect of transferred interest

**G. Allocation of Net Profits and Net Losses and Distributions in Respect of Transferred Interest.** If an Economic Interest is Transferred, or is increased or decreased by reason of the admission of a new Member or otherwise, during any Fiscal Year of the Company, Net Profits or Net Losses for such Fiscal Year shall be assigned to each day in the particular period of such Fiscal Year to which such item is attributable (*i.e.*, the day on or during which it is accrued or otherwise incurred) and the amount of each such item so assigned to any such day shall be allocated to the Member or Assignee based on such Member's or Assignee's Economic Interest at the close of such day.

However, for the purpose of accounting convenience and simplicity, the Company shall treat a Transfer of, or an increase or decrease in, an Economic Interest that occurs at any time during a semi-monthly period (commencing with the semi-monthly period including the date hereof) as having been consummated on the last day of such semi-monthly period, regardless of when during such semi-monthly period such transfer, increase, or decrease actually occurs (*i.e.*, sales and dispositions made during the first fifteen (15) days of any month will be deemed to have been made on the 15th day of the month).

Notwithstanding any provision above to the contrary, gain or loss of the Company realized in connection with a sale or other disposition of any of the assets of the Company shall be allocated solely to the Persons owning Economic Interests as of the date such sale or other disposition occurs.

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.139 5. Form: Compliance With Law and Regulations

## §11.139 5. Form: Compliance With Law and Regulations

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11.139-1 Compliance with law and regulations

**H. *Compliance with Law and Regulations.*** It is the intent of the Members that each Member's allocated share of Company income, gain, loss, deduction, and credit be determined in accordance with this Agreement to the fullest extent permitted by Internal Revenue Code §704(b)-(c) and the Treasury Regulations promulgated thereunder. Notwithstanding anything to the contrary contained in this Agreement, if the Company is advised that, as a result of the adoption of new or amended Treasury Regulations under Internal Revenue Code §704(b)-(c), or the issuance of authorized interpretations, the allocations provided in this Agreement are unlikely to be respected for federal income tax purposes, the Manager is hereby granted the power to amend the allocation provisions of this Agreement, on advice of accountants and legal counsel, to the minimum extent necessary to cause such allocation provisions to be respected for federal income tax purposes.

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## §11.140 6. Form: Distributions of Distributable Cash by the Company

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11.140-1 Distributions of distributable cash by the company

**I. Distributions of Distributable Cash by the Company.** Subject to applicable law and any limitations contained elsewhere in this Agreement, the Manager may elect from time to time to distribute Distributable Cash to the Members. The Company shall make all such distributions only to the Persons who, according to the books and records of the Company, are the holders of record of the Economic Interests in respect of which such distributions are made on the actual date of distribution. If a Member owes money to the Company, the Company may deduct the amount owed by the Member from the amount of any distribution, and apply such deduction against the amount owed. The Company shall make distributions in the following order of priority:

*[If applicable, add the following option]*

*[Option: Distribution for income tax]*

**1. First, to all Members in proportion to their respective Percentage Interests, an annual distribution to such Members on or before April 1 of each calendar year until each Member has received an amount sufficient to fund such Member's federal and state income taxes due with respect to allocations of Net Profits to such Member under Section \_\_ *[specify section of agreement]* \_\_ during the prior fiscal year, which amount shall be forty-four percent (44%) of such Net Profits allocated to such Member during the prior fiscal year. The Manager may adjust such percentage to reflect any change in the federal or state income tax rates.**

*[Continue]*

*[Add one of the following alternatives]*

*[Alternative 1: Percentage Interests]*

**[2.] \_\_ *[Thereafter, to/To]* \_\_ the Members in proportion to their respective Percentage Interests.**

*[Alternative 2: Priority return of capital contribution]*

**[2.] \_\_ *[Second, to/First, to]* \_\_ the Members in proportion to their respective Capital Contribution Account balances, until each of their Capital Contribution Account balances is reduced to zero; and**

**[3.] Thereafter, to the Members in proportion to their respective Percentage Interests.**

*[Alternative 3: Preferred interest on, and then priority return of, capital contribution]*

**[2.] \_\_ *[Second, to/First, to]* \_\_ the Members in proportion to their respective Capital Contribution Account balances, until each Member has received an amount equal to \_\_ *[specify percent]* \_\_ of the Member's Capital Contribution Account balance at the beginning of the Fiscal Year;**

**[3.] Next, to the Members in proportion to their respective Capital Contribution Account balances, until each of their Capital Contribution Account balances is reduced to zero; and**

**[4.] Thereafter, to the Members in proportion to their respective Percentage Interests.**

*Comment:* The Beverly-Killea Limited Liability Company Act provides that distributions to the members will be as provided in the operating agreement. If the operating agreement does not provide, then distributions that are a return of capital will be in proportion to the capital contributions by each member, and distributions that are not a return of capital will be in proportion to the allocation of profits. Corp C §17250. The Act gives the practitioner great flexibility in designating how distributions are to be made.

If used, the optional income tax provision should be first in the order of priority of distributions. The income tax provision is generally used when the members want to ensure that the manager distributes sufficient cash to fund the payment of taxes instead of using all profits to reinvest in the business, or when allocations of profits are not proportionate to distributions. The latter may occur when percentage interests are not proportionate to capital contributions, allocations of profits are according to percentage interests, and distributions are first to return capital contributions. The members that have a disproportionately higher percentage interest than capital contribution will receive allocations of profits but may not receive sufficient cash distributions to pay the resulting income taxes on such allocations. In addition, some practitioners limit distributions to pay income taxes only for allocations of income that represent cumulative profits and not for allocations that are to reverse prior allocations of loss, on the theory that the members have already received the income tax benefit of the prior losses. This assumes that the members independently have the cash flow to pay the taxes.

Alternative 1 should be used when the members' capital contributions are proportionate to percentage interests. Alternative 2 may be used when capital contributions are not proportionate to percentage interests and the members contributing substantially all of the capital want their contributions returned before all members share in the profits. Alternative 3 is the same as Alternative 2, but the members receive a preferred return on their capital contributions.

A great many variations of distribution provisions are possible, and these provisions may be adapted as the parties desire. A common variation, especially in the real estate field, is that distributions of profits from operations are pursuant to one set of provisions, while distributions based on loan proceeds or the sale of capital assets are pursuant to a different set of provisions.

The practitioner should examine the provisions regarding allocations of net profits and net losses in §§11.127-11.128 so that allocations of net profits will correlate with distributions. Because distributions will reduce the members' capital accounts, generally there will need to be corresponding allocations of net profits in the same proportions as distributions, so that some members do not deplete their capital accounts while the capital accounts of other members increase. For example, if members receive a priority return as in Alternative 3, then there should be matching allocations of net profits. However, in a situation in which capital contributions are not proportionate to percentage interests and the members that contributed substantially all of the capital want to receive a return of their capital before profits are distributed, then the members may desire to reduce the capital accounts of the members that contributed substantially all of the capital so that ultimately capital account balances will be commensurate with percentage interests. The practitioner may wish to discuss the provisions regarding allocations and distributions with a tax specialist.

## §11.141 7. Form: Form of Distributions

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §11.48 and ends in §11.233

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11.141-1 Form of distributions

**J. Form of Distributions. A Member, regardless of the nature of his, her, or its Capital Contribution, has no right to demand and receive any distribution from the Company in any form other than money. Except as provided in Section \_\_[specify section of agreement; see §11.167]\_\_, no Member may be compelled to accept from the Company a distribution of any asset in kind in lieu of a proportionate distribution of money being made to other Members and no Member may be compelled to accept a distribution of any asset in kind.**

*Comment:* This provision follows Corp C §17253. The statutory provision may be modified in the operating agreement.

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## §11.142 8. Form: Restrictions on Distributions

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11.142-1 Restrictions on distributions

### ***K. Restrictions on Distributions***

#### **1. *Distributions Prohibited.*** No distribution shall be made if, after giving effect to the distribution:

(a) The Company would not be able to pay its debts as they become due in the usual course of business; or

(b) The Company's total assets would be less than the sum of its total liabilities \_\_ *[plus the amount that would be needed, if the Company were to be dissolved at the time of the distribution, to satisfy the preferential rights of other members on dissolution that are superior to the rights of the member receiving the distribution]*\_\_.

**2. *Basis for Determination.*** The Manager may base a determination that a distribution is not prohibited on any of the following:

(a) Financial statements prepared on the basis of accounting practices and principles that are reasonable in the circumstances;

(b) A fair valuation; or

(c) Any other method that is reasonable in the circumstances.

**3. *Date of Effect of Distribution.*** Except as provided in Corporations Code §17254(e), the effect of a distribution is measured as of the date the distribution is authorized if the payment occurs within one hundred twenty (120) days after the date of authorization, or the date payment is made if it occurs more than one hundred twenty (120) days of the date of authorization.

**4. *Liability for Improper Distributions.*** A Member or Manager who votes for a distribution in violation of this Agreement or the Act is personally liable to the Company for the amount of the distribution that exceeds what could have been distributed without violating this Agreement or the Act if it is established that the Member or Manager did not act in compliance with this Section or Section \_\_ *[specify section of agreement; see §11.166]*\_\_. Any Member or Manager who is so liable shall be entitled to compel contribution from (a) each other Member or Manager who also is so liable, and (b) each Member or Assignee for the amount such Member or Assignee received with knowledge of facts indicating that the distribution was made in violation of this Agreement or the Act.

*Comment:* Subsections 1, 2, and 3 of this form follow Corp C §17254(a), (b), and (c). Subsection 4 of the form follows Corp C §17255(a)-(b).

**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.143 9. Form: Return of Distributions

## §11.143 9. Form: Return of Distributions

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §11.48 and ends in §11.233

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11.143-1 Return of distributions

**L. *Return of Distributions.*** Members who receive distributions made in violation of the Act or this Agreement shall return such distributions to the Company. Except for those distributions made in violation of the Act or this Agreement, no Member shall be obligated to return any distribution to the Company or pay the amount of any distribution for the account of the Company or to any creditor of the Company. The amount of any distribution returned to the Company by a Member or paid by a Member for the account of the Company or to a creditor of the Company shall be added to the Member's Capital Account from which it was subtracted when it was distributed to the Member.

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.144 10. Form: Obligations of Members to Report Allocations

## §11.144 10. Form: Obligations of Members to Report Allocations

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11.144-1 Obligations of members to report allocations

**M. *Obligations of Members to Report Allocations.* The Members are aware of the income tax consequences of the allocations made by this Article VI and agree to be bound by the provisions of this Article VI in reporting their shares of Company income and loss for income tax purposes.**

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.145 11. Form: Economic Interests

## §11.145 11. Form: Economic Interests

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11.145-1 Economic interests

**N. *Economic Interests*.** Only for the purposes of (1) determining allocations of Net Profits and Net Losses, (2) making distributions of Distributable Cash or other property, or (3) returning distributions, Economic Interests shall be deemed to be Membership Interests and references to Members shall include Assignees.

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/ H. Transfer of Membership Interests or Units/§11.146 1. Form: Transfer

## H. Transfer of Membership Interests or Units

### §11.146 1. Form: Transfer

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11.146-1 Transfer

### ARTICLE VII TRANSFER OF \_\_\_[MEMBERSHIP INTERESTS/UNITS]\_\_

**A. Transfer.** No Member shall be entitled to Transfer \_\_\_[a Membership Interest/any Units]\_\_ except with the prior written consent of \_\_\_[the Manager/a Majority Interest/all other Members/the Manager and a Majority Interest]\_\_, which consent may be given or withheld, conditioned, or delayed (as allowed by this Agreement or the Act), as the \_\_\_[Manager/Members]\_\_ may determine in the \_\_\_[Manager's/Members]\_\_ sole and absolute discretion. Transfers in violation of this Article VII shall only be effective to the extent set forth in Section \_\_\_[specify section of agreement; see §11.149]\_\_. After the consummation of any Transfer, the \_\_\_[Membership Interest/Units]\_\_ so Transferred shall continue to be subject to the terms and provisions of this Agreement and all further Transfers shall be required to comply with all the terms and provisions of this Agreement.

Without limiting the generality of the foregoing, the sale or exchange of at least fifty percent (50%) of the voting stock of a Member (whether by the sale or exchange of shares or by the issuance of new shares), if a Member is a corporation, or the transfer of an interest or interests of at least fifty percent (50%) in the capital or profits of a Member (whether by the sale or exchange of interests or by the admission of new partners or members), if a Member is a limited liability company, partnership, trust, or other entity, or the cumulative transfer of such shares or interests in a Member that effectively equal the foregoing (including transfer of interests followed by the incorporation of a Member and subsequent stock transfers, or transfers of stock followed by the liquidation of a Member and subsequent transfers of interests) will be deemed to constitute a Transfer subject to this Article VII.

*Comment:* Unless the articles of organization or the operating agreement provide otherwise, no membership interest may be assigned without the consent of a majority in interest of the members not transferring their interests. Corp C §17301(a). In addition to the alternatives for consents of the manager or members as provided, the operating agreement may provide that no consent is required for a transfer. However, some form of consent is usually advisable so that the manager or controlling members may ensure that no one who is not approved obtains a membership interest.

For discussion of transfers of membership interests and the rights of third party creditors against members of the LLC, see Forming and Operating California Limited Liability Companies §§12.8-12.10 (2d ed Cal CEB 2007).

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## §11.147 2. Form: Further Restrictions on Transfers

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11.147-1 Further restrictions on Transfers

**B. Further Restrictions on Transfers.** In addition to other restrictions found in this Agreement, no Member shall Transfer any \_\_[Membership Interest/Units]\_\_ (1) without compliance with federal and all applicable state securities laws, (2) without compliance with the notice, negotiation rights, and refusal rights contained in Sections \_\_[specify sections of agreement; see §§11.152 and 11.153]\_\_ , except (a) for a Transfer permitted under Section \_\_[specify section of agreement; see §11.149]\_\_ , or (b) by obtaining the prior written consent of all other Members, or (3) if the \_\_[Membership Interest/Units]\_\_ to be Transferred, when added to the total of all other \_\_[Membership Interests/Units]\_\_ Transferred in the preceding twelve (12) consecutive months, would cause the tax termination of the Company under Internal Revenue Code §708(b)(1)(B).

*Comment:* This provision is to ensure that any transfer complies with applicable securities laws, complies with the first negotiation and first refusal rights contained in the operating agreement (the clause may be deleted if the operating agreement does not provide for first negotiation and first refusal rights), and will not result in a tax termination of the LLC. A tax termination will occur if within a 12-month period there is a sale or exchange of 50 percent or more of the total interest in capital and profits. IRC 708(b)(1)(B).

### §11.148 3. Form: Substitution of Members

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §11.48 and ends in §11.233

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11.148-1 Substitution of members

**C. Substitution of Members.** An Assignee of an Interest shall have the right to become a substitute Member only if the Assignee (1) meets the requirements of Sections \_\_[specify section of agreement; see §§11.146-11.147]\_\_, (2) executes an instrument satisfactory to the Manager accepting and adopting the terms and provisions of this Agreement, and (3) pays all reasonable expenses in connection with the Assignee's admission as a new Member. The admission of an Assignee as a substitute Member shall not release the Member who Transferred the \_\_[Membership Interest/Units]\_\_ from any liability that the Member may have to the Company.

*Comment:* Unless the articles of organization or the operating agreement provide otherwise, an assignee may become a member only on the approval of a majority in interest of the members. Corp C §17303(a).

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.149 4. Form: No Effect to Transfers in Violation of This Agreement

#### §11.149 4. Form: No Effect to Transfers in Violation of This Agreement

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11.149-1 No effect to transfers in violation of this agreement

**D. No Effect to Transfers in Violation of This Agreement.** On any Transfer of \_\_ \_\_[a Membership Interest/Units]\_\_ in violation of Section \_\_ \_\_[specify section of agreement; see §11.146]\_\_ \_\_, the transferee shall have no right to vote or participate in the management of the business, property, and affairs of the Company or to exercise any rights of a Member. Such transferee shall only be entitled to become an Assignee and thereafter shall only receive the applicable share of the Company's Net Profits, Net Losses, and distributions of the Company's assets to which the transferor of such Economic Interest would otherwise be entitled. Notwithstanding the immediately preceding sentences, if the Company determines that a Transfer is in violation of Sections \_\_ \_\_[specify section of agreement; see §§11.147, 11.152, and 11.153]\_\_ \_\_, then the Transfer shall be null and void and the purported transferee shall become neither a Member nor an Assignee.

*Comment:* The first two sentences of this provision follow Corp C §17301(a)(2)-(a)(3).

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## §11.150 5. Form: Permitted Transfers

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11.150-1 Permitted transfer

**E. Permitted Transfers.** Without compliance with Sections \_\_ \_\_ [specify sections of agreement; see §§11.146, 11.152, and 11.153]\_\_ \_\_, a Member may Transfer \_\_ \_\_ [a Membership Interest/Units]\_\_ \_\_ (1) to any other Member, subject to compliance with Section \_\_ \_\_ [specify section of agreement; see §11.147]\_\_ \_\_, (2) to the Company, (3) to a revocable inter vivos trust of which the Member is a settlor, the Member is a trustee and the only other trustee, if any, is the Member's spouse, and the Member is a primary beneficiary and the only other primary beneficiary, if any, is the Member's spouse, subject to compliance with Section \_\_ \_\_ [specify section of agreement; see §11.147]\_\_ \_\_, and (4) by bequest, devise, or otherwise in connection with the death of the Member, subject to compliance with Section \_\_ \_\_ [specify section of agreement; see §11.147]\_\_ \_\_, any Transfer subject to clauses (3) and (4) of this Section, the transferee shall, as a condition of such Transfer, execute and deliver to the Company an instrument satisfactory to the Manager accepting and adopting the terms and provisions of this Agreement.

*Comment:* This provision may be modified to suit the members' needs. The drafter may select some or all of the permitted transfers that are contained in this provision, or may add additional permitted transfers as circumstances dictate. As written, permitted transfers do not require any approval. If desired, some or all of the permitted transfer may require the consent of the manager, which should not be unreasonably withheld. In addition, the provision as written allows the transfer of membership interests as a permitted transfer. This may be modified so that only economic interests are transferred in a permitted transfer and not membership interests.

## §11.151 6. Form: Rights of Legal Representatives

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §11.48 and ends in §11.233

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11.151-1 Rights of legal representatives

**F. *Rights of Legal Representatives.*** If a Member who is an individual dies or is adjudged by a court of competent jurisdiction to be incompetent to manage the Member's person or property, the Member's executor, administrator, guardian, conservator, or other legal representative may exercise all of the Member's rights for the purpose of settling the Member's estate or administering the Member's property. If a Member is a corporation, limited liability, partnership, trust, or other entity and is dissolved or terminated, the powers of that Member may be exercised by its legal representative or successor.

*Comment:* See Corp C §17304.

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## §11.152 7. Form: Right of First Negotiation

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11.152-1 Right of first negotiation

**G. Right of First Negotiation.** If a Member wants to Transfer \_\_ *[a Membership Interest/Units]* \_\_ other than under Section \_\_ *[specify section of agreement; see §11.150]* \_\_, then the Selling Member shall give written notice to the Company and all other Members. For thirty (30) days thereafter, the Selling Member shall negotiate with the Members and the Company for the sale of the Selling Member's \_\_ *[Membership Interest/Units]* \_\_. During such period, the Selling Member shall not solicit any third Person for the Transfer of the \_\_ *[Membership Interest/Units]* \_\_.

*Comment:* This provision is optional, and may be used when appropriate.

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## §11.153 8. Form: Right of First Refusal

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11.153-1 Right of first refusal

**[H.] Right of First Refusal.** If a Member proposes to Transfer \_\_[a Membership Interest/Units]\_\_ (including by operation of law or other involuntary Transfer) other than under Section \_\_[specify section of agreement; see §11.150]\_\_, then in addition to complying with the provisions of Sections \_\_[specify sections of agreement; see §§11.146-11.147 and 11.152]\_\_, the Selling Member shall first offer the \_\_[Membership Interest/Units]\_\_ to the Company and the non-Transferring Members in accordance with the following provisions:

**1. Selling Member's Notice.** The Selling Member shall deliver a written notice (the "Selling Member's Notice") to the Company. The Selling Member's Notice shall name the proposed transferee, shall specify the \_\_[Membership Interest/number of Units]\_\_ to be Transferred, the purchase price, the terms of payment, and all other terms and conditions of the proposed Transfer, and shall be accompanied by the proposed instrument of Transfer and the offer or proposed agreement of sale between the Selling Member and the proposed transferee, which agreement shall contain the agreement of the proposed transferee to become a party to this Agreement on the consummation of the purchase of the \_\_[Membership Interest/Units]\_\_ to be Transferred.

**2. Noncash Consideration.** If the purchase price of the \_\_[Membership Interest/Units]\_\_ to be Transferred is to be all or in part an exchange for property other than cash, then such purchase price shall be deemed an offer for cash to the extent of the fair market value of such noncash portion of the purchase price as determined by the Company Accountants, which determination shall be conclusive and binding on all parties. The Selling Member shall pay the costs and expenses of the Company Accountants in making such determination of fair market value.

**3. The Company's Option.** On receipt of the Selling Member's Notice, the Company shall have the Company Accountants determine the fair market value of the noncash portion of the purchase price, if any, under \_\_[specify section of agreement]\_\_. When the Company Accountants have determined the purchase price, the Company shall notify the Selling Member in writing. For thirty (30) days after (a) the date that the Company receives the Selling Member's Notice if there is no noncash portion of purchase price, or (b) the date that the Company receives the Company Accountants' determination of the fair market value of the noncash portion of the purchase price if there is any noncash portion of the purchase price, the Company shall have the option to purchase all but not less than all of the \_\_[Membership Interest/Units]\_\_ to be Transferred at the purchase price and on the terms set forth in the Selling Member's Notice, including the fair market value of any noncash portion of the purchase price. The Company shall exercise such option by delivering a written notice of exercise to the Selling Member within the thirty (30)-day period.

**4. Notice to the Non-Transferring Members.** If the Company does not exercise its option within the applicable time period, then the Selling Member shall provide the non-Transferring Members with a copy of the Selling Member's Notice, together with written notice that the Company has not exercised its option and, if applicable, the Company Accountants' determination of the fair market value of the noncash portion purchase price.

**5. Non-Transferring Members' Option to Purchase.** For thirty (30) days following each non-Transferring Members' receipt of the Selling Member's Notice, the non-Transferring Members shall have the option to purchase all but not less than all of the \_\_[Membership Interest/Units]\_\_ to be Transferred at the purchase price and on the terms set forth in the Selling Member's Notice, including the fair market value of any noncash portion of the purchase price. The non-Transferring Members shall exercise such option by delivering a written notice of exercise to the Company. Each purchasing Member shall purchase that portion of the \_\_[Membership Interest/Units]\_\_ to be Transferred represented by a fraction, the numerator of which is the \_\_[Percentage Interest/number of Units]\_\_ owned by the purchasing Member, and the denominator of which is the \_\_[Percentage Interest/number of Units]\_\_ owned by all purchasing Members. The purchasing Members may

agree amongst themselves to reallocate the \_\_[Membership Interest/Units]\_\_ to be purchased by each of them, as long as all of the Selling Member's \_\_[Membership Interest/Units]\_\_ to be Transferred are purchased. The Company shall deliver a written notice of the purchasing Members' election to exercise and the number of \_\_[Membership Interest/Units]\_\_ to be purchased by each to the Selling Member and the purchasing Members.

**6. Sale of the \_\_[Membership Interest/Units]\_\_ to Be Transferred to the Company or the Purchasing Members.** The closing of the sale to the Company or the purchasing Members of the Selling Member's \_\_[Membership Interest/Units]\_\_ to be Transferred shall take place within thirty (30) days after receipt by the Selling Member of the written notice of the exercise of the option by the Company or the purchasing Members, as applicable. The Selling Member and the Company or the purchasing Members shall execute all documents and make all deliveries as may be reasonably required to consummate such purchase.

**7. Sale to Third Party.** In the event that the Company and the non-Transferring Members do not elect to exercise their options to purchase all of the \_\_[Membership Interest/Units]\_\_ to be Transferred, then the Selling Member may sell the \_\_[Membership Interest/Units]\_\_ to be Transferred to the proposed transferee named in the Selling Member's Notice under the instrument of transfer and agreements and conditions specified in the Selling Member's Notice, or for such other purchase price or on such other terms and conditions that are not more favorable to the proposed transferee than as specified in the Selling Member's Notice; provided that on the closing of such sale, the transferee must become a party to this Agreement and agree to be bound by its provisions; the Transfer must comply with the provisions of Sections \_\_[specify sections of agreement; see §§11.146-11.147]\_\_; and provided further that such sale must close within thirty (30) days after the expiration of the time period for the non-Transferring Members to exercise their purchase option. If the Selling Member does not close the sale within such time, then the Selling Member may not Transfer any \_\_[Membership Interest/Units]\_\_ without first complying with the provisions of this Section. Each Member hereby acknowledges that compliance with this Section does not modify any of the other Transfer restrictions in this Article VII or otherwise entitle a Member to Transfer \_\_[Membership Interest/Units]\_\_ other than in the manner prescribed by this Article VII.

*Comment:* This provision is optional, and may be used when appropriate. This provision requires that the LLC or the other members purchase all of the membership interest that is to be sold. It may be modified to allow purchase of only a portion of the interest, but such a modification is generally considered to be harsh on the selling member. The third party purchaser may not be willing to consummate the purchase for less than all of the selling member's interest, and in that event the selling member would remain as a member, but with a smaller interest having sold a portion to the LLC or the other members.

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## §11.154 9. Form: Sale of the Company

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11.154-1 Sale of the company

### [I.] *Sale of the Company.*

**1. Mandatory Sale.** In the event that a Majority Interest elects to accept an offer from an unrelated third party purchaser to purchase all of the outstanding \_\_[Membership Interests/Units]\_\_, then the Majority Interest shall give written notice to the other Members setting forth the purchase price, the payment terms, and all other terms and conditions of such sale. All Members shall then sell their \_\_[Membership Interests/Units]\_\_ to the same purchaser, for the same purchase price, including the same type and percentage of noncash consideration, if any, and on the same terms and conditions as the \_\_[Membership Interests/Units]\_\_ sold by the Majority Interest. The provisions of Sections \_\_[specify sections of agreement; see §§11.146-11.147, 11.152-11.153]\_\_ shall not apply to any such sale.

**2. Mandatory Purchase.** In the event that a Majority Interest elects to accept an offer from one or more third party purchasers to purchase some or all of the \_\_[Membership Interests/Units]\_\_ owned by the Majority Interest in one transaction or a series of related transactions, such that the \_\_[Percentage Interest/number of Units]\_\_ being purchased represents at least a majority of the outstanding \_\_[Percentage Interests/Units]\_\_, the Majority Interest shall promptly give a Selling Member's Notice to each other Member. Each other Member shall have fifteen (15) days from receipt of the Selling Member's Notice to notify the Majority Interest that the Member requires that the purchaser purchase from the Member the same percentage of the Member's \_\_[Membership Interest/Units]\_\_ as are being purchased from the Majority Interest for the same purchase price, including the same type and percentage of noncash consideration, if any, and on the same terms and conditions as the \_\_[Membership Interests/Units]\_\_ sold by the Majority Interest. The provisions of Sections \_\_[specify sections of agreement]\_\_ shall not apply to any such sale.

**3. Asset Sale or Merger.** In the event that the Company accepts an offer from an unrelated third party to purchase substantially all of the Company's operating assets, or to consummate a merger or other form of reorganization with the Company where the Company is not the surviving entity, and if a Majority Interest approves of such sale, merger, or reorganization, then all Members shall vote their \_\_[Membership Interests/Units]\_\_ in approval of such transaction and no Member shall exercise any dissenter's rights, provided that, in the event of a merger or reorganization, all Members receive the same purchase price, including the same type and percentage of noncash consideration, if any, and on the same terms and conditions as the \_\_[Membership Interests/Units]\_\_ tendered by the Majority Interest. The provisions of Sections \_\_[specify sections of agreement]\_\_ shall not apply to any such merger or reorganization.

*Comment:* These provisions are optional, and some or all may be used when appropriate. Mandatory sale, or "drag along," rights allow the majority to sell the entire LLC without the concern of a potential holdout. Mandatory purchase, or "tag along," rights allow the minority to participate in a significant sale of membership interests by the majority. The asset sale or merger provision allows the majority to complete a sale of assets or merger without the concern of a holdout.

**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.155 10. Form: Economic Interests

## §11.155 10. Form: Economic Interests

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §11.48 and ends in §11.233

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11.155-1 Economic interests

**[J.] *Economic Interests.* Any Transfer of an Economic Interest shall be subject to the restrictions and obligations set forth in this Article VII, but no Assignee shall have any purchase rights under Sections \_\_[specify section of agreement; see §§11.152-11.153]\_\_ or sale rights under Sections \_\_[specify section of agreement; see §11.154]\_\_.**

*Comment:* Because most of the provisions regarding transfer discuss membership interests and not economic interests, this provision clarifies that the same restrictions apply to economic interests.

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.156 11. Optional Provisions

§11.156 11. Optional Provisions

Depending on the circumstances, additional provisions may be added to the operating agreement regarding the purchase, sale, and transfer of membership interests. Provisions that are customary in a buy-sell agreement may be added, such as purchase of membership interests on the death, disability, or retirement of a member. Such purchases are usually at fair market value, and a procedure for appraisal is needed if the parties cannot agree on price.

The operating agreement may allow the purchase of a membership interest in the event a membership interest is taken by judicial process or levy, a member divorces and the non-member spouse receives a membership interest, a member violates an obligation to keep the LLC's confidential information confidential, or the LLC terminates for cause the employment of a member who is an employee of the LLC. The purchase of the membership interest in these events is generally considered punitive in nature, and the purchase price may be at book value, the price that the member originally paid for the membership interest (or even such price less all distributions), or a percentage of fair market value.

The operating agreement may provide for the purchase of a membership interest of a member that is an employee of the LLC if the member terminates the employment, or if the LLC terminates the employment not for cause. To provide an incentive for the employee-member to remain an employee, in a manner similar to employee stock options, the right to purchase may lapse for a portion of the membership interest each year for a number of years, or the right to purchase at a discount price instead of fair market value may lapse for a portion of the membership interest each year for a number of years. There are significant income tax consequences for a membership interest that is subject to a risk of forfeiture (a purchase at less than fair market value) and the lapse of such risk. If he or she does not fully understand these consequences, the practitioner should consult with an income tax specialist.

Another option is a buy-out or "put-call" provision. This is best used when there are only a few members. If the members have a substantial difference of opinion and cannot effectively continue as members, then one member initiates the process by giving notice to the other member, including an estimate of the value of the LLC. The second member then has the option to either purchase the first member's membership interest at the price or sell the member's membership interest to the first member at the price.

The members also may desire to impose a covenant not to compete on a member when the member's interest is purchased by the LLC or the other members. The member on whom the covenant is imposed must sell the member's entire membership interest, and must receive the goodwill associated with the membership interest. Bus & P C §16601. Receiving goodwill is generally interpreted to mean that the member must receive the fair market value of the membership interest. If the operating agreement allows for the purchase of a membership interest at a discounted price, the purchasers should have the option to pay fair market value for the membership interest and to impose the covenant not to compete on the selling member. The covenant must be limited to a specified geographic area, which is generally where the LLC carries on its business. The covenant must also be for a reasonable duration.

For further information and sample provisions, see Business Buy-Sell Agreements (Cal CEB 1991).

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## I. Accounting, Records, Reporting by Members

### §11.157 1. Form: Books and Records

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §11.48 and ends in §11.233

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11.157-1 Books and records

## ARTICLE VIII ACCOUNTING, RECORDS, REPORTING BY MEMBERS

*[Add one of the following alternatives]*

*[Alternative 1: Short form of company obligation to keep books and records]*

**A. Books and Records.** The Company shall keep its books and records, and shall record its financial position and the results of its operations, in accordance with the accounting methods followed for federal income tax purposes. The books and records of the Company shall reflect all the Company transactions and shall be appropriate and adequate for the Company's business. The Company shall maintain at its principal office in California all of the records that it is required to maintain under Corporations Code §17058. Members and Assignees shall have the right to inspect and receive copies of the records set forth in Corporations Code §17106.

*[Alternative 2: Long form of company obligation to keep books and records]*

**A. Books and Records.** The Company shall keep its books and records, and shall record its financial position and the results of its operations, in accordance with the accounting methods followed for federal income tax purposes. The books and records of the Company shall reflect all the Company transactions and shall be appropriate and adequate for the Company's business. The Company shall maintain at its principal office in California all of the following:

1. A current list of the full name and last known business or residence address of each Member and Assignee set forth in alphabetical order, together with the Capital Contributions, Capital Account,      *[number of Units,]*      and Percentage Interest of each Member and Assignee;
2. A current list of the full name and business or residence address of the Manager;
3. A copy of the Articles and any and all amendments to them together with executed copies of any powers of attorney under which the Articles or any amendments have been executed;
4. 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;
5. A copy of this Agreement and any and all amendments to them together with executed copies of any powers of attorney under which this Agreement or any amendments have been executed;
6. Copies of the financial statements of the Company, if any, for the six (6) most recent Fiscal Years; and
7. 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.

### **B. Delivery to Members and Inspection.**

1. On the request of any Member or Assignee for purposes reasonably related to the interest of that Person as a Member or Assignee, the Manager shall promptly deliver to the requesting Member or Assignee, at the

expense of the Company, a copy of the information required to be maintained under Section A of this Article VIII and copies of the Articles and this Agreement.

2. Each Member, Manager, and Assignee has the right, on reasonable request for purposes reasonably related to the interest of the Person as Member, Manager, or Assignee, to:

(a) Inspect and copy during normal business hours any of the Company records described in *Section 8.1* \_\_[see §11.157]\_\_; and

(b) Obtain from the Manager, promptly after their becoming available, a copy of the Company's federal, state, and local income tax or information returns for each Fiscal Year.

3. If the Company has more than thirty-five (35) Members, then Members representing at least five percent (5%) of the outstanding \_\_[Percentage Interests/Units]\_\_, or three (3) or more Members, may request from the Manager an income statement of the Company for the initial three (3)-month, six (6)-month, or nine (9)-month period of the current Fiscal Year that ended more than thirty (30) days prior to the date of the request, and a balance sheet of the Company as of the end of that period. Such statements shall be accompanied by the report, if any, of the independent accountants engaged by the Company or, if there is no report, the certificate of the Manager or the Chief Financial Officer that the statements were prepared without audit from the books and records of the Company. If so requested, the statements shall be delivered or mailed to the Members within thirty (30) days thereafter.

4. Any request, inspection, or copying by a Member or Assignee under this Section may be made by that Person or that Person's agent or attorney.

5. The Manager shall promptly furnish to a Member a copy of any amendment to the Articles or this Agreement executed by the Manager under a power of attorney from the Member.

6. Within forty-five (45) days after the end of each fiscal quarter, the Manager shall furnish each Member with financial statements prepared by the Company, including a balance sheet of the Company as at the end of the fiscal quarter and an income statement for such period. Within forty-five (45) days after the end of each fiscal quarter, the Manager shall furnish each Member with a statement of any change in the compensation of the Manager or the Chief Executive Officer during that fiscal quarter.

*Comment:* Corporations Code §17057(a) requires that an LLC continuously maintain the records specified in Corp C §17058(a) at an office in California. These items are listed in Alternative 2, Section A of this form.

Alternative 2, Section B, subsections 1-5 are based on Corp C §17106. These rights to obtain information may not be varied by the operating agreement (Corp C §17005(b)(4)), and any waiver of such rights is unenforceable (Corp C §17106(h)). Alternative 2, Section B, subsection 6 is an optional clause to require the LLC to provide information to the members in addition to the statutory requirements. This provision may be modified or deleted as circumstances require.

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## §11.158 2. Form: Annual Statements

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11.158-1 Annual statements

### **[C.] Annual Statements.**

**1. If the Company has more than thirty-five (35) Members, the Manager shall cause an annual report to be sent to each of the Members not later than one hundred twenty (120) days after the close of the Fiscal Year. The report shall contain a balance sheet as of the end of the Fiscal Year and an income statement and statement of changes in financial position for the Fiscal Year. Such financial statements shall be accompanied by the report, if any, of the independent accountants engaged by the Company or, if there is no report, the certificate of the Manager or the Chief Financial Officer that the financial statements were prepared without audit from the books and records of the Company.**

**2. The Company shall annually prepare, at its expense, the information necessary for the Members and Assignees to prepare federal and state income tax returns. The Company shall send to each Member or Assignee within ninety (90) days after the end of each taxable year such information as is necessary to complete federal and state income tax or information returns, together with a copy of the Company's federal, state, and local income tax or information returns for that year, and, if the Company has thirty-five (35) or fewer Members, a copy of the Company's federal, state, and local income tax or information returns for that year.**

**3. The Company shall file an information statement at least biannually with the California Secretary of State as required under Corporations Code §17060.**

*Comment:* Subsections (1), (2), and (3) are based on, respectively, Corp C §§17106(c)(1) and (c)(3), 17106(e), and 17060. The rights to receive information in subsections (1) and (2) may not be varied by the operating agreement (Corp C §17005(b)(4)), and any waiver of such rights is unenforceable (Corp C §17106(h)). For the Statement of Information, see the form in §11.46.

**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.159 3. Form: Financial and Other Information

### §11.159 3. Form: Financial and Other Information

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11.159-1 Financial and other information

**[D.] *Financial and Other Information.*** The Manager shall provide such financial and other information relating to the Company or any other Person in which the Company owns, directly or indirectly, an equity interest, as a Member may reasonably request. The Manager shall distribute to the Members, promptly after the preparation or receipt of it by the Manager, any financial or other information relating to any Person in which the Company owns, directly or indirectly, an equity interest, including any filings by such Person under the Securities Exchange Act of 1934, as amended, that is received by the Company with respect to any equity interest of the Company in such Person.

*Comment:* This provision may be modified or deleted as circumstances dictate.

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## §11.160 4. Form: Filings

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11.160-1 Filings

**[E.] Filings.** The Manager, at the Company's expense, shall cause the income tax returns for the Company to be prepared and timely filed with the appropriate authorities. The Manager, at the Company's expense, shall also cause to be prepared and timely filed, with appropriate federal and state regulatory and administrative bodies, amendments to, or restatements of, the Articles and all reports required to be filed by the Company with those entities under the Act or other applicable laws, rules, and regulations. If the Manager fails, within a reasonable period of time after demand, or refuses to execute or file any document required by the Act, any Member \_\_\_\_, *on approval of a Majority Interest,* \_\_\_\_, may prepare, execute, and file that document with the California Secretary of State.

*Comment:* The last sentence follows Corp C §17650(a). It is advisable to require approval of the members before allowing another member to file documents with the Secretary of State.

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**§11.161 5. Form: Bank Accounts**

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11.161-1 Bank accounts

**[F.] *Bank Accounts.*** The Company shall maintain its funds in one or more separate bank accounts in its own name, and shall not permit its funds to be commingled in any fashion with the funds of any other Person. The Manager is authorized to endorse checks, drafts, and other evidences of indebtedness made payable to the order of the Company for the purpose of deposit into the Company's accounts, and subject to Section \_\_[specify section of agreement; see §11.118]\_\_, is authorized to sign all checks, drafts, and other instruments obligating the Company to pay money.

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.162 6. Form: Accounting Decisions and Reliance on Others

## **§11.162 6. Form: Accounting Decisions and Reliance on Others**

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11.162-1 Accounting decisions

**[G.] *Accounting Decisions and Reliance on Others.* All decisions as to accounting matters, except as otherwise specifically set forth in this Agreement, shall be made by the Manager. The Manager may rely on the advice of the Company's accountants as to whether such decisions are in accordance with accounting methods followed for federal income tax purposes.**

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.163 7. Form: Tax Matters for the Company Handled by the Tax Matters Member

## §11.163 7. Form: Tax Matters for the Company Handled by the Tax Matters Member

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §11.48 and ends in §11.233

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11.163-1 Tax matters for the company handled by the tax matters member

**[H.] Tax Matters for the Company Handled by the Tax Matters Member.** The Tax Matters Member shall from time to time cause the Company to make such tax elections as the Tax Matters Member deems to be in the best interests of the Company and the Members. The Tax Matters Member shall represent the Company (at the Company's expense) in connection with all examinations of the Company's affairs by tax authorities, including any judicial or administrative proceeding, and may enter into settlement agreements with such tax authorities, which settlement agreements shall be binding on the Members. The Tax Matters Member may expend the Company's funds for professional services and associated costs. The Tax Matters Member shall oversee the Company's tax affairs in the overall best interests of the Company but shall not have the right to agree to extend any statute of limitations without the approval of a Majority Interest. If for any reason the Tax Matters Member can no longer serve in that capacity or ceases to be a Member, the Members may designate another to be Tax Matters Member provided that the Tax Matters Member is a Member.

*Comment:* The tax matters member must be a member. For a manager-managed LLC, any manager who is also a member may be designated the tax matters member. If no manager is also a member, then a member must be designated as the tax matters member. For a member-managed LLC, any member may be designated as the tax matters member. Treas Reg §301.6231(a)(7)-2. The tax matters member receives notice from the IRS and represents the LLC in tax matters before the IRS. IRC §§6223-6231. In general, an agreement made by the tax matters member with the IRS regarding the taxes of an LLC is binding on all of the members. IRC §6224(c)(3).

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## **J. Dissolution and Winding Up**

### **§11.164 1. Form: Dissolution**

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §11.48 and ends in §11.233

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11.164-1 Dissolution

## **ARTICLE IX DISSOLUTION AND WINDING UP**

**A. *Dissolution.*** The Company shall be dissolved, its assets shall be disposed of, and its affairs wound up on the first to occur of the following:

- 1. At the time or on the happening of any event of dissolution specified in the Articles, if any;**
- 2. The approval of \_\_[a Super Majority/a Majority Interest/all of the Members]\_\_;**
- 3. The entry of a decree of judicial dissolution under Corporations Code §17351; or**

**4. The sale of all or substantially all of the assets of Company, unless a Majority Interest elects to continue the existence of the Company.**

*Comment:* Subsections 1 through 3 are specified in Corp C §17350. Others, such as subsection 4, may be added as appropriate. The vote to approve dissolution of an LLC may be greater than a majority interest if contained in the articles of organization or a written operating agreement (Corp C §17350(b)), but may not be less than a majority interest (Corp C §§17005(b)(3), 17103(c)).

Note that the articles of organization or a written operating agreement may vary the provisions in the Beverly-Killea Limited Liability Company Act for dissolution only to the extent allowed in such provisions. Corp C §17005(c).

**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.165 2. Form: Winding Up

## §11.165 2. Form: Winding Up

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11.165-1 Winding up

**B. *Winding Up.*** On the dissolution of the Company as set forth in Section A of this Article IX the Company shall continue solely for the purpose of winding up its affairs in an orderly manner, liquidating its assets, and satisfying the claims of its creditors. The Manager, or if the Manager wrongfully dissolved the Company then the Members, shall be responsible for overseeing the winding up and liquidation of Company, shall take full account of the liabilities of Company and assets, shall either cause its assets to be sold or distributed, and if sold as promptly as is consistent with obtaining its fair market value, shall cause the proceeds, to the extent sufficient, to be applied and distributed as provided in Section C of this Article IX. The Company shall give written notice of the commencement of the dissolution to all of its known creditors. The Manager or Members winding up the affairs of the Company shall be entitled to reasonable compensation for their services.

*Comment:* This clause is based on Corp C §§17352(a), (c) and 17354(a). Those statutes govern winding up of an LLC's affairs.

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### §11.166 3. Form: Order of Payment on Dissolution

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11.166-1 Order of payment on dissolution

**C. Order of Payment on Dissolution.** After determining that all the known debts and liabilities of the Company have been paid or adequately provided for, including but not limited to all debts and liabilities owed to Members, the remaining assets shall be distributed to the Members in accordance with their positive Capital Account balances after taking into account allocations of Net Profit and Net Losses for the Company's taxable year during which liquidation occurs. Such liquidating distributions shall be made by the end of the Company's taxable year in which the Company is liquidated, or, if later, within ninety (90) days after the date of such liquidation.

*Comment:* Unless the articles of organization or a written operating agreement provide otherwise, after all known debts and liabilities have been paid or adequately provided for, the remaining assets must be distributed (Corp C §17353(a)):

- To the members in satisfaction of liabilities for distributions under Corp C §17201, §17202, or §17255;
- To the members for the return of their capital contribution; and
- To the members in the proportion in which they share distributions.

As discussed in §11.23, the "safe harbor" provisions of Treas Reg §1.704-1(b)(2) require that liquidating distributions be made in accordance with positive capital account balances. Treas Reg §1.704-1(b)(2)(ii)(b)(2). Therefore, an operating agreement that intends to comply with the "safe harbor" provisions should follow the sample provision and not the statutory language.

Corporations Code §17353(c) provides nonexclusive methods for when a debt or liability is adequately provided for.

## §11.167 4. Form: Distributions in Kind

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11.167-1 Distributions in kind

**D. *Distributions in Kind.* Any non-cash asset distributed to one or more Members shall first be valued at its fair market value to determine the Net Profit or Net Loss that would have resulted if such asset were sold for such value, such Net Profit or Net Loss shall then be allocated under Article VI, and the Members' Capital Accounts shall be adjusted to reflect such allocations. The amount distributed and charged to the Capital Account of each Member receiving an interest in such distributed asset shall be the fair market value of the interest (net of any liability secured by such asset that such Member assumes or takes subject to). The Manager shall determine the fair market value of the asset, or if any Member objects, then an independent appraiser (any such appraiser must be recognized as an expert in valuing the type of asset involved) selected by the Manager shall determine the fair market value of the asset.**

*Comment:* A member may be compelled to accept a distribution in kind as a result of a dissolution of the LLC, but even in a dissolution, a member may not be compelled to accept a distribution in kind in lieu of a proportionate distribution of cash being made to the other members. Corp C §17253(b)-(c). The operating agreement may alter these provisions.

## §11.168 5. Form: Deficit Restoration Requirement

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11.168-1 Deficit restoration requirement

**E. Deficit Restoration Requirement.** On liquidation, if any member has a deficit Capital Account balance, after taking into account all Capital Account adjustments for the Company's taxable year during which liquidation occurs, the member shall contribute cash to the capital of the Company in an amount necessary to eliminate the deficit balance by the end of the Company's taxable year during which liquidation occurs or, if later, within ninety (90) days after the date of such liquidation.

*Comment:* This provision is optional. As discussed in §11.23, the "safe harbor" provisions of Treas Reg §1.704-1(b)(2) require that each member restore any capital account deficit on liquidation. Treas Reg §1.704-1(b)(2)(ii)(b)(3). Instead of a deficit restoration provision, an operating agreement may have "loss limitation" and "qualified income offset" provisions that comply with Treas Reg §1.704-1(b)(2)(ii)(d). See §§11.129, 11.136. Because an unlimited requirement to restore any capital account deficit is generally undesirable, the "loss limitation" and "qualified income offset" provisions are included in the operating agreement and the deficit restoration provision is omitted.

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.169 6. Form: Limitations on Payments Made in Dissolution

## **§11.169 6. Form: Limitations on Payments Made in Dissolution**

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11.169-1 Limitations on payments made in dissolution

**[F.] *Limitations on Payments Made in Dissolution.* Except as otherwise specifically provided in this Agreement, each Member shall only be entitled to look solely to the assets of the Company for the return of the Member's Capital Contributions or positive Capital Account balance and shall have no recourse for the Member's Capital Contributions, positive Capital Account balance, or share of Net Profits (on dissolution or otherwise) against any Member or Manager.**

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.170 7. Form: Certificates

## §11.170 7. Form: Certificates

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11.170-1 Certificates

**[G.] Certificates.** The Manager, or if the Manager wrongfully dissolved the Company then the Members, shall execute and file a Certificate of Dissolution with the California Secretary of State on the dissolution of the Company, and shall execute and file a Certificate of Cancellation with the California Secretary of State on the completion of the winding up of the Company's affairs.

*Comment:* See Corp C §17356. Forms for the Certificate of Dissolution (Secretary of State Form LLC-3) and the Certificate of Cancellation (Secretary of State Form LLC-4/7) are available on the Secretary of State's website at [http://www.sos.ca.gov/business/bpd\\_forms.htm#llc](http://www.sos.ca.gov/business/bpd_forms.htm#llc).

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## §11.171 8. Form: Covenant Not to Compete

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11.171-1 Covenant not to compete

**[H.] *Covenant not to Compete.*** Each Member covenants and agrees that on dissolution of the Company and for two (2) years thereafter, as long as \_\_[*name*]\_\_ engages in the same business as the Company prior to its dissolution, \_\_[*he/she*]\_\_ shall not, directly or indirectly through any other person, firm, or entity, engage in the same business as the Company prior to its dissolution in any county in California or state in the United States where the Company engaged in such business during the two (2)-year period prior to its dissolution. For the purposes of this Section, the Members acknowledge and agree that the Company has created goodwill in each such county and state where it had customers. For the purposes of this Section, engaging in the same business as the Company prior to its dissolution includes being an employee, independent contractor, consultant, agent, officer, director, member, manager, partner, investor, equity owner of (excluding ownership of less than one percent (1%) of the outstanding shares of a publicly traded company), or any relationship that would allow the Member to receive any form of compensation from, any person, firm, or entity engaged in such business.

*Comment:* This form is optional. On dissolution of an LLC, or the termination of a member's interest in an LLC (including a series of LLCs formed in a jurisdiction recognizing series LLCs), a member may agree not to carry on a business similar to that of the LLC within a specified geographic area where the LLC transacted business, as long as any other member carries on a like business. Bus & P C §16602.5. If a covenant not to compete is added to the operating agreement, the practitioner should carefully consider which member or members have the right to continue to engage in the LLC's business.

## §11.172 9. Form: No Action for Dissolution

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11.172-1 No action for dissolution

**[I.] No Action for Dissolution.** Except as expressly permitted in this Agreement, no Member shall take any voluntary action that causes the dissolution of the Company. The Members acknowledge that irreparable damage would be done to the goodwill and reputation of the Company if any Member should bring an action in court to dissolve the Company under circumstances in which dissolution is not required by \_\_ *[specify section of agreement; see §11.164]* \_\_. This Agreement has been drawn carefully to provide fair treatment of all parties and equitable payment in liquidation of their Economic Interests. Accordingly, except when the Manager has failed to liquidate the Company as required by this Article IX, each Member waives and renounces his, her, or its Member's right to initiate legal action to seek the appointment of a receiver or trustee to liquidate the Company or to seek a decree of judicial dissolution of the Company on the ground that (1) it is not reasonably practicable to carry on the business of the Company in conformity with the Articles or this Agreement, or (2) dissolution is reasonably necessary for the protection of the rights or interests of the complaining Member. Damages for breach of this Section may be offset against distributions by the Company to which the Member would otherwise be entitled.

## K. Indemnification and Insurance

### §11.173 1. Form: Indemnification and Insurance (Short Form)

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11.173-1 Indemnification and insurance (short form)

## ARTICLE X INDEMNIFICATION AND INSURANCE

**A. Indemnification of Agents.** The Company shall indemnify and advance expenses to any Manager or Member, and may indemnify and advance expenses to any other Person, who was or is a party or is threatened to be made a party to any threatened, pending, or contemplated action, suit, or proceeding, including any action, suit, or proceeding in right of the Company, because such Person is or was a Manager, Member, officer, employee, or other agent of the Company or because, being or having been a Manager, Member, officer, employee, or agent, such Person is or was serving at the request of the Company as a manager, director, officer, employee, or other agent of another limited liability company, corporation, partnership, joint venture, trust, or other enterprise, to the fullest extent permitted by applicable law in effect on the date of this Agreement and to such greater extent as applicable law may hereafter from time to time permit. The Manager is authorized, on behalf of the Company, to enter into indemnification agreements from time to time with any Person entitled to indemnification from the Company under this Section, on such terms and conditions as the Manager deems appropriate in the Manager's business judgment.

**B. Insurance.** The Company may purchase and maintain insurance on behalf of any Manager, Member, or Person who is or was an agent of the Company against any liability asserted against the Manager, Member, or Person and incurred by the Manager, Member, or Person in any such capacity, or arising out of the Manager's, Member's, or Person's status as a Manager, Member, or agent, whether or not the Company would have the power to indemnify the Manager, Member, or Person against such liability under the provisions of this Article X or of Corporations Code §17155. In the event a Manager, Member, or Person receives payment from any insurance carrier or from the plaintiff in any action against the Manager, Member, or Person with respect to indemnified amounts after payment on account of all or part of such indemnified amounts having been made by the Company under this Article X, the Manager, Member, or Person shall reimburse the Company for the amount, if any, by which the sum of the payment by the insurance carrier or the plaintiff and payments by the Company to the Manager, Member, or Person exceeds the indemnified amounts; provided, however, that such portions, if any, of the insurance proceeds that are required to be reimbursed to the insurance carrier under the terms of the insurance policy shall not be deemed to be payments to the Manager, Member, or Person. In addition, on payment of indemnified amounts under the terms and conditions of this Agreement, the Company shall be subrogated to the Manager's, Member's, or Person's rights against any insurance carrier with respect to such indemnified amounts (to the extent permitted under the insurance policies). Such right of subrogation shall be terminated on receipt by the Company of the amount to be reimbursed by the Manager, Member, or Person under the second sentence of this Section.

**C. Partial Indemnification.** If a Person is entitled to indemnification from the Company for a portion of any liability or expense incurred by the Person in any action, suit, or proceeding but not, however, for the total amount thereof, the Company shall nevertheless indemnify such Person for the portion of the liability or expense to which the Person is entitled.

*Comment:* The provisions in Section A permit indemnification to the fullest extent permitted by law. However, an LLC may not indemnify a manager for breach of a fiduciary duty owed to the LLC or its members. Corp C §17155(a). This broad indemnification works well with member-managed LLCs, and with manager-managed LLCs where broad indemnification is desired. For a more limited indemnification, see §§11.174-11.185.

The provisions in Section B authorize the LLC to obtain insurance against indemnity to its agents, whether or not the LLC could indemnify agents for such liability. Corp C §17155(b). Section B also requires reimbursement to avoid overpayments and subrogation rights for the LLC.

## 2. Indemnification and Insurance (Long Form)

### §11.174 a. Form: Definitions

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11.174-1 Definitions

## ARTICLE X INDEMNIFICATION AND INSURANCE

**A. Definitions.** For purposes of this Article X, the following definitions shall apply:

1. "Expenses" shall include attorney fees, disbursements and retainers, court costs, transcript costs, fees of accountants, experts, and witnesses, travel expenses, duplicating costs, printing and binding costs, telephone charges, postage, delivery service fees, and all other expenses of the types customarily incurred in connection with prosecuting, defending, preparing to prosecute or defend, investigating, or being or preparing to be a witness or other participant in a Proceeding.

2. "Proceeding" includes any action, suit, arbitration, alternative dispute resolution mechanism, investigation, administrative hearing, or other proceeding, whether civil, criminal, administrative, or investigative in nature, except a proceeding initiated by a Person under Section \_\_ *[specify section of agreement; see §11.183]* \_\_ to enforce such Person's rights under this Agreement.

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## §11.175 b. Form: Indemnification of Manager and Officers

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11.175-1 Indemnification of manager and officers

### ***B. Indemnification of Manager and Officers.***

**1. Proceeding Other than in Right of the Company.** The Company shall indemnify any Manager or officer who was or is a party or is threatened to be made a party to, or otherwise becomes involved in, any Proceeding (other than a Proceeding by or in the right of the Company) by reason of the fact that the Manager or officer is or was an agent of the Company against all Expenses, amounts paid in settlement, judgments, fines, penalties, and ERISA excise taxes actually and reasonably incurred by or levied against the Manager or officer in connection with such Proceeding if it is determined as provided in Section \_\_ [specify section of agreement; see §11.177]\_\_ or by a court of competent jurisdiction that the Manager or officer acted in good faith and in a manner he or she reasonably believed to be in or not opposed to the best interests of the Company and, with respect to any criminal Proceeding, had no reasonable cause to believe his or her conduct was unlawful. The termination of any Proceeding, whether by judgment, order, settlement, or conviction, or on a plea of nolo contendere or its equivalent, shall not, of itself, create a presumption that a Manager or officer did not act in good faith and in a manner that he or she reasonably believed to be in or not opposed to the best interests of the Company or, with respect to any criminal Proceeding, that a Manager or officer had reasonable cause to believe that his or her conduct was unlawful.

**2. Proceeding in Right of Company.** The Company shall indemnify any Manager or officer who was or is a party or is threatened to be made a party to, or otherwise becomes involved in, any Proceeding by or in the right of the Company to procure a judgment in its favor by reason of the fact that the Manager or officer is or was an agent of the Company only against Expenses actually and reasonably incurred by the Manager or officer in connection with such Proceeding if it is determined as provided in Section \_\_ [specify section of agreement; see §11.177]\_\_ or by a court of competent jurisdiction that the Manager or officer acted in good faith and in a manner he or she reasonably believed to be in or not opposed to the best interests of the Company, except that no indemnification shall be made with respect to any claim, issue or matter as to which the Manager or officer shall have been adjudged liable to the Company unless and only to the extent that the court in which such Proceeding was brought or other court of competent jurisdiction shall determine on application that, despite the adjudication of liability but in view of all the circumstances of the case, the Manager or officer is fairly and reasonably entitled to indemnification for such Expenses that the court shall deem proper.

**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.176 c. Form: Successful Defense

**§11.176 c. Form: Successful Defense**

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11.176-1 Successful defense

**C. *Successful Defense.*** Despite any other provision of this Agreement, to the extent that a Manager or officer has been successful on the merits or otherwise in defense of any Proceeding referred to in Section B of this Article X or in defense of any claim, issue, or matter therein, the Manager or officer shall be indemnified against Expenses actually and reasonably incurred in connection therewith.

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.177 d. Form: Determination of Conduct

**§11.177 d. Form: Determination of Conduct**

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11.177-1 Determination of conduct

**D. Determination of Conduct.** Any indemnification under Section B of this Article X (unless ordered by a court as referred to in that Section) shall be made by the Company only as authorized in the specific case on a determination that indemnification of the Manager or officer is proper in the circumstances because such Manager or officer has met the applicable standard of conduct set forth in Section B. Such determination shall be made (1) by the Managers by a majority vote of a quorum consisting of Managers who were not parties to such Proceeding, (2) if such quorum is not obtainable or, even if obtainable, a quorum of such disinterested Managers so directs, by independent legal counsel in a written opinion, or (3) by the Members by a vote of a majority of the \_\_[Membership Interests/Units]\_\_ entitled to vote held by Members, whether or not constituting a quorum, who were not parties to the Proceeding.

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.178 e. Form: Payment of Expenses in Advance

**§11.178 e. Form: Payment of Expenses in Advance**

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11.178-1 Payment of expenses in advance

**E. *Payment of Expenses in Advance.* Expenses incurred by a Manager or officer in connection with a Proceeding shall be paid by the Company in advance of the final disposition of the Proceeding on receipt of a written undertaking by or on behalf of the Manager or officer to repay such amount if it shall ultimately be determined that the Manager or officer is not entitled to be indemnified by the Company as authorized in this Article X.**

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.179 f. Form: Indemnification of Other Agents

**§11.179 f. Form: Indemnification of Other Agents**

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11.179-1 Indemnification of other agents

**F. *Indemnification of Other Agents.*** The Company may, but shall not be obligated to, indemnify any Person (other than a Manager or officer of the Company) who was or is a party or is threatened to be made a party to, or otherwise becomes involved in, any Proceeding (including any Proceeding by or in the right of the Company) by reason of the fact that the Person is or was an agent of the Company (including Members who are not Managers), against all Expenses, amounts paid in settlement, judgments, fines, penalties, and ERISA excise taxes actually and reasonably incurred by the Person in connection with the Proceeding under the same circumstances and to the same extent as is provided for or permitted in this Article X with respect to a Manager or officer.

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.180 g. Form: Indemnity Not Exclusive

**§11.180 g. Form: Indemnity Not Exclusive**

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11.180-1 Indemnity not exclusive

**G. *Indemnity Not Exclusive.*** The indemnification and advancement of Expenses provided by, or granted under, the provisions of this Article X shall not be deemed exclusive of any other rights to which any Person seeking indemnification or advancement of Expenses may be entitled under any agreement, vote of the Managers, or otherwise, both as to action in the Person's capacity as an agent of the Company and as to action in another capacity while serving as an agent. All rights to indemnification under this Article X shall be deemed to be provided by a contract between the Company and each Manager or officer at any time while this Agreement and relevant provisions of the Act and other applicable law, if any, are in effect. Any repeal or modification of this Agreement or the Act shall not affect any such rights then existing.

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**§11.181 h. Form: Insurance**

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11.181-1 Insurance

**H. Insurance.** The Company shall have the power to purchase and maintain insurance on behalf of any Person who is or was an agent of the Company against any liability asserted against the Person and incurred by the Person in any such capacity, or arising out of the Person's status as an agent, whether or not the Company would have the power to indemnify the Person against such liability under the provisions of this Article X or Corporations Code §17155. In the event a Person receives payment from any insurance carrier or from the plaintiff in any action against the Person with respect to indemnified amounts after payment on account of all or part of such indemnified amounts having been made by the Company under this Article X, the Person shall reimburse the Company for the amount, if any, by which the sum of the payment by the insurance carrier or the plaintiff and payments by the Company to the Person exceeds the indemnified amounts; provided, however, that the portions, if any, of the insurance proceeds that are required to be reimbursed to the insurance carrier under the terms of the insurance policy shall not be deemed to be payments to the Person under this Agreement. In addition, on payment of indemnified amounts under the terms and conditions of this Agreement, the Company shall be subrogated to the Person's rights against any insurance carrier with respect to the indemnified amounts (to the extent permitted under such insurance policies). Such right of subrogation shall be terminated on receipt by the Company of the amount to be reimbursed by the Person under the first sentence of this Section.

**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.182 i. Form: Heirs, Executors, and Administrators

**§11.182 i. Form: Heirs, Executors, and Administrators**

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11.182-1 Heirs, executors, and administrators

**I. Heirs, Executors, and Administrators.** The indemnification and advancement of Expenses provided by, or granted under, this Article X shall, unless otherwise provided when authorized or ratified, continue as to a Person who has ceased to be an agent of the Company and shall inure to the benefit of the Person's heirs, executors, and administrators.

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.183 j. Form: Right to Indemnification on Application

## §11.183 j. Form: Right to Indemnification on Application

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11.183-1 Right to indemnification on application

### ***J. Right to Indemnification on Application.***

1. Any indemnification or advance under Sections B, C, or E of this Article X shall be made promptly, and in no event later than sixty (60) days, after the Company's receipt of the written request of a Manager or officer, unless, in the case of an indemnification, a determination shall have been made as provided in Section D that the Manager or officer has not met the relevant standard for indemnification set forth in Section B.

2. The right of a Person to indemnification or an advance of Expenses as provided by this Article X shall be enforceable in any court of competent jurisdiction. Neither the failure by the Managers or Members of the Company or its independent legal counsel to have made a determination that indemnification or an advance is proper in the circumstances, nor any actual determination by the Managers or Members of the Company or its independent legal counsel that indemnification or an advance is not proper, shall be a defense to the action or create a presumption that the relevant standard of conduct has not been met. The burden of proving that indemnification or an advance is not proper shall be on the Company. In any such action, the Person seeking indemnification or advancement of Expenses shall be entitled to recover from the Company any and all expenses of the types described in the definition of Expenses in Section A, subsection 1, actually and reasonably incurred by such Person in such action, but only if the Person prevails in the action.

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.184 k. Form: Limitations on Indemnification

## §11.184 k. Form: Limitations on Indemnification

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11.184-1 Limits on indemnification

**K. *Limitations on Indemnification.* No payments under this Agreement shall be made by the Company:**

**1. To indemnify or advance funds to any Person with respect to a Proceeding initiated or brought voluntarily by such Person and not by way of defense, except as provided in Section J, subsection 2, with respect to a Proceeding brought to establish or enforce a right to indemnification under this Agreement, otherwise than as required under California law, but indemnification or advancement of Expenses may be provided by the Company in specific cases if a determination is made in the manner provided in Section D that it is appropriate; or**

**2. If a court of competent jurisdiction finally determines that any indemnification or advance of Expenses under this Agreement is unlawful.**

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## §11.185 I. Form: Partial Indemnification

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11.185-1 Partial indemnification

**L. *Partial Indemnification.* If a Person is entitled under any provision of this Article X to indemnification by the Company for a portion of Expenses, amounts paid in settlement, judgments, fines, penalties, or ERISA excise taxes incurred by such Person in any Proceeding but not, however, for the total amount thereof, the Company shall nevertheless indemnify the Person for the portion of the Expenses, amounts paid in settlement, judgments, fines, penalties, or ERISA excise taxes to which the Person is entitled.**

*Comment:* This long form of indemnification in §§11.174-11.185 is patterned on typical indemnification provisions found in corporate bylaws, and provides for minimum standards of conduct to be met, detailed procedures for indemnification, burden of proof, procurement of and coordination with insurance, and mandatory and permissive indemnification. It is not as broad an indemnification as the short form in §11.173, and may be further limited if desired. Note that an LLC may not indemnify a manager for breach of a fiduciary duty owed to the LLC or its members. Corp C §17155(a).

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/ L. Investment Representations/§11.186 1. Form: Representations and Warranties

## L. Investment Representations

### §11.186 1. Form: Representations and Warranties

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11.186-1 Representations and warranties

## ARTICLE XI INVESTMENT REPRESENTATIONS

**A. Representations and Warranties.** Each Member hereby represents and warrants to the Company and to each other Member as follows:

*Comment:* These representations and warranties are designed to give the LLC assurances from the prospective members that they meet the requirements so that the LLC will qualify for an exemption from registration and qualification under federal and California securities laws. Unless an LLC is member-managed and each member actively participates in the management of the LLC, membership interests are securities and the LLC will need to qualify for an exemption under both federal securities laws and state securities laws in each state where a member resides. See §§11.9-11.11.

The drafter should consider adding additional representations, if applicable, describing the risks associated with a newly formed entity, a growth state entity, competition, intellectual property, concentrated ownership, dilution, need for additional capital, key employees, and other risks that are unique to the LLC and to the business in which it intends to engage.

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.187 a. Form: Residency

**§11.187 a. Form: Residency**

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11.187-1 Residency

**1. Residency.** The Member is a resident of \_\_ [the State of California/the state indicated for the Member's address in Exhibit A]\_\_.

*Comment:* Since the LLC must meet the requirements for an exemption under the securities laws of each state where a purchaser resides, this representation provides the LLC with assurances of residency so the LLC knows which state securities laws are applicable.

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.188 b. Form: No Broker

**§11.188 b. Form: No Broker**

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11.188-1 No broker

**2. No Broker. The Member has not employed any broker or finder or incurred any liability for any brokerage fees, commissions, or finder's fees in connection with the purchase of the \_\_[Membership Interest/Units]\_\_.**

*Comment:* This representation assures the LLC that it will not find itself liable for any broker or finder employed by the member.

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.189 c. Form: Accredited Investor

### §11.189 c. Form: Accredited Investor

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11.189-1 Accredited investor

**3. Accredited Investor. The Member is an "Accredited Investor," as such term is defined in Rule 501(a) of Regulation D, promulgated under the Securities Act.**

*Comment:* The drafter should use this provision only if the offering of membership interests will be limited to accredited investors. It is more difficult to meet the requirements of many exemptions under federal and state securities laws if membership interests are sold to purchasers who are not accredited investors. If desired, the definition of an accredited investor may be added to this representation in the operating agreement.

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.190 d. Form: Investment Intent

## §11.190 d. Form: Investment Intent

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11.190-1 Investment intent

**4. *Investment Intent.*** The Member is acquiring the \_\_ *[Membership Interest/Units]* \_\_ solely for the Member's own account and not as a nominee or agent for any third party, for investment purposes only, and not with a view to or for sale in connection with any distribution. The Member does not have any contract, undertaking, agreement, or arrangement with any person to sell or transfer the \_\_ *[Membership Interest/Units]* \_\_ or grant participation interests in the \_\_ *[Membership Interest/Units]* \_\_ to such person or to any third person. If the Member is not a natural person, the Member was not formed for the purpose of making an investment in the Company.

*Comment:* See Rule 502(d)(1) (17 CFR §230.502(d)(1)) and Corp C §25102(f)(3).

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.191 e. Form: No Registration of Membership Interest or Units

**§11.191 e. Form: No Registration of Membership Interest or Units**

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §11.48 and ends in §11.233

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11.191-1 No registration

**5. No Registration of** \_\_[Membership Interest/Units]\_\_. The Member understands that the sale of the \_\_[Membership Interest/Units]\_\_ has not been registered under the Securities Act or registered or qualified under the Securities Laws in reliance on exemptions from such registration and qualification requirements, and that such exemptions are dependent in part on the representations made in this Agreement. The Member understands that any subsequent resale of the \_\_[Membership Interest/Units]\_\_ must either be registered and/or qualified under the Securities Laws or be under an exemption from registration and qualification contained in the Securities Laws or the rules and regulations under it.

*Comment:* See Rule 502(d)(2) (17 CFR §230.502(d)(2)).

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.192 f. Form: Economic Risk; No Obligation to Register

**§11.192 f. Form: Economic Risk; No Obligation to Register**

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11.192-1 Economic risk; no obligation to register

**6. Economic Risk; No Obligation to Register.** The Member understands that since the sale of the \_\_[Membership Interest/Units]\_\_ has not been registered or qualified under the Securities Laws, the Member must bear the economic risk of an investment in the \_\_[Membership Interest/Units]\_\_ for an indefinite period of time. The Member understands that the Company has no obligation to register or qualify the \_\_[Membership Interest/Units]\_\_ for resale under the Securities Laws or to take any action (including the filing of reports or the publication of information required by Rule 144 under the Securities Act of 1933) that would make available any exemption from such registration and/or qualification requirements.

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.193 g. Form: High Degree of Risk

### §11.193 g. Form: High Degree of Risk

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11.193-1 High degree of risk

**7. High Degree of Risk.** The Member understands that the purchase of the \_\_ *[Membership Interest/Units]* \_\_ involves a high degree of risk, and the Member has taken full cognizance of and understands all the risks related to the purchase of the \_\_ *[Membership Interest/Units]* \_\_. The Member has the knowledge, sophistication, and experience in financial and business matters to be capable of fully evaluating the merits and risks of the Member's purchase of the \_\_ *[Membership Interest/Units]* \_\_, to be capable of fully understanding the information provided by the Company, and to be able to protect the Member's interests in connection with the purchase of the \_\_ *[Membership Interest/Units]* \_\_. The Member is capable of bearing the economic risk of a complete loss of the Member's investment in the \_\_ *[Membership Interest/ Units]* \_\_.

*Comment:* See Rule 506 (17 CFR §230.506) and Corp C §25102(f)(2).

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## §11.194 h. Form: Independent Investigation

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11.194-1 Independent investigation

**8. *Independent Investigation.*** The Member has undertaken an independent investigation of the investment in the \_\_ *[Membership Interest/Units]* \_\_ and of the business potential of the Company as a prudent, sophisticated investor would deem appropriate for an investment in the \_\_ *[Membership Interest/Units]* \_\_. The Member believes that he, she, or it has received all the information that the Member considers necessary or appropriate for deciding whether to purchase the \_\_ *[Membership Interest/Units]* \_\_. The Member has had the opportunity to ask questions and receive answers from the Company concerning its businesses and financial condition and the terms and conditions of the purchase of the \_\_ *[Membership Interest/Units]* \_\_ and to obtain additional information (to the extent the Company possessed such information or could acquire it without unreasonable effort or expense) necessary to verify the accuracy of any information furnished to the Member or to which the Member had access. The Member understands that such discussions and any other pertinent information provided by the Company were intended to describe certain aspects of the Company's business and prospects but were not a thorough or exhaustive description.

*Comment:* See Rule 502(b)(v) (17 CFR §230.502(b)(v)).

**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.195 i. Form: Preexisting Relationship

## **§11.195 i. Form: Preexisting Relationship**

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11.195-1 Pre-existing relationship

**9. *Preexisting Relationship.* The Member has a preexisting business or personal relationship with the Company or its Manager or controlling persons, which is of such a nature and duration as has enabled the Member, as a reasonably prudent investor, to be aware of the character, business acumen, and general business and financial circumstances of the Company or such persons connected with the Company.**

*Comment:* See Corp C §25102(f)(2).

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## §11.196 j. Form: Legend on Certificates

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11.196-1 Legend

**10. Legend.** The Member understands that the Company will issue stop transfer instructions to its transfer agent with respect to the \_\_[Membership Interest/Units]\_\_ and that certificates evidencing the \_\_[Membership Interest/Units]\_\_ will contain restrictive transfer legends substantially as follows:

**THE SECURITIES REPRESENTED BY THIS CERTIFICATE HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED (THE "SECURITIES ACT"), OR REGISTERED OR QUALIFIED UNDER APPLICABLE STATE SECURITIES LAWS IN RELIANCE ON EXEMPTIONS THEREFROM. THE HOLDER MAY NOT OFFER, SELL, TRANSFER, ASSIGN, PLEDGE, HYPOTHECATE, OR OTHERWISE DISPOSE OF OR ENCUMBER THESE SECURITIES EXCEPT PURSUANT TO AN EFFECTIVE REGISTRATION STATEMENT UNDER THE SECURITIES ACT AND THE RULES AND REGULATIONS PROMULGATED THEREUNDER AND IN COMPLIANCE WITH APPLICABLE STATE SECURITIES LAWS, OR ON RECEIPT BY THE ISSUER OF AN OPINION OF LEGAL COUNSEL FOR THE HOLDER REASONABLY SATISFACTORY TO THE ISSUER AND ITS LEGAL COUNSEL THAT SUCH OFFER, SALE, TRANSFER, ASSIGNMENT, PLEDGE, HYPOTHECATION, OR OTHER DISPOSITION OR ENCUMBRANCE IS EXEMPT FROM THE REGISTRATION PROVISIONS OF THE SECURITIES ACT AND THE RULES AND REGULATIONS PROMULGATED THEREUNDER AND THE REGISTRATION AND/OR QUALIFICATION PROVISIONS OF APPLICABLE STATE SECURITIES LAWS.**

**THE SECURITIES REPRESENTED BY THIS CERTIFICATE ARE ALSO SUBJECT TO CERTAIN RESTRICTIONS ON TRANSFER AND FIRST NEGOTIATION RIGHTS, REFUSAL RIGHTS, AND MANDATORY SALE RIGHTS AS SET FORTH IN THE ISSUER'S OPERATING AGREEMENT. THE RIGHTS AND OBLIGATIONS OF THE HOLDER OF THIS CERTIFICATE ARE ALSO SET FORTH IN THE ISSUER'S OPERATING AGREEMENT. A COPY OF SUCH OPERATING AGREEMENT WILL BE FURNISHED TO THE RECORD HOLDER OF THIS CERTIFICATE WITHOUT CHARGE ON WRITTEN REQUEST TO THE ISSUER AT ITS PRINCIPAL PLACE OF BUSINESS.**

*Comment:* See Rule 502(d)(3) (17 CFR §230.502(d)(3)). The drafter should use this provision only if the LLC will or may issue certificates to evidence membership interests.

**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.197 k. Form: No Advertising

**§11.197 k. Form: No Advertising**

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11.197-1 No advertising

**11. No Advertising.** The Member has not seen, received, been presented with, or been solicited by any radio or television advertisement, newspaper or magazine article or advertisement, public promotional meeting, leaflet, or any other form of advertising or general solicitation in connection with the purchase of the \_\_[Membership Interest/Units]\_\_.

*Comment:* See Rule 502(c) (17 CFR §230.502(c)) and Corp C §25102(f)(4).

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.198 I. Form: No Recommendation

**§11.198 I. Form: No Recommendation**

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11.198-1 No recommendation

**12. *No Recommendation.*** The Member understands that neither the Securities and Exchange Commission nor the securities administrator of any state has issued any finding or determination relating to the fairness of an investment in the \_\_[*Membership Interest/Units*]\_\_ and that neither the Securities and Exchange Commission nor the securities administrator of any state has or will recommend or endorse any such investment.

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.199 m. Form: Percent of Net Worth

**§11.199 m. Form: Percent of Net Worth**

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11.199-1 Percent of net worth

**13. *Percent of Net Worth.* The investment in the \_\_ *[Membership Interest/Units]* \_\_ does not exceed ten percent (10%) of the Member's net worth.**

*Comment:* This is a requirement under the securities laws of a number of states, but not federal or California securities laws. Although it is useful to show that the prospective member can adequately bear the economic risk of the investment, this provision may be deleted if it is not necessary and it creates a problem.

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.200 n. Form: Membership Interest or Units as Speculative

**§11.200 n. Form: Membership Interest or Units as Speculative**

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11.200-1 Membership interest or units as speculative

**14.** \_ \_ *[Membership Interest is/Units are]* \_ \_ **Speculative.** The Member understands that the \_ \_ *[Membership Interest is/Units are]* \_ \_ **speculative and that an investment in the Company involves a high degree of risk.**

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.201 o. Form: No Trading Market

**§11.201 o. Form: No Trading Market**

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11.201-1 No trading market

**15. No Trading Market.** The Member understands that there is no trading market for the \_\_[Membership Interests/Units]\_\_ and that the Company does not anticipate that a trading market will develop, or if developed, will continue. If no market develops, it may be difficult or impossible for the Member to sell the \_\_[Membership Interest/Units]\_\_ should the Member desire to do so. There are no assurances that the Member will be able to sell the \_\_[Membership Interest/Units]\_\_, or if the Member is able to sell, that the Member will be able to sell the \_\_[Membership Interest/Units]\_\_ at the purchase price.

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.202 p. Form: Limitation on Distributions

**§11.202 p. Form: Limitation on Distributions**

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11.202-1 Limitation on distributions

**16. *Limitation on Distributions.*** The Member understands that California law prohibits the Company from paying any distribution on the \_\_*[Membership Interest/Units]*\_\_ if after the payment of such distribution the Company could not pay its debts as they became due in the usual course of business or when the Company's total assets would be less than the sum of its total liabilities plus the amount that would be needed, if the Company were to be dissolved at the time of the distribution, to satisfy the preferential rights of other members on dissolution that are superior to the rights of the member receiving the distribution. Because of these restrictions, there are no assurances that the Company will be able to pay any distribution on the \_\_*[Membership Interest/Units]*\_\_.

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.203 q. Form: Tax Consequences

### §11.203 q. Form: Tax Consequences

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11.203-1 Tax consequences

**17. Tax Consequences.** The Member acknowledges that the tax consequences of investing in the Company will depend on the Member's particular circumstances, and that neither the Company, the Manager, the other Members, nor the partners, shareholders, members, managers, agents, officers, directors, employees, Affiliates, or consultants of any of them will be responsible or liable for any tax consequences of an investment in the Company. The Member will look solely to, and rely on, the Member's own advisers with respect to the tax consequences of this investment.

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.204 r. Form: No Assurance of Tax Benefits

**§11.204 r. Form: No Assurance of Tax Benefits**

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11.204-1 No assurances

**18. *No Assurance of Tax Benefits.*** The Member acknowledges that there can be no assurance that the Code or the Regulations will not be amended or interpreted in the future in such a manner as to deprive the Company and the Members of some or all of the tax benefits they might now receive, nor that some of the deductions claimed by the Company or the allocations of items of income, gain, loss, deduction, or credit among the Members may not be challenged by the Internal Revenue Service.

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**§11.205 s. Form: Consultation With Advisors**

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11.205-1 Consultation with advisors

**19. *Consultation With Advisors.*** The Member has been advised to consult with the Member's own independent legal counsel regarding all legal matters concerning an investment in the Company and consult with the Member's own independent tax and other advisors concerning the tax consequences of participating in the Company, and has done so to the extent the Member considers necessary. The Member acknowledges that the Company Counsel has not provided any advice or assistance to any Member regarding such Member's rights, liabilities, and obligations under this Agreement, the potential tax consequences that may result from this Agreement, or any other aspect of this Agreement.

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.206 2. Form: Indemnification

## §11.206 2. Form: Indemnification

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11.206-1 Indemnification

**B. *Indemnification.*** The Member shall indemnify, save, defend, and hold the Company and each other Member harmless from and against any and all claims, demands, expenses, lawsuits, liabilities, and losses, including but not limited to penalties, interest, court costs, and attorney fees, arising out of or in connection with any breach of a representation or warranty contained in Section A of this Article XI by the Member, or any breach of such representation or warranty alleged by a third party.

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## **M. General Provisions**

### **§11.207 1. Form: Amendment**

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11.207-1 Amendment

## **ARTICLE XII GENERAL PROVISIONS**

**A. Amendment.** All amendments or modifications of the Articles or this Agreement shall be in writing and shall be approved by \_\_[a Majority Interest/a Super Majority Interest/all of the Members]\_\_.

*Comment:* Corporations Code §17103(b) provides that any amendment of the articles of organization must be approved by a vote of not less than a majority in interest. The operating agreement may provide that the approval of more than a majority is required, but may not lower the requirement to less than a majority. Corp C §17005(b)(3). A written operating agreement may provide how the operating agreement may be amended. Corp C §17059.

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**§11.208 2. Form: Waiver**

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11.208-1 Waiver

**B. Waiver. Any waiver of any right, power, or privilege hereunder must be in writing and signed by the party being charged with the waiver. No delay on the part of any party to this agreement in exercising any right, power, or privilege hereunder shall operate as a waiver of any other right, power, or privilege hereunder, nor shall any single or partial exercise of any right, power, or privilege under this Agreement preclude any other or further exercise thereof or the exercise of any other right, power, or privilege.**

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**§11.209 3. Form: Notices**

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11.209-1 Notices

**C. Notices.** All notices or other communications required or permitted to be given under this Agreement shall be in writing and shall be delivered personally or sent by overnight courier or by certified mail, return receipt requested. Notices delivered personally or sent by overnight courier shall be effective on the date received, while notices sent by certified mail, return receipt requested, shall be deemed to have been received and to be effective three (3) business days after deposit into the mails. Notices shall be given to the Company at its address set forth in Section \_\_ *[specify section of agreement; see §11.94]* \_\_, or to such other address as the Company may designate in writing, to the Initial Members at their addresses set forth in Exhibit A, to all other Members to their address in the Company's records, or to any Member at such other address as the Member may designate in writing.

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.210 4. Form: Successors and Assigns

#### §11.210 4. Form: Successors and Assigns

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11.210-1 Successors and assigns

**D. Successors and Assigns.** Subject to the provisions of this Agreement relating to the Transfer of \_\_[Membership Interests/Units]\_\_, this Agreement and each of its provisions shall be binding on and shall inure to the benefit of the parties to this Agreement and their respective successors and assigns.

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.211 5. Form: Governing Law

## §11.211 5. Form: Governing Law

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11.211-1 Governing law

**E. *Governing Law.* This Agreement has been negotiated, executed, and delivered and shall be performed in the State of California, and shall be governed by and construed and enforced in accordance with the laws of the State of California, without regard for its conflict of laws rules.**

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## §11.212 6. Form: Jurisdiction

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11.212-1 Jurisdiction

**F. *Jurisdiction.*** Each Member hereby irrevocably submits to the exclusive jurisdiction of the courts of the State of California and any United States District Court situated in the State of California in any action on a claim arising out of, under, or in connection with this Agreement. Each Member further agrees that personal jurisdiction over such Member may be effected by service of process by certified mail addressed as provided in Section C of this Article XII, and that when so made shall be as if served on such Member personally within the State of California.

*Comment:* In a written operating agreement, a member may consent to be subject to the nonexclusive jurisdiction of the courts of a specified jurisdiction, or the exclusive jurisdiction of the courts of California. Corp C §17061(f). Along with a consent to jurisdiction, a member may consent to be served in the manner prescribed in a written operating agreement. Corp C §17061(h).

While it is common in agreements to designate the venue for any litigation (e.g. the courts of Los Angeles County), any such designation is illegal and void. *General Acceptance Corp. v Robinson* (1929) 207 C 285, 289, 277 P 1039; *Alexander v Superior Court* (2003) 114 CA4th 723, 732, 8 CR3rd 111.

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.213 7. Form: Attorney Fees

## §11.213 7. Form: Attorney Fees

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11.213-1 Attorney fees

**G. Attorney Fees.** Should a lawsuit or arbitration be commenced to interpret or enforce the terms of this Agreement, the prevailing party shall be entitled to recover costs and attorney fees in addition to any other recovery to which such party may be entitled.

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## §11.214 8. Form: Mediation

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11.214-1 Mediation

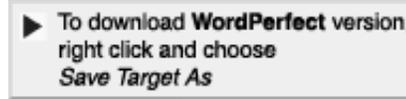
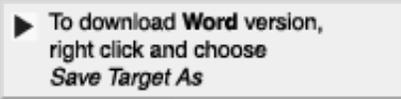
**H. Mediation.** If any dispute arises concerning the interpretation, validity, or performance of this Agreement or any of its terms and provisions, except if the amount claimed by a party is equal to or less than the jurisdictional limit of the California Small Claims Court, or except for the enforcement of (1) the covenants not to engage in certain activities under Sections \_\_[specify sections of agreement; see §§11.106, 11.121, and 11.171]\_\_, (2) the confidentiality provisions set forth in Section \_\_[specify section of agreement; see §11.114]\_\_, (3) the restrictions against Transfer set forth in Article VII, then the parties shall first try to settle the dispute through mediation administered before a \_\_[mediator/retired judge]\_\_ selected from \_\_[name of mediation organization]\_\_ or any similar organization mutually acceptable to the parties. The parties shall mutually agree on one mediator from the list provided by the mediating organization; provided that if the parties cannot agree, then one mediator shall be selected according to the then prevailing rules of the mediating organization. The mediation shall take place in \_\_[name]\_\_ County, and shall be conducted in accordance with the then prevailing rules of the mediating organization.

*Comment:* This provision is optional. Mediation before a trained mediator can be very effective in resolving disputes before the parties become embroiled in litigation.

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## §11.215 9. Form: Arbitration

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §11.48 and ends in §11.233



11.215-1 Arbitration

**[I.] Arbitration.** If any dispute arises concerning the interpretation, validity, or performance of this Agreement or any of its terms and provisions, including but not limited to the issue of whether or not a dispute is arbitrable, (1) if the amount claimed by a party is equal to or less than the jurisdictional limit of the California Small Claims Court, then the parties shall resolve the matter in the California Small Claims Court, or (2) if the amount claimed by the party exceeds the jurisdictional limit of the California Small Claims Court \_\_ [and if the parties are unable to settle the dispute by mediation under Section H of this Article XII] \_\_, then the parties shall submit the dispute for binding determination before \_\_ [an arbitrator/a retired judge] \_\_ selected from \_\_ [name of mediation organization] \_\_ or any similar organization mutually acceptable to the parties. The parties shall mutually agree on one arbitrator from the list provided by the arbitrating organization; provided that if the parties cannot agree, then one arbitrator shall be selected according to the then prevailing rules of the arbitrating organization. The arbitration shall take place in \_\_ [name] \_\_ County, and shall be conducted in accordance with the then prevailing rules of the arbitrating organization, except as set forth in this Section I of Article XII. The parties shall have all rights for depositions and discovery as provided in Code of Civil Procedure §1283.05. The arbitrator shall apply California substantive law and the California Evidence Code to the proceeding. The arbitrator shall have the power to grant all legal and equitable remedies including provisional remedies and award compensatory damages provided by law, but the arbitrator may not order relief in excess of what a court could order. The arbitrator shall not have authority to award punitive or exemplary damages. The arbitrator shall prepare and provide the parties with a written award including factual findings and the legal reasoning on which the award is based. The arbitrator shall not have the power to commit errors of law or legal reasoning or to make findings of fact except on sufficiency of the evidence. Any award that contains errors of law or legal reasoning or makes findings of fact except on the sufficiency of the evidence exceeds the power of the arbitrator, and may be corrected or vacated as provided by applicable law. The arbitrator shall award costs and attorney fees in accordance with the terms and conditions of this Agreement. Any court having jurisdiction may enter judgment on the award rendered by the arbitrator, or correct or vacate such award as provided by applicable law. The Members understand that by agreement to binding arbitration they are giving up the rights they may otherwise have to trial by a court or a jury and all rights of appeal, and to an award of punitive or exemplary damages. Pending resolution of any arbitration proceeding, either party may apply to any court of competent jurisdiction for any provisional remedy, including but not limited to a temporary restraining order or a preliminary injunction but excluding any dispute relating to discovery matters, and for enforcement of any such order. The application for or enforcement of any provisional remedy by a party shall not operate as a waiver of the within agreement to submit a dispute to binding arbitration.

*Comment:* Binding arbitration may resolve a dispute in less time than litigation, and may be less expensive. This arbitration provision provides for one arbitrator to decide the matter; alternatively, the practitioner may provide for three arbitrators to decide the matter by majority vote. This provision gives the parties broad discovery rights, which may be beneficial to the parties in preparing their case, but will lead to greater expense. This provision gives guidelines to and places restrictions on the arbitrator so as to reach a result that follows California law. In a written operating agreement, a member may consent to be nonexclusively subject to arbitration in a specified state, or be exclusively subject to arbitration in California. Corp C §17061(g).

**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.216 10. Form: Further Assurances

## §11.216 10. Form: Further Assurances

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11.216-1 Further assurances

**[J.] *Further Assurances.* Each Member agrees at any time or from time to time on request to promptly execute and deliver such additional documents and instruments and to promptly perform such acts as may be reasonably necessary to more fully carry out the provisions of this Agreement.**

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**§11.217 11. Form: Remedies**

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11.217-1 Remedies

**[K.] Remedies.** The Members expressly acknowledge and agree that the provisions contained in Sections \_\_[specify sections of Agreement; see §§11.106, 11.114, 11.121, 11.171, and 11.146-11.155]\_\_ are necessary for the protection of the Company and the Members, that the Company and the Members will not have an adequate remedy at law and will be irreparably harmed in the event that any of such provisions are not performed in accordance with their specific terms or are otherwise breached, and in the event of such breach, money damages would not sufficiently compensate the Company and the Members for their injury. In addition to all other remedies available at law or in equity, the Company and the Members shall be entitled to specific performance and injunctive or other equitable relief as a remedy for any such breach by a Member, and each Member hereby waives any requirement for the receiving or posting of any bond in connection with such remedy.

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.218 12. Form: Parties in Interest

## §11.218 12. Form: Parties in Interest

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11.218-1 Parties in interest

**[L.] *Parties in Interest.* Except as expressly provided in the Act, nothing in this Agreement shall confer any rights or remedies under or by reason of this Agreement on any Person other than the Members and their successors and assigns nor shall anything in this Agreement relieve or discharge the obligation or liability of any third person to any party to this Agreement, nor shall any provision give any third person any right of subrogation or action over or against any party to this Agreement.**

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.219 13. Form: No Interest in Company Property

**§11.219 13. Form: No Interest in Company Property**

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11.219-1 No interest in company property

**[M.] *No Interest in Company Property.* No Member or Assignee has any interest in specific property of the Company.**

*Comment:* Corp C §17300.

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.220 14. Form: Counterparts

**§11.220 14. Form: Counterparts**

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11.220-1 Counterparts

**[N.] Counterparts.** This Agreement may be executed in two or more counterparts, including by facsimile transmission or e-mail of a scanned signature page, all of which together shall constitute a single instrument.

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.221 15. Form: Reliance on Authority of Person Signing Agreement

## **§11.221 15. Form: Reliance on Authority of Person Signing Agreement**

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11.221-1 Reliance on authority of person signing agreement

**[O.] *Reliance on Authority of Person Signing Agreement.* If a Member is not a natural person, neither the Company nor any Member shall be required to determine the authority of the individual signing this Agreement to make any commitment or undertaking on behalf of such entity or to determine any fact or circumstance bearing on the existence of the authority of such individual, or be responsible for the application or distribution of proceeds paid or credited to individuals signing this Agreement on behalf of such entity.**

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.222 16. Form: Severability of Provisions

## §11.222 16. Form: Severability of Provisions

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11.222-1 Severability of provisions

**[P.] *Severability of Provisions.* In the event any one or more of the provisions of this Agreement shall for any reason be held to be invalid, illegal, or unenforceable in any respect, such invalidity, illegality, or unenforceability shall not affect any other provision hereof, and this Agreement shall be construed as if such invalid, illegal, or unenforceable provision had never been contained herein.**

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.223 17. Form: Integration

## §11.223 17. Form: Integration

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11.223-1 Integration

**[Q.] *Integration.* The Articles and this Agreement, including the Exhibit(s) attached to this Agreement, constitute the complete and exclusive statement of the understanding and agreement between the Members with respect to the subject matter hereof and supersede all previous communications, representations, or understandings, either oral or written, between the Members relating to the subject matter hereof, all of which are merged into this Agreement. No representation, statement, condition, or warranty not contained in the Articles or this Agreement will be binding on the Members or have any force or effect whatsoever. To the extent that any provision of the Articles conflicts with any provision of this Agreement, the Articles shall control.**

*Comment:* An integration provision is important because the Beverly-Killea Limited Liability Company Act allows oral operating agreements. Corp C §17001(ab). The last sentence of this clause follows Corp C §17005(f).

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.224 18. Form: Interpretation

## §11.224 18. Form: Interpretation

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11.224-1 Interpretation

**[R.] *Interpretation.*** The headings in the articles, sections, and subsections of this Agreement are for convenience only and shall not constitute a part hereof. Whenever the context so requires, the masculine shall include the feminine and the neuter, the singular shall include the plural, and conversely. Any reference to the Code, the Regulations, the Act, the Corporations Code, or other statutes or laws will include all amendments, modifications, or replacements of the specific sections and provisions concerned. The terms and all parts of this Agreement shall in all cases be interpreted simply and according to their plain meaning and neither for nor against any party to this Agreement.

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.225 19. Form: References to This Agreement

### §11.225 19. Form: References to This Agreement

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11.225-1      References to this agreement

**[S.] *References to This Agreement.* References to numbered or lettered articles, sections, subsections, and clauses contained in this Agreement refer to articles, sections, subsections, and clauses of this Agreement unless otherwise expressly stated.**

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.226 20. Form: Exhibits

**§11.226 20. Form: Exhibits**

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11.226-1 Exhibits

**[T.] Exhibits.** All Exhibits attached to this Agreement are incorporated and shall be treated as if set forth in it.

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## §11.227 21. Form: Company Counsel

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11.227-1 Company counsel

**[U.] Company Counsel.** The Company has selected \_\_ *[name of law firm]* \_\_ as the Company Counsel. \_\_ *[The Company Counsel also represents \_\_ *[name of member]* \_\_]* \_\_. Each Member acknowledges that the Company Counsel does not represent any Member unless there is a clear and explicit written agreement to such effect between the Member and the Company Counsel, and that in the absence of any such agreement the Company Counsel shall owe no duties directly to a Member. The Manager may execute on behalf of the Company and the Members any conflict waiver or consent to the representation of the Company that the Company Counsel may request. Notwithstanding any adversity that may develop, in the event any dispute or controversy arises between any Member and the Company, or between any Manager and the Company, or between any Member or the Company on the one hand, and a Member or Manager (or Affiliate of a Member or Manager) that the Company Counsel represents on the other hand, then each Member agrees that the Company Counsel may represent any or all of the Company, the Member, or the Manager (or Affiliate) in any such dispute or controversy to the extent permitted by the California Rules of Professional Conduct, and each Member consents to such representation.

*Comment:* This provision says who the practitioner represents, and states in writing that the practitioner does not represent anyone else. All waivers of conflicts of interest require informed written consent. Cal Rules of Prof Cond 3-310(E). Depending on the circumstances, this waiver may not be sufficient to waive all future conflicts that may arise. The practitioner should monitor events and, if needed, obtain an additional waiver when a conflict occurs.

**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.228 22. Form: Independent Representation

## §11.228 22. Form: Independent Representation

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11.228-1 Independent representation

**[V.] *Independent Representation.* Each Member acknowledges that (1) this Agreement may result in substantial tax consequences to such Member, (2) such Member has had the opportunity to consult with such Member's own independent tax advisors regarding such tax consequences before signing this Agreement, (3) such Member has had the opportunity to consult with such Member's own independent legal counsel before signing this Agreement, and (4) the Company Counsel has not provided any advice or assistance to such Member regarding such Member's rights, liabilities, and obligations under this Agreement, the potential tax consequences that may result from this Agreement, or any other aspect of this Agreement.**

*Comment:* This provision may be deleted if the operating agreement contains the representations in §§11.203-11.205.

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**Source:** Business Law/Selecting and Forming Business Entities/11 Limited Liability Companies/§11.229 23. Form: Consent of Spouse

### §11.229 23. Form: Consent of Spouse

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11.229-1 Spousal consent

**[W.] *Consent of Spouse.* Within ten (10) days after any individual becomes a Member or a Member marries, such Member shall have his or her spouse execute a consent substantially in the form attached to this Agreement.**

*Comment:* Family Code §1100(d) provides that a spouse who is operating or managing a business or an interest in a business that is all or substantially all community property has the primary management and control of the business or interest, including the authority to dispose of such business or interest. Nevertheless, a spousal consent is useful to give notice to the non-member spouse and to give assurances to the other members that the non-member spouse will not interfere. See the form of Consent of Spouse in §11.232.

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## §11.230 24. Form: Special Power of Attorney

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11.230-1 Special power of attorney

### **[X.] Special Power of Attorney.**

**1. Attorney in Fact.** Each Member irrevocably constitutes and appoints the Manager, including each successor in that office, as the Member's true and lawful attorney in fact, with all power and authority to act in the Member's name and on the Member's behalf to execute, acknowledge, and deliver and swear to in the execution, acknowledgment, delivery, and filing of the following documents:

(a) Any certificate or other instrument that may be necessary, desirable, or appropriate to qualify the Company as a limited liability company or to transact business as such in any jurisdiction in which the Company conducts business;

(b) Any certificate or amendment to the Articles or to any certificate or other instrument that may be necessary, desirable, or appropriate to reflect an amendment approved by the Members under the provisions of this Agreement;

(c) Any certificate or amendment of this Agreement that may be necessary, desirable, or appropriate on the admission of a new Member or the Transfer of \_\_ *[a Membership Interest/Units]* \_\_ to accurately reflect the ownership of \_\_ *[Percentage Interests/Units]* \_\_ and Membership Interests in any exhibit to this Agreement;

(d) Any certificate or other instrument that may be necessary, desirable, or appropriate to reflect the dissolution or winding up of the Company;

(e) Any certificate or other instrument that may be necessary, desirable, or appropriate to comply with the provisions of this Agreement;

(f) Promissory notes, security agreements, and other documents and instruments to be delivered under Section \_\_ *[specify section of agreement; see §11.101]* \_\_;

(g) Assignments of \_\_ *[Membership Interests or Economic Interests/Units]* \_\_ or other documents of Transfer in connection with the purchase or sale of \_\_ *[Membership Interests or Economic Interests/Units]* \_\_ under Sections \_\_ *[specify section of agreement; see §§11.153-11.154]* \_\_; and

(h) Any consent to the representation of the Company Counsel as described in Section U of this Article XII.

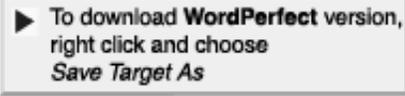
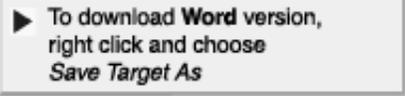
**2. Irrevocable Power.** The special power granted in Section X.1 of this Article XII is irrevocable, is coupled with an interest, and shall survive a Member's death, incapacity, or dissolution.

**3. Signatures.** The Manager may exercise the special power of attorney granted in Section X.1 of this Article XII by a signature or facsimile signature.

*Comment:* The power of attorney with respect to the consents stated in clause 1.(h) of this form may not be enforceable.

§11.231 N. Form: Signatures

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11.231-1 Signatures

**IN WITNESS WHEREOF, the Initial Members have duly executed this Agreement, effective as of the date first written above.**

*[If applicable, add one or more of the following options]*

*[Option 1: Individual signature]*

Date: \_\_\_\_\_  
    \_\_ [Signature]\_\_  
    \_\_ [Typed name]\_\_

*[Option 2: Signatures for corporation]*

Date: \_\_\_\_\_  
    \_\_ [NAME OF CORPORATION]\_\_ ,  
a \_\_ [state of incorporation]\_\_ **corporation**

By: \_\_\_\_\_  
    \_\_ [typed name]\_\_

**President**

By: \_\_\_\_\_  
    \_\_ [typed name]\_\_

**Secretary**

*[Option 3: Signatures for partnership]*

Date: \_\_\_\_\_  
    \_\_ [NAME OF PARTNERSHIP]\_\_ ,  
a \_\_ [state of organization]\_\_ **partnership**

By: \_\_ [Signature]\_\_  
Name: \_\_ [Typed name]\_\_  
Its: \_\_ [Title]\_\_

*[Option 4: Signatures for limited partnership with corporation as general partner]*

Date: \_\_\_\_\_  
    \_\_ [NAME OF PARTNERSHIP]\_\_ ,  
a \_\_ [state of organization]\_\_ **limited partnership**

By: \_\_ [name of corporate general partner]\_\_  
Its: **General Partner**

By: \_\_\_\_\_  
    \_\_ [typed name]\_\_  
**President**

By: \_\_\_\_\_  
    \_\_ [typed name]\_\_  
**Secretary**



**§11.233 P. Form: Exhibit A**

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11.233-1 Exhibit A

**EXHIBIT A**

**CAPITAL CONTRIBUTIONS AND ADDRESSES  
OF THE MANAGER AND THE INITIAL MEMBERS  
OF \_\_[name]\_\_ LLC  
AS OF \_\_[date]\_\_**

Name and Address	Capital Contribution	__[Percentage Interest/Number of Units]__
<u>The Manager:</u> __[name]__ __[address]__		
<u>The Initial Members:</u> __[name]__ __[address]__ [repeat as appropriate]	Cash in the amount of \$ __[amount]__, with a Capital Account credit of \$ __[amount]__, and a Capital Contribution Account credit of \$ __[amount]__. [repeat as appropriate]	__[Specify percentage interest or number of units]__
__[name]__ __[address]__ [repeat as appropriate]	__[Description]__ with an aggregate fair market value of \$ __[amount]__, with a Capital Account credit of \$ __[amount]__, and a Capital Contribution Account credit of \$ __[amount]__.	__[Specify percentage interest or number of units]__

# 12

## Converting Existing Entity to Limited Liability Company

Brad J. Brigante

### I. SCOPE OF CHAPTER §12.1

### II. PRELIMINARY CONSIDERATIONS WHEN CONVERTING TO A LIMITED LIABILITY COMPANY

- A. Why Convert? §12.2
- B. Statutory Conversion Provisions §12.3
- C. Statutory Conversion as Preferable Change of Entity Method §12.4
- D. Other Change of Entity Methods §12.5
  - 1. Statutory Merger §12.6
  - 2. LLC Holding Company §12.7
  - 3. Liquidation and Recontribution §12.8
  - 4. Drop Down to LLC §12.9

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    - b. Converting S Corporations §12.12
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  - 4. Effective Date of Conversion §12.35
- J. Notifying Creditors of Conversion §12.36
- K. Where Plan Must Be Kept §12.37
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### VI. CHECKLIST AND CHART

A. Checklist: Conversion §12.41

B. Chart: Secretary of State Conversion Information §12.42

## VII. FORMS

A. Form: Plan of Conversion for Partnership Converting to LLC §12.43

B. Form: Articles of Organization—Conversion (Secretary of State Form LLC-1A) §12.44

**§12.1 I. SCOPE OF CHAPTER**

This chapter discusses statutory conversions of other business entities (*i.e.*, foreign LLCs and domestic and foreign corporations, general partnerships, limited partnerships, business trusts, real estate investment trusts, and unincorporated associations (other than a nonprofit association)) into California LLCs. In addition, it discusses related tax issues (see §§12.10-12.18) and securities considerations (see §§12.19-12.22) affecting the decision of whether to convert an existing domestic or foreign business entity to a California LLC. Statutory conversion procedures are discussed in §§12.23-12.40.

This chapter assumes that the LLC formed as a result of the conversion will be taxed as a partnership. Conversion of partnerships or corporations to LLCs by merger and other forms of conversion, conversion of partnerships to corporations, conversion of LLCs to partnerships or corporations, and conversion of corporations to LLCs or partnerships are beyond the scope of this chapter. For further discussion of conversion, see *Advising California Partnerships*, chap 18 (3d ed Cal CEB 1999) and *Forming and Operating California Limited Liability Companies*, chap 11 (2d ed Cal CEB 2007).

**Source:** Business Law/Selecting and Forming Business Entities/12 Converting Existing Entity to Limited Liability Company/ II. PRELIMINARY CONSIDERATIONS WHEN CONVERTING TO A LIMITED LIABILITY COMPANY/§12.2  
A. Why Convert?

## **II. PRELIMINARY CONSIDERATIONS WHEN CONVERTING TO A LIMITED LIABILITY COMPANY**

### **§12.2 A. Why Convert?**

An existing partnership or corporation ordinarily converts to an LLC to obtain the corporate benefit of limited liability for its members and the partnership benefit of one level of income taxation. In addition, the LLC form often allows greater simplicity and more flexibility than partnership and corporation statutes, which impose more formal governance provisions than the Beverly-Killea Limited Liability Company Act (the Act) (Corp C §§17000-17656). Some practitioners may select the LLC form and elect corporate tax treatment solely to obtain the LLC governance rights. Further, because of relaxed entity formalities for LLCs as compared with corporations, it is less likely that an LLC's liability veil will be pierced due to failure to follow entity formalities.

To ensure that the client's objectives in converting to an LLC are satisfied, the practitioner must look at both the business and income tax considerations (see §§12.10-12.14), securities issues (see §§12.19-12.22), and other tax issues (see §§12.15-12.18).

### **§12.3 B. Statutory Conversion Provisions**

The conversion process enables a general partnership, limited partnership, corporation, or LLC to change its legal structure while not changing property ownership, contract rights and obligations, or relationships with creditors and debtors. In general, conversions from California or foreign other business entities to a California LLC are permissible if:

- The laws under which the converted business entity will exist expressly permit the formation of that entity by conversion (see Corp C §§1151(b)(1), 15911.02(b)(1), 16902(b)(1), 17540.8);
- The plan of conversion is approved by the requisite number of shareholders, partners, or members of the converting business entity (see Corp C §§1152(b), 15911.03(b), 16903(b));
- No economic dilution occurs to any shareholder, partner, or member of the converting business entity (see Corp C §§1151(a), 15911.02(a)(1), 16902(a)); and
- The requisite filings are made with the California Secretary of State and other foreign appropriate authorities, if applicable. See Corp C §§1151(b)(2), 15911.04(b), 16902(b)(2), 16906.

On the statutes that govern conversions, see §12.23.

**Source:** Business Law/Selecting and Forming Business Entities/12 Converting Existing Entity to Limited Liability Company/§12.4 C. Statutory Conversion as Preferable Change of Entity Method

### **§12.4 C. Statutory Conversion as Preferable Change of Entity Method**

If permitted, converting existing partnerships or corporations to LLCs via the statutory conversion provisions is usually preferable to other change of entity techniques (see §12.5). Like a statutory merger, a statutory conversion in compliance with state law ensures that the conversion is legally valid, the conversion is accomplished without numerous conveyance documents, and the assets and liabilities of the partnership become the assets and liabilities of the LLC by operation of law. Unlike a statutory merger, the converted LLC is treated as the same entity that existed before the conversion, thus avoiding conveyance or transfer taxes. Corp C §§1156, 1158(a), 15911.09, 16907, 16909(a).

**NOTE:** A conversion is not a change in ownership that results in a real property tax reassessment (Rev & T C §60), nor is it a transfer between entities excluded from reassessment under Rev & T C §62(a)(2) that will subject the LLC's real property to a reassessment when the original co-owners transfer more than 50 percent of their interests in the LLC in one or more future transactions. See §§12.16-12.17. For discussion of the statutory conversion provisions, see §§12.23-12.40.

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**Source:** Business Law/Selecting and Forming Business Entities/12 Converting Existing Entity to Limited Liability Company/§12.5 D. Other Change of Entity Methods

## **§12.5 D. Other Change of Entity Methods**

The statutory conversion approach may not always be available if the foreign jurisdiction involved does not provide for conversions (or for out-bound conversions) or the requisite entity approvals or other statutory requirements cannot be obtained or met. The four other common methods of changing the form of an entity into an LLC are discussed in §§12.6-12.9.

For a detailed discussion of these change of entity methods, see *Forming and Operating California Limited Liability Companies*, chap 11 (2d ed Cal CEB 2007).

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**Source:** Business Law/Selecting and Forming Business Entities/12 Converting Existing Entity to Limited Liability Company/§12.6 1. Statutory Merger

## **§12.6 1. Statutory Merger**

An entity may merge into a newly created LLC if authorized by the laws under which the entity is organized. Corp C §17550. California corporations, limited partnerships, and general partnerships are authorized to merge with existing LLCs. Corp C §§1113, 15911.10-15911.11, 16910. In a merger, the assets and liabilities of the disappearing business entity become the assets and liabilities of the surviving LLC by operation of law, without any further acts. Corp C §17554. Merging a corporation or partnership into an LLC in compliance with the Act's merger provisions ensures that the merger will be legally valid.

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**Source:** Business Law/Selecting and Forming Business Entities/12 Converting Existing Entity to Limited Liability Company/§12.7 2. LLC Holding Company

## **§12.7            2. LLC Holding Company**

The shareholders or partners in an existing corporation or partnership may contribute their shares or interests in the partnership to the LLC in exchange for LLC membership interests and then dissolve the corporation or partnership.

This structure does not meet the exact definition of a reorganization under Corp C §25120 and is probably better characterized as an issuer transaction under Corp C §25110. It would appear that the policy behind the protections afforded by the permit application process is unwarranted in this transaction, because any one partner could prevent the conversion under this method by declining to transfer its partnership interest to the LLC. Alternatively, it could be considered an exchange of securities by the issuer exclusively with its existing security holders under 10 Cal Code Regs §260.103. In either event, the transaction should be exempt if it meets the private-placement requirements of Corp C §25102(f). For further discussion of security issues, see §§12.19-12.22.

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**Source:** Business Law/Selecting and Forming Business Entities/12 Converting Existing Entity to Limited Liability Company/§12.8 3. Liquidation and Recontribution

### **§12.8            3. Liquidation and Recontribution**

A corporation or partnership may distribute its assets to the shareholders or partners in complete liquidation of their shares or partnership interests and the shareholders or partners may then contribute the assets to the newly formed LLC in exchange for membership interests.

This transaction should be viewed as an issuer transaction under Corp C §25110 and subject to the private-placement exemption under Corp C §25102(f). A step-transaction argument could be applied to make the reorganization provisions of Corp C §25120 applicable, but the same step-transaction argument should also make the provisions of 10 Cal Code Regs §260.103 available. See §12.7. For further discussion of security issues, see §§12.19-12.22.

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**Source:** Business Law/Selecting and Forming Business Entities/12 Converting Existing Entity to Limited Liability Company/§12.9 4. Drop Down to LLC

#### **§12.9            4. Drop Down to LLC**

Corporation or partnership assets may be contributed to a new LLC in exchange for membership interests followed by liquidation of the corporation or partnership and distribution of the LLC membership interests to the shareholders or partners.

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### **III. TAX ISSUES**

#### **A. Federal and State Income Taxes**

##### **§12.10 1. Converting Corporations**

Converting a corporation into an LLC that will be taxed as a partnership for federal income tax purposes can raise significant adverse tax consequences that may nullify the justifications for the conversion. When a corporation converts to an LLC and fails to elect to continue to be taxed as a corporation, the conversion results in two deemed steps for federal income tax purposes:

First, the corporation is treated as having been liquidated. See IRC §§331 (deemed liquidation occurs when corporation ceases to be going concern), 1001. This first step, consisting of distribution of corporate assets to the shareholders in complete liquidation of the corporation, is ordinarily not tax free. The distribution is regarded as a payment to the shareholders in exchange for their stock. This deemed liquidation can result in a double taxation of income to the corporation and to the shareholders. A corporate level tax applies to the deemed distributions of appreciated property; the corporation is taxed on the amount by which the fair market value of its appreciated assets on the deemed distribution date exceeds the corporation's tax basis in them. IRC §336. A shareholder level tax applies to deemed distributions of appreciated property; a shareholder is taxed on the amount by which the fair market value of the distributed assets exceeds the shareholder's basis in his or her stock. IRC §331.

Second, the shareholders are considered to have contributed the corporate assets to the LLC in exchange for membership interests. This second step generally is tax free. IRC §721.

**PRACTICE TIP:** Because of this double taxation, corporations should not ordinarily convert to LLCs when significant income tax exposure exists. However, in limited circumstances, conversion from the corporate form to the LLC form will not result in taxes, or it will make sense to pay the tax so that the shareholders can avail themselves of partnership tax classification. Counsel, in consultation with the corporation's accountant, should analyze the time value of money and the projected future growth of the corporation's business and evaluate whether the tax price and benefits of a conversion from a corporation to an LLC make conversion economically reasonable.

**Source:** Business Law/Selecting and Forming Business Entities/12 Converting Existing Entity to Limited Liability Company/§12.11 a. When Converting a C Corporation Is Appropriate

### **§12.11 a. When Converting a C Corporation Is Appropriate**

In general, the conversion of corporations to LLCs may generate adverse tax consequences. Accordingly, corporations should not ordinarily disincorporate and convert to LLC status. However, this rule does not necessarily apply in the following situations:

- For S or C corporations without built-in gain and with little or no appreciated assets (including goodwill).
- For S corporations with shareholders whose tax bases in their stock exceed the value of the assets distributed, resulting in a capital loss sufficient to offset any gain from the deemed distribution (*e.g.*, if a shareholder purchased shares at a value greater than the proportionate share of the tax basis of the S corporation assets or acquired shares from a decedent shareholder and the tax basis of the acquired shares is "stepped up" under IRC §1014(a)(1)).

**NOTE:** S corporations cannot make the special election available to partnerships under IRC §754 to adjust the basis of assets of the S corporation in an amount attributable to the increased value of the stock paid by an acquiring shareholder.

- For C corporations with little or no built-in gain or with sufficient net operating losses that offset any gain recognized under IRC §336 on the deemed liquidation of the corporation if (1) the fair market value of the corporation's assets do not exceed the shareholders' tax bases in the shares or (2) the shareholders have capital loss carryovers to offset the gain recognized from the deemed distribution under IRC §331.

**NOTE:** For California tax purposes, a net operating loss incurred in any income year is ordinarily eligible for carryover unless the taxpayer operates a new business or an eligible small business, as defined. The portion eligible for carryover is 100 percent for taxable years beginning on or after January 1, 2004. Rev & T C §§17276(b)(1)(D), 24416(b)(1)(D). However, the net operating loss carryovers for most businesses were suspended for 2008 and 2009. Rev & T C §17276.9. See also Rev & T C §§17041, 17276-17276.10, 24416.1-24416.10.

- When the shareholders intend the LLC to be taxed as a corporation for federal income tax purposes and the LLC makes a timely election to be taxed as a corporation on IRS Form 8832 under Treas Reg §301.7701-3(c). The conversion could then occur through a tax-free reorganization.
- When an 80-percent-or-more-owned subsidiary of a C corporation merges into an LLC and the requirements of IRC §332(b) are met.

## **§12.12      b. Converting S Corporations**

The general rules governing corporate liquidations (see §12.11) apply to an S corporation's liquidation because no specific S corporation provision addresses this issue. In the S corporation context, taxable gain is recognized at the corporate level to the extent that the fair market value of appreciated property distributed to S corporation shareholders in liquidation of their shares exceeds the corporation's tax basis in that property. IRC §§1363(b), 1371. However, for federal income tax purposes, only a single level of tax is imposed because the gain passes through to the shareholders, increasing their tax bases by the amount of recognized gain, resulting in a single tax at the shareholder level. IRC §1367(a)(1). This pass-through gain increases the shareholders' bases and prevents additional taxation in excess of the tax already imposed on the S corporation but paid by the shareholders.

**NOTE:** California deviates from the federal tax provisions on this issue, by taxing the S corporation on recognizable gain and thus effectively imposing two levels of tax. Rev & T C §23802.

The S corporation issues are more complicated if it has a C corporation history. For federal tax purposes, the corporation is subject to unrecognized built-in gain to the extent of the S corporation's income for its last taxable year. IRC §1374.

The IRS may view a statutory conversion of an S corporation into an LLC as either of the following:

- A liquidation of the corporation with the distribution of the corporation's assets to its shareholders, followed by their contribution to the LLC; or
- A contribution of the corporation's assets to the LLC in exchange for LLC interests that are then distributed to the shareholders in a liquidation distribution.

In IRS Letter Ruling 9543017, the IRS viewed a statutory merger of an S corporation into an LLC as a transfer by the corporation of its assets to the LLC in a nontaxable exchange for LLC interests under IRC §721, and then as a distribution of the LLC interests to the shareholders of the S corporation in complete liquidation of the corporation under IRC §331.

**NOTE:** In IRS Letter Ruling 9636007, the IRS permitted an S corporation to convert to an LLC in a tax-free reorganization and retain its S corporation status, even though the LLC was not a corporation under local law. Although the LLC was treated as a corporation under former classification regulations, the same principle should apply to permit a converting S corporation to avoid a taxable distribution of appreciated property if the resulting LLC elects to be treated as a corporation under the current check-the-box regulations.

### **§12.13 c. Corporations With Minimal Tax Risks**

The adverse tax consequences associated with the conversion of a corporation into an LLC taxed as a partnership ordinarily outweigh the nontax benefits. A corporation should consider changing into such an LLC only if the recognizable gain is limited or the corporation or its shareholders have sufficient losses to offset any gain that may be recognized. Corporations in the following three situations have minimal (but not completely eliminated) tax risks:

- **Net Operating Loss Carryovers.** A C corporation with net operating losses sufficient to offset any gain recognized under IRC §336 on the deemed liquidation, provided that the shareholders have either (1) tax bases in their shares greater than the fair market value of the C corporation's assets, or (2) capital losses sufficient to offset the gain recognized from the deemed distribution under IRC §331. See IRC §172; see also Rev & T C §§17041, 17276-17276.10, 24416, 24416.1-24416.10, 25108, 25110 (restrictions on net operating losses and deductions).
- **No Appreciation or Built-In Gain.** An S or C corporation that does not have any appreciated assets or an S corporation with no remaining prior built-in C corporation gain.
- **Inherent Loss in S Corporation Stock.** An S corporation with shareholders whose tax bases in their shares exceed the value of the distributed assets so that the shareholders have sufficient capital losses to offset any gain from the deemed distribution. This would occur if the shareholder (1) originally bought at a higher price than his or her proportionate share of the tax basis of the S corporation assets, or (2) received the shares from a decedent shareholder and the tax basis of the shares was "stepped-up" to the fair market value at the time of that transfer under IRC §1014(a)(1).

## **§12.14 2. Converting Partnerships**

The conversion of a general or limited partnership into an LLC that will be taxed as a partnership for federal income tax purposes is ordinarily income tax free if the members of the LLC continue to own their same proportionate ownership interests. See Rev Rul 95-37, 1995-1 Cum Bull 130, confirming that the tax consequences of a conversion of a partnership to an LLC are the same as those of a conversion of a general partnership to a limited partnership, as described in Rev Rul 84-52, 1984-1 Cum Bull 157.

Revenue Ruling 95-37 also provides guidance to taxpayers on the conversion of partnerships to LLCs. Revenue Ruling 95-37 holds that the converting domestic partnership's taxable year does not close with respect to any or all partners, that the new LLC does not need a new taxpayer identification number, and that the federal income tax consequences are the same no matter which method of conversion is adopted.

There are exceptions to the general rule that such conversions are income tax free. An LLC member's interest in the former partnership's debt may be decreased for tax purposes as a result of the conversion. A decrease in a partner's share of recourse debt is treated as a deemed distribution of cash to that partner. IRC §752(b). If the decrease in recourse debt exceeds the tax basis in the member's LLC interest, the member will recognize gain to that extent. IRC §§731(a), 752(b).

Normally, there is no such problem on conversion of a general partnership if the former general partners maintain the same share of all items and there are no different debt-sharing arrangements. However, when a limited partnership converts, the general partner's liability for recourse obligations may decline either immediately (if the general partner is actually released from liability for the obligations) or over a period of time (as the recourse trade payables are replaced by nonrecourse trade payables). The former general partner's share of increased nonrecourse liabilities usually will be less, resulting in a net decrease in debt.

**NOTE:** A recourse loan does not automatically become nonrecourse merely because the partnership converts to an LLC. The obligation may still be treated as recourse as to the general partners who signed the promissory note. Unless the lender executes a novation, the loan will be recourse under principles of equity and for purposes of IRC §752.

**PRACTICE TIP:** An accountant or tax attorney should analyze these issues before conversion to ascertain its likely impact.

## **B. Other Taxes**

### **§12.15 1. Sales and Use Taxes**

Any transfer of substantially all of the property of a business is exempt from sales and use tax if the real or ultimate ownership of the property is substantially similar before and after the transfer. Rev & T C §§6006.5(b), 6367. Corporate statutory mergers are categorically exempt under 18 Cal Code Regs §1595(b)(3). Other transfers are exempt if 80 percent or more of the property of the business is transferred and 80 percent or more of the ownership is unchanged by the transfer. 18 Cal Code Regs §1595(b)(2).

A contribution of assets to a newly formed partnership or corporation in exchange only for an interest in the newly formed entity does not ordinarily result in the imposition of sales tax. However, a sales tax could result if a new LLC receives tangible personal property subject to debt and the LLC assumes the liabilities. See 18 Cal Code Regs §1595(b)(4); *Beatrice Co. v State Bd. of Equalization* (1993) 6 CA4th 767, 25 CR2d 438 (formation of wholly owned subsidiary that received certain assets of the parent corporation subject to debt triggered taxable sale to extent of debt attributable to the tangible personal property transferred). This would not be the situation in a statutory conversion of a corporation or partnership into an LLC, because the corporation or partnership that converts into an LLC is treated as the same entity that existed before the conversion. Corp C §§1158, 15911.09(a), 16909(a), 17540.9(a).

## **§12.16 2. Real Property Transfer Taxes**

Cities and counties in California may impose a tax on the transfer of real property. Rev & T C §11911. The county tax is known as a documentary transfer tax and is levied at the rate of \$1.10 per \$1000 of equity of the real property transferred. Many cities have conveyance taxes that have their own unique rules and are levied generally at much higher rates than the county documentary transfer tax. The transfer of real property without consideration is exempt from real property transfer taxes. However, most counties in California treat transfers to partnerships in exchange for partnership interests as "consideration" subject to transfer taxes. Nevertheless, the legislature has exempted from county documentary transfer taxes transfers between legal entities that result solely in a change in the method of holding title and in which the proportional ownership interests remain the same immediately after the transfer. Rev & T C §11925(d).

A statutory conversion of a corporation or partnership into an LLC should not result in the imposition of real property transfer taxes. The conversion statutes provide that an entity that converts to another entity in a statutory conversion is for all purposes the same entity that existed before the conversion. Corp C §§1158, 15911.09(a), 16909(a), 17540.9(a).

**PRACTICE TIP:** To reduce the likelihood of rejection by the county recorder of a real property deed that does not state transfer taxes, any deed of conveyance from a partnership or corporation to an LLC recorded to change the title to the name of the LLC should contain a recital stating that no transfer tax is due because the grantee is treated as a continuing partnership within the meaning of IRC §708 and Rev & T C §11925(a) or because the transfer is treated as only a change in the method of holding title under Rev & T C §11925(d).

**§12.17      3. Property Tax Reassessment**

Real property is reassessed for tax purposes if there is a change in ownership as defined in Rev & T C §§60-69.5. See Cal Const art XIII A, §2(a). Real property owned by a corporation will be reassessed even in tax-free corporate reorganizations under IRC §368 unless all the corporations participating in the reorganization are members of an affiliated group. Rev & T C §64(b).

However, a statutory conversion of partnership or corporate interests into LLC membership interests, such that the former partners or shareholders retain the same economic percentage interests after the conversion, constitutes only a change in the *method* of ownership. Such a conversion would not be considered a change of ownership causing a reassessment of real property owned by the partnership or corporation. See Rev & T C §62(a). This result parallels county assessors' offices' treatment of conversions of general partnerships into limited partnerships.

**Source:** Business Law/Selecting and Forming Business Entities/12 Converting Existing Entity to Limited Liability Company/§12.18 4. Franchise Tax Considerations

#### **§12.18 4. Franchise Tax Considerations**

Conversion of an existing entity to an LLC requires the formation of an LLC and payment of the \$800 franchise tax fee for the year. Rev & T C §§17941, 23153(d)(1). An LLC that was converted from a corporation or limited partnership is not entitled to a credit for the franchise tax that the corporation or limited partnership was required to pay when filing its final tax return. The corporation or limited partnership and the LLC each must pay franchise taxes for the year and file state tax returns. However, the conversion of a corporation or limited partnership into an LLC may not subject the entity to an additional tax if a statutory conversion is used because the converted entity is treated as the same entity for all purposes. Corp C §§1158, 15911.09(a), 17540.9(a).

**PRACTICE TIP:** To save duplicate franchise tax fees, practitioners not using a statutory conversion should consider converting a corporation or limited partnership to an LLC effective on the last day of the entity's taxable year.

#### **IV. SECURITIES ISSUES**

##### **§12.19 A. Applicability of Securities Laws**

If the LLC membership interest issued in a conversion is a security, federal and state securities laws apply. The definition of "security" found in federal law does *not* specifically include LLC membership interests. 15 USC §77b(a)(1). However, the interests may be classified as securities under the "investment contract" analysis found in *SEC v W. J. Howey Co.* (1946) 328 US 293, 90 L Ed 1244, 66 S Ct 1100, and followed in *SEC v Edwards* (2004) 540 US 389, 157 L Ed 2d 813, 124 S Ct 892. If an LLC membership interest is treated as a security, the issuance of unregistered LLC interests violates the Securities Act of 1933 (15 USC §§77a-77aa) unless an exemption applies. See 15 USC §§77c-77d.

LLC membership interests are securities under California law unless all members of the LLC are actively engaged in its management. Corp C §25019. An LLC interest that is a security offered or sold in California must be "qualified" (equivalent to "registration" under federal laws) with the Department of Corporations, unless an exemption from the qualifying requirements is available.

## **§12.20 B. General Partnership Interests as Securities**

General partnership interests may or may not be securities under federal law. See *Matek v Murat* (9th Cir 1988) 862 F2d 720 (general partnership interest not found to be security); *Williamson v Tucker* (5th Cir 1981) 645 F2d 404, 424 (general partnership interest found to be security). See also *Hocking v Dubois* (9th Cir 1989) 885 F2d 1449, 1459 (adopting *Williamson* test in Ninth Circuit). Under the *Williamson* test, a general partnership interest (or joint venture interest) may be designated a security if the investor establishes the following (*Holding v Hagopian* (1992) 978 F2d 1115, 1119):

- The agreement among the parties leaves so little power in the hands of the partner that the arrangement distributed power as would a limited partnership;
- The partner is so inexperienced and unknowledgeable in business affairs that he or she is incapable of intelligently exercising his or her partnership powers; or
- The partner is so dependent on some unique entrepreneurial or management ability of the promoter or manager that he or she cannot replace the manager or otherwise exercise meaningful powers.

General partnership and LLC interests may or may not be securities under California law. See Corp C §25019. If the converted LLC membership interests are not securities, the conversion can be effected by a statutory conversion without a permit. If the converted LLC membership interests are securities and the partnership interests are not securities, the conversion can be viewed as an exchange of general partnership assets in exchange for LLC interests—a transaction more appropriately characterized as a Corp C §25110 issuer transaction and not a Corp C §25120 reorganization transaction. Hence, the transaction could be exempt if the requirements of Corp C §25102(f) are met.

However, if the conversion of the partnership interests into LLC membership interests that are securities occurs pursuant to the statutory conversion provisions, the conversion is an "entity conversion transaction," which is considered a Corp C §25120 reorganization transaction. See Corp C §§25005.1, 25120. The exemption of Corp C §25103(h) would ordinarily apply to the conversion if the transaction would have been exempt as an issuer transaction under Corp C §25102(f) (without giving effect to §25102(f)(3)). Corp C §25103(h)(1). Further, either of the following must be true (Corp C §25103(h)(1)):

- Not less than 75 percent of the outstanding equity securities of each converting entity entitled to vote on the proposed transaction voted in favor of the transaction; no more than 10 percent of the outstanding equity securities of each converting entity entitled to vote on the proposed transaction voted against the transaction; and the general partnership interests must be subject to a state statute that provides for dissenters' rights for those who do not vote in favor of, or who vote against, the transaction (Corp C §25103(h)(1)(A)); or
- The transaction is solely for the purposes of changing the partnership's state or form of organization; all the securities of the same class or series, unless all the security holders of the class or series consent, are treated equally; and the holders of nonredeemable voting equity securities receive nonredeemable voting equity securities. Corp C §25103(h)(1)(B).

A general partnership has dissenters' rights under Corp C §16909(e) and thus could come within the Corp C §25103(h)(1)(A) requirement. Under this alternative, the transaction must be approved by at least 75 percent of the membership interests and no more than 10 percent of the membership interests may vote against the transaction. Corp C §25103(h)(1)(A)(i)-(ii). The LLC is considered the same entity as the partnership "for all purposes" and thus may not represent a change in form of organization under Corp C §25103(h)(1)(B). Corp C §§16909(a), 17540.9(a).

### **§12.21 C. Limited Partnership Interests as Securities**

Limited partnership interests are ordinarily presumed to be securities, both under federal and state securities laws, because limited partners are statutorily precluded from exercising significant control over the management of the entity. A private offering exemption under federal securities law will likely be available for the conversion if the limited partnership is not publicly held. 15 USC §77d(2). A statutory conversion is an "entity conversion transaction" and, if not exempted, the conversion must be qualified under California law. See Corp C §§25005.1, 25120. Changes to the rights, preferences, privileges, or restrictions accompanying a conversion from a limited partnership to an LLC constitute a "sale" and, if not exempted, the transaction must be qualified under California law.

For statutory conversions, the exemption of Corp C §25103(h) ordinarily applies. To qualify, the transaction must meet the requirements of a private placement transaction under Corp C §25102(f) (without giving effect to §25102(f)(3)). The transaction also must be approved by at least 75 percent of the outstanding equity securities of both constituents, there may not be more than 10 percent dissenters, and each constituent entity must be subject to a law providing for dissenters' rights, or the transaction must be solely for the purpose of changing the state or form of organization, all security holders of the same class must be treated equally or consent, and holders of nonredeemable voting equity securities must receive nonredeemable voting equity securities. Corp C §25103(h)(1)(A)-(B). A limited partnership has dissenters' rights under Corp C §§15911.20-15911.33 (see Corp C §15911.03(c)) and thus could come within the Corp C §25103(h)(1)(A) requirement. See §12.6.

**Source:** Business Law/Selecting and Forming Business Entities/12 Converting Existing Entity to Limited Liability Company/§12.22 D. Corporate Shares as Securities

**§12.22 D. Corporate Shares as Securities**

An ownership interest in a corporation is a security under federal and state law. 15 USC §77b(a)(1); Corp C §25019. The issue of compliance with securities laws is therefore similar to the analysis triggered by a limited partnership's conversion to an LLC. See §12.21.

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**Source:** Business Law/Selecting and Forming Business Entities/12 Converting Existing Entity to Limited Liability Company/ V. STATUTORY CONVERSIONS/§12.23 A. Statutes Governing Conversion

## **V. STATUTORY CONVERSIONS**

### **§12.23 A. Statutes Governing Conversion**

The general circumstances under which a statutory conversion may take place are discussed in §12.3. With respect to the authorizing statutes, the Beverly-Killea Limited Liability Company Act (Corp C §§17000-17656) permits an "other business entity," a "foreign other business entity," or a foreign LLC to convert into a California LLC if conversion is authorized by the statute under which the converting entity is organized. Corp C §17540.8. The California General Corporation Law (Corp C §§100-2319), the Uniform Partnership Act of 1994 (RUPA) (Corp C §§16100-16962), and the Uniform Limited Partnership Act of 2008 (Re-RULPA) (Corp C §§15900-15912.07) contain provisions authorizing corporations, general partnerships, and limited partnerships to convert to other business entities or foreign other business entities.

**NOTE:** The Beverly-Killea Act also permits an LLC to convert into an "other business entity," a "foreign other business entity," or a foreign LLC. Corp C §17540.2.

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**Source:** Business Law/Selecting and Forming Business Entities/12 Converting Existing Entity to Limited Liability Company/§12.24 B. Conversion Entities

## **§12.24 B. Conversion Entities**

A limited partnership may convert into an "other business entity" (defined to include a corporation, a general partnership, and an LLC), a "foreign other business entity," or a foreign limited partnership. Corp C §15901.02(u).

A general partnership may convert into a limited partnership, LLC, corporation, or "foreign other business entity." Corp C §16902.

A corporation may convert into a "domestic other business entity" (defined to include a general partnership, a limited partnership, and an LLC organized under the laws of California). Corp C §§167.7, 1150-1151.

An LLC may convert to an "other business entity" (defined to include a corporation, a general partnership, and a limited partnership), a "foreign other business entity," or a foreign LLC. Corp C §§17001(s), (ac), 17540.2.

**NOTE:** Differences in the statutes are that a general partnership cannot convert to a general partnership even if the entities were formed in different states and that a domestic corporation may not convert into foreign other business entities.

For a chart that shows the various conversion entities, see §12.42.

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## **§12.25 C. Conversion Prerequisites**

The conversion of a California partnership or LLC can occur only if each of the partners or members of the converting entity receives a percentage interest in the profits and capital of the converted entity equal to that partner's or member's percentage interest in profits and capital of the converting entity. Corp C §§15911.02, 16902, 17540.2.

If the converting partnership or LLC is converting into a foreign entity, the conversion proceedings will be in accordance with the laws of the place of organization of the foreign entity and the conversion will become effective in accordance with that law. Corp C §§15911.05(b), 16905(b), 17540.5(b).

A conversion into a California entity is allowed only if the law under which the converting entity is organized authorizes the entity to effect the conversion. Corp C §§1157(a), 15911.08(a), 16908(a), 17540.8(a).

The conversion of a California corporation into a California partnership or LLC can occur only if (Corp C §1151(a)):

- Each share of the same class or series of the converting corporation must, unless all the shareholders of the class or series consent, be treated equally with respect to any cash, rights, securities, or other property to be received by, or any obligations or restrictions to be imposed on, the holder of that share; and
- Nonredeemable common shares of the converting corporation must be converted only into nonredeemable equity securities of the converted entity unless all of the shareholders of the class consent.

**NOTE:** The California General Corporation Law (Corp C §§100-2319) does not provide for the conversion of a California corporation into a foreign other business entity.

## **§12.26 D. Rights and Obligations on Conversion**

Each of the conversion statutes provides that an entity that converts into another entity pursuant to the governing statutes is for all purposes the same entity that existed before the conversion. Corp C §§1158(a), 15911.09(a), 16909(a), 17540.9(a). When a conversion takes effect, all of the following apply (Corp C §§1158(b), 15911.09(b), 16909(b), 17540.9(b)):

- All rights and property, whether real, personal, or mixed, of the converting entity are vested in the converted entity.
- All debts, liabilities, and obligations of the converting entity continue as debts, liabilities, and obligations of the converted entity.
- All rights of creditors and liens on the property of the converting entity are preserved unimpaired and remain enforceable against the converted entity to the same extent as against the converting entity as if the conversion had not occurred.
- Any action or proceeding pending by or against the converting entity may be continued against the converted entity as if the conversion had not occurred.

A shareholder, partner, or member of a converting entity is liable for all obligations of the converting entity for which the shareholder, partner, or member was personally liable before the conversion. Corp C §§1158(c)(1), 15911.09(c)(1), 16909(c)(1), 17540.9(c)(1). Similarly, a shareholder, partner, or member of a converting entity is liable for all obligations of the converted entity incurred after the conversion takes effect. However, these obligations may only be satisfied out of the converted entity's property if the interest holder is an LLC member unless the articles of organization or other governing documents expressly provide to the contrary. Corp C §§1158(c)(2)(B), 15911.09(c)(2), 16909(c)(2), 17540.9(c)(2). Further, a shareholder, partner, or member of a converted entity remains liable for any obligations of the converting entity for which the partner or member was personally liable before the conversion. Corp C §§1158(d), 15911.09(d), 16909(d), 17540.9(d).

If a party to a transaction with a converted entity reasonably believes at the time of the transaction that a shareholder, limited partner, or member continues to be a general partner of the converted entity, then the shareholder, limited partner, or member is liable for any obligation of the converted entity arising within 90 days after the conversion takes effect. Corp C §§1158(e), 15911.09(e), 17540.9(e).

**Source:** Business Law/Selecting and Forming Business Entities/12 Converting Existing Entity to Limited Liability Company/§12.27 E. Plan of Conversion

## **§12.27 E. Plan of Conversion**

A California converting entity must approve a plan of conversion, which includes the following (Corp C §§1152(a), 15911.03(a), 16903(a), 17540.3(a)):

- The terms and conditions of the conversion;
- The place of organization of the converting and the converted entities;
- The name of the converted entity after conversion, if different from that of the converting entity;
- The manner in which the interests of the converting entity will be converted into interests of the converted entity;
- The provisions of the governing documents of the converted entity, including the articles of organization and operating agreement, to which the holders of the converted entity will be bound;
- Any other details or provisions required by the law of the converted entity; and
- Any other details or provisions desired by the parties.

An entity converting to a California entity must approve a plan of conversion or similar instrument as required pursuant to the law under which the converting entity is organized. Corp C §§1157(b), 15911.08(b), 16908(b), 17540.8(b). See §12.29. The converted entity must then maintain the plan at the office where records are required to be kept under Corp C §17057. See §12.38.

**§12.28 F. Approval of Plan**

For a California converting limited partnership, the plan of conversion must be approved by all general partners and a majority in interest of each class of limited partners, unless a greater or lesser approval is required by the partnership agreement. However, if the limited partners would become personally liable for any obligations of the converted entity as a result of the conversion, the plan of conversion must be approved by all limited partners, unless the plan provides that all limited partners will have dissenters' rights. Corp C §15911.03(b).

For a California converting general partnership, the plan must be approved by the number or percentage of partners stated in the partnership agreement required to approve a conversion. If the agreement is silent, the plan must be approved by the number or percentage of partners required to amend the partnership agreement. If the conversion effects a change in the partnership agreement for which the partnership agreement requires a greater vote than is required to amend the agreement, the greater vote is required. If the partnership agreement is silent on the vote needed to amend the agreement, all partners must approve the plan of conversion. Corp C §16903(b). A partner of a converting general partnership who does not vote to approve a conversion and who does not agree to be a member of the converted entity has the right to dissociate from the partnership. Corp C §16909(e).

For a California converting corporation, the plan of conversion must be approved by the board of the converting corporation. Corp C §1152(b); see Corp C §151. The principal terms of the plan of conversion must also be approved by the outstanding shares of each class of the converting corporation. The approval of the outstanding shares may be given before or after the approval by the board. However, if the converting corporation is a close corporation, the conversion must be approved by at least two-thirds of each class of outstanding shares of the converting corporation (except that the articles may provide for a lesser vote, but not less than a majority of the outstanding shares of each class). Corp C §1152(b).

If a corporation is converted into a LLC, then the plan of conversion must also be approved by each shareholder who would become a manager, unless the shareholders have dissenters' rights. Corp C §1152(c).

**NOTE:** The approval required for a conversion of a foreign entity into a California LLC is governed by the law under which the converting entity is organized (or any permitted greater or lesser percentages stated in the converting entity's governing documents. Corp C §§15911.08(c), 16908(c), 17540.8(c).

**§12.29 G. Amendment of Plan**

Notwithstanding its prior approval, a plan of conversion may be amended before the conversion takes effect. Corp C §§1152(e), 15911.03(d), 16903(e).

If the converting entity is a corporation, the amendment must be approved by the board; if the amendment changes any of the principal terms of the plan of conversion, the shareholders of the converting corporation must approve the amendment in the same manner and to the same extent as was required for approval of the original plan of conversion. Corp C §1152(e).

If the converting entity is a limited partnership, the amendment must be approved by all general partners of the converting limited partnership; if the amendment changes any of the principal terms of the plan of conversion, the amendment must be approved by the limited partners of the converting limited partnership in the same manner and to the same extent as required for the approval of the original plan of conversion. Corp C §15911.03(d).

If the converting entity is a general partnership, the amendment must be approved by the partnership in the same manner, and by the same number or percentage of partners, as was required for approval of the original plan of conversion. Corp C §16903(e).

**Source:** Business Law/Selecting and Forming Business Entities/12 Converting Existing Entity to Limited Liability Company/§12.30 H. Dissenters' Rights

### **§12.30 H. Dissenters' Rights**

A statutory conversion is a "reorganization," that causes the dissenters' rights provisions of the corporate, limited partnership, and LLC conversion statutes to become applicable. Corp C §§1159, 15911.20-15911.33, 17600-17613. A partner in a general partnership may be entitled to dissociate from the partnership in the event of a conversion. Corp C §16909(e).

Within 10 days of the approval of the conversion, the converting entity must notify all shareholders and limited partners not voting in favor of the conversion of their dissenters' rights. Corp C §§1301(a), 15911.22(a). Persons wishing to exercise these rights must make a written demand for the purchase and payment, ordinarily within 30 days after the date that the notice of approval of conversion was sent to the dissenter. Corp C §§1301(b), 15911.22(b).

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**Source:** Business Law/Selecting and Forming Business Entities/12 Converting Existing Entity to Limited Liability Company/§12.31 I. Statement or Certificate of Conversion

### **§12.31 I. Statement or Certificate of Conversion**

Once a plan of conversion has been approved, a California converting entity must file a statement of conversion or a certificate of conversion with the Secretary of State. A statement of conversion is information added to an organizational document, such as an LLC's articles of organization. A certificate of conversion is a separate and independent document.

A statement or certificate of conversion ordinarily contains the name and Secretary of State file number of the converting entity, a statement that the plan of conversion has been properly approved, and the name, form, and jurisdiction of organization of the converted entity. Corp C §§1155(b), 15911.06(b), 16906(a), 17540.6(b). If the converting entity is a limited partnership, the statement or certificate of conversion must also state the mailing address of the converted entity's agent for service of process and the chief executive or executive office of the converted entity. Corp C §15911.06(b)(4).

If the converting entity is a domestic corporation, the statement or certificate of conversion must be executed and acknowledged by the chairman of the board, the president or any vice president, and by the secretary, the chief financial officer, the treasurer, or any assistant secretary or assistant treasurer. Corp C §§173, 1155(b).

If the converting entity is a domestic limited partnership, the statement or certificate of conversion must be executed and acknowledged by all general partners unless a lesser number is provided in the certificate of limited partnership. Corp C §15911.06(b).

If the converting entity is a domestic general partnership, the document must be signed by at least two partners. Corp C §16105(c).

**NOTE:** If the converting entity is foreign, the signature requirements are determined according to the laws of that jurisdiction. See chart in §12.42.

**Source:** Business Law/Selecting and Forming Business Entities/12 Converting Existing Entity to Limited Liability Company/§12.32 1. Filing Statement or Certificate of Conversion

### **§12.32 1. Filing Statement or Certificate of Conversion**

As discussed in §12.31, if a California entity is converting to a California LLC, a statement of conversion must be added to the articles of organization of the converted LLC. Corp C §§1155(a)(3), 15911.06(a)(1), 16906(a). The Secretary of State has adopted Form LLC-1A (Articles of Organization—Conversion), comprising articles of organization containing a statement of conversion, to be used when the converted entity is a domestic LLC. See form in §12.44.

The amount of the applicable fee that must accompany Form LLC-1A depends on the nature of the converting entity. If a corporation is involved in the conversion, the filing fee is \$150; in all other situations, the applicable filing fee is \$70. See chart in §12.42.

**NOTE:** The Secretary of State offers a "preclearance" service, which allows a customer to submit a business entity document in person in the Sacramento office before filing to determine if the document conforms to law and to receive a preclearance response within a guaranteed time frame. Only one copy of the document need be submitted. The Secretary of State also permits "expedited filing," which allows a customer to submit a business entity document in person in the Sacramento office and receive a filing response within a guaranteed time frame. For further information, consult the Secretary of State's website at the address listed in the Directory.

In contrast to a domestic LLC, if the converted entity will be a foreign entity, a certificate of conversion must be filed with the Secretary of State. Corp C §§15911.06(a)(4), 16906(b), 17540.6(a)(4). Form CONV-1A (Certificate of Conversion) may be used for this purpose. The Secretary of State also promulgates forms that a converted domestic general or limited partnership may use to file a statement of conversion: Form LP-1A (Certificate of Limited Partnership—Conversion) and Form GP-1A (General Partnership—Statement of Partnership Authority). Corp C §§1157(e), 15911.06(a)(1), (4), 16906(a), 17540.6(a). These forms are available on the Secretary of State's website; for the website address, see the Directory. See also conversion chart in §12.42.

**Source:** Business Law/Selecting and Forming Business Entities/12 Converting Existing Entity to Limited Liability Company/§12.33 2. Effect of Filing Statement or Certificate of Conversion

## **§12.33 2. Effect of Filing Statement or Certificate of Conversion**

Filing a certificate of conversion or an organizational document containing a statement of conversion with the Secretary of State has the effect of filing a certificate of dissolution or a certificate of cancellation of the converting entity; no other filing to dissolve the converting entity is required. Corp C §§1155(d), 15911.06(c), 16906(c), 17540.6(c). The filing of a certificate of conversion by a foreign entity is equivalent to a certificate of cancellation and the automatic surrender of the right to transact intrastate business. Corp C §§1157(f), 15911.08(e), 16908(e), 17540.8(e).

A copy of the certificate of conversion or organizational document containing a statement of conversion, certified by the Secretary of State, is conclusive evidence of the conversion of the converting entity. Corp C §§1153(b), 15911.04(b), 16904(b), 17540.4(b). On the effectiveness of a conversion, all shareholders, partners, or members of a converting entity, except those who exercise dissenters' rights or who dissociate, are deemed parties to any governing documents of the converted entity. Corp C §§1152(d), 15911.03(c), 16903(d), 17540.3(d).

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**Source:** Business Law/Selecting and Forming Business Entities/12 Converting Existing Entity to Limited Liability Company/§12.34 3. Recording Certified Evidence of Conversion by Converted Entity

**§12.34      3. Recording Certified Evidence of Conversion by Converted Entity**

If an entity that owns California real estate converts to another entity and the law of the state of organization of that entity provides substantially that the conversion vests in the converted entity all of the real property of the converting entity, certified evidence of the conversion may be recorded in the county in which the real estate is located. The filing will evidence record ownership in the converted entity of all interest of the converting entity in the real property located in the county of filing. Corp C §§1156(a), 15911.07(a), 16907(a), 17540.7(a). In addition, this filing creates, in favor of a bona fide purchaser or encumbrancer for value, a conclusive presumption that the conversion was validly completed. Corp C §§1156(c), 15911.07(c), 16907(c), 17540.7(c).

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**Source:** Business Law/Selecting and Forming Business Entities/12 Converting Existing Entity to Limited Liability Company/§12.35 4. Effective Date of Conversion

#### **§12.35 4. Effective Date of Conversion**

The conversion of a California entity becomes effective on the required approval of the shareholders, partners, or members of the converting entity, the filing of all documents required to create the converted entity (including a statement of conversion, if required), and the occurrence of the effective date if set forth in the plan of conversion. Corp C §§1157(d), 15911.04(a), 16904(a), 17540.4(a).

The conversion of a foreign entity into a California LLC becomes effective at the time the conversion is effective under the laws under which the converting entity is organized, provided that 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 conversion, the conversion is effective on the completion of all acts required under California law to form an LLC. Corp C §17540.8(d).

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**Source:** Business Law/Selecting and Forming Business Entities/12 Converting Existing Entity to Limited Liability Company/§12.36 J. Notifying Creditors of Conversion

**§12.36 J. Notifying Creditors of Conversion**

A member of a converted LLC is liable for obligations incurred by the converted entity within 90 days after the effective date of the conversion if the other party to the transaction reasonably believed that the member is a general partner. Corp C §17540.9(e). Thus, the LLC should consider notifying persons and companies who have done business with any of the converting entities of the conversion to avoid confusion and limit the potential liability of the members.

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**Source:** Business Law/Selecting and Forming Business Entities/12 Converting Existing Entity to Limited Liability Company/§12.37 K. Where Plan Must Be Kept

**§12.37 K. Where Plan Must Be Kept**

The converted entity must keep the plan of conversion at the office at which records are required to be kept under Corp C §17057 if the converted entity is a domestic limited liability company. Corp C §§1152(g), 15911.03(f), 16903(g). On the request of a shareholder or partner of the converting entity, the authorized person on behalf of the converted entity must promptly deliver a copy of the plan of conversion to the requesting party at the expense of the converted entity. A waiver by the holder of these rights is unenforceable. Corp C §§1152(g), 15911.03(f), 16903(g).

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**Source:** Business Law/Selecting and Forming Business Entities/12 Converting Existing Entity to Limited Liability Company/§12.38 L. Assumption of Tax Liabilities of Converting Entity

**§12.38 L. Assumption of Tax Liabilities of Converting Entity**

The Secretary of State will notify the Franchise Tax Board of the conversion. On the effectiveness of a conversion, a converted entity that is a domestic partnership, domestic limited partnership, or domestic limited liability company will be deemed to have assumed the liability of the converting corporation to (Corp C §1155(e)):

- Prepare and file, or cause to be prepared and filed, all tax and information returns otherwise required of the converting corporation under the Bank and Corporation Tax Law; and
- Pay any tax liability determined to be due pursuant to that law.

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**Source:** Business Law/Selecting and Forming Business Entities/12 Converting Existing Entity to Limited Liability Company/§12.39 M. Securities Law Compliance

### **§12.39 M. Securities Law Compliance**

If the LLC membership interests to be received in the statutory conversion are securities, the conversion is an "entity conversion transaction" and, if not exempted, the conversion must be qualified under California law. See Corp C §§25005.1, 25120. More specifically, an "entity conversion transaction" means a conversion pursuant to Corp C §§1151, 1157, 15911.02, 15677.8, 15911.02, 15911.08, 16902, 16908, 17540.2, 17540.8, or a conversion that occurs entirely out of state, unless the interests in the entity resulting from the conversion to be held by the equity holders of the entity being converted as a result of the conversion are not securities. Corp C §25005.1. However, most statutory conversions will be exempted under Corp C §25103(h). See §§12.19-12.22.

**NOTE:** For purposes of Corp C §§25103 and 25120, an entity conversion transaction is not a change in the rights, preferences, privileges, or restrictions of or on outstanding securities or an exchange of securities by the issuer with its existing security holders exclusively.

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**Source:** Business Law/Selecting and Forming Business Entities/12 Converting Existing Entity to Limited Liability Company/§12.40 N. Abandonment of Conversion

**§12.40 N. Abandonment of Conversion**

After a conversion has been approved, the parties may abandon the conversion before it is effective, subject to the contractual rights of third parties, if the converting entity obtains approval by the partners in the same manner as required for approval of the original plan of conversion. Corp C §§1152(f), 15911.03(e), 16903(f), 17540.3(f).

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## VI. CHECKLIST AND CHART

### §12.41 A. Checklist: Conversion

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- Determine whether statutory conversion to LLC can be approved by converting entities. See §12.28.
- Perform preliminary name check for converted LLC. See chap 3.
- Reserve proposed name of converted LLC. See chap 3.
- Draft plan of conversion. See §§12.27, 12.44.
- Determine manner of converting interests of converting entities into converted LLC. See §§12.26, 12.34.
- Submit plan of conversion for approval of converting entities. See §12.28.
- Will there be dissenting interests? See §12.30.
  - If so, arrange for buyout and determine how entity will purchase dissenting interests.
- Determine whether federal and state securities laws require that securities involved in conversion must be qualified or registered or are exempt. See §§12.19-12.22, 12.39.
- Determine who will manage converted LLC.
- Draft all LLC formation documents, including articles of organization containing a statement of conversion and an operating agreement. See chap 11.
- Complete all filings to establish LLC. See chap 11.
- Record certified original or copy of certified statement of conversion in every county where converted entity owns real property. See §12.34.
- Notify all creditors of effective date of conversion. See §12.36.
- Maintain plan of conversion at office where records are required to be kept under Corp C §17057. See §12.37.

**Source:** Business Law/Selecting and Forming Business Entities/12 Converting Existing Entity to Limited Liability Company/§12.42 B. Chart: Secretary of State Conversion Information

**§12.42 B. Chart: Secretary of State Conversion Information**



## California Secretary of State Conversion Information

A domestic (California) stock corporation (Corp) can convert into a California other business entity; a California limited liability company (LLC), limited partnership (LP) or general partnership (GP) can convert into a California or foreign other business entity; and a foreign business entity can convert into a California Corp, LLC, LP or registered GP if the conversion is permitted under the laws of the jurisdiction of the foreign business entity. (California Corporations Code commencing with Sections 1150, 15911.01, 16901 and 17540.1.) Note: A California Corp cannot convert to a foreign entity.

The following table identifies the correct document or form to be used and the fee required based on the specific type of conversion:

Document/Form	Converting Entity	Converted Entity	Filing Fee
Articles of Incorporation containing a statement of conversion. Article samples are available for the following conversions: <ul style="list-style-type: none"> <li>• Converting from a California LLC</li> <li>• Converting from a California LP</li> <li>• Converting from a California GP</li> <li>• Converting from a Foreign Entity</li> </ul>	California LLC, LP or GP; or Foreign Corp, LLC, LP, GP or Other Business Entity	California Corp	\$150
Limited Liability Company Articles of Organization – Conversion <ul style="list-style-type: none"> <li>• Form LLC-1A</li> </ul>	California Corp, LP, GP; or Foreign Corp, LLC, LP, GP or Other Business Entity	California LLC	\$150 if California Corp involved; \$70 for all others
Certificate of Limited Partnership - Conversion <ul style="list-style-type: none"> <li>• Form LP-1A</li> </ul>	California Corp, LLC, GP; or Foreign Corp, LLC, LP, GP or Other Business Entity	California LP	\$150 if California Corp involved; \$70 for all others
General Partnership Statement of Partnership Authority - Conversion <ul style="list-style-type: none"> <li>• Form GP-1A</li> </ul>	California Corp, LLC, LP; or Foreign Corp, LLC, LP or Other Business Entity	Registered GP	\$150 if California Corp involved; \$70 for all others
Certificate of Conversion <ul style="list-style-type: none"> <li>• Form CONV-1A</li> </ul>	California Corp, LLC, LP; or Foreign Corp, LLC, LP or Other Business Entity	Non-registered GP	\$150 if California Corp involved; \$30 for all others
	California LLC, LP, or Registered California GP	Foreign Entity	\$30

The following table clarifies the signature requirements for specific types of conversion filings:

Converting Entity	Signatories
California Corp	Executed and acknowledged by the chairman of the board, the president or any vice president <b>AND</b> the secretary, the chief financial officer, the treasurer or any assistant secretary or assistant treasurer. (California Corporations Code section 1155(b).)
California LLC	Executed and acknowledged by all the managers, unless a lesser number is provided in the articles of organization or the operating agreement. (California Corporations Code section 17540.6(b).)
California LP	Executed and acknowledged by all general partners, unless a lesser number is provided in the certificate of limited partnership. (California Corporations Code section 15911.06(b).) Note: Signing a document on behalf of a converting LP constitutes an affirmation under penalty of perjury that the facts stated in the document are true. (California Corporations Code section 15902.08(b).)
California GP	Executed by at least two partners. (California Corporations Code section 16105(c).)
Foreign Entity	According to the laws of the foreign jurisdiction.

CONVERSION INFORMATION (REV 01/2010)

*Comment:* This chart is available at the Secretary of State's website, <http://www.sos.ca.gov/business/llc/forms/llconv.pdf>.



## VII. FORMS

### §12.43 A. Form: Plan of Conversion for Partnership Converting to LLC

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#### AGREEMENT AND PLAN OF CONVERSION

*[Add one of the following alternatives]*

*[Alternative 1: Converting entity is general partnership]*

Effective as of \_\_[date]\_\_, the undersigned, being \_\_[all/a majority in interest/more than]\_\_ \_\_[percentage number]\_\_ percent of the Partners of \_\_[name of converting entity]\_\_, a California General Partnership (the "Partnership"), acting pursuant to Corporations Code §§16902 and 16903, which are part of the Uniform Partnership Act of 1994 (the "Partnership Act"), consent to this Agreement and Plan of Conversion (the "Agreement") with respect to the following facts:

#### RECITALS

A. The Partnership was formed under the laws of the State of California, pursuant to a General Partnership Agreement, dated \_\_[date]\_\_ (the "Partnership Agreement"), and a Statement of Partnership (Form GP-1) filed on \_\_[date]\_\_ with the California Secretary of State.

B. The Partners desire to convert the Partnership into a California limited liability company named \_\_[name of converted entity]\_\_, pursuant to Corporations Code §§16902-16903 and 16906, which are part of the Partnership Act, and Corporations Code §17540.8, which is part of the Beverly-Killea Limited Liability Company Act.

*[Alternative 2: Converting entity is limited partnership]*

Effective as of \_\_[date]\_\_, the undersigned, being \_\_[all/a majority in interest/more than]\_\_ \_\_[percentage number]\_\_ percent of the Partners of \_\_[name of converting entity]\_\_, a California limited partnership (the "Partnership"), acting pursuant to Corporations Code §§15911.02 and 15911.03, which are part of the Uniform Limited Partnership Act of 2008 (the "Limited Partnership Act") consent to this Agreement and Plan of Conversion (the "Agreement") with respect to the following facts:

#### RECITALS

A. The Partnership was formed under the laws of the State of California, pursuant to a Limited Partnership Agreement, dated \_\_[date]\_\_ (the "Partnership Agreement"), and a Certificate of Limited Partnership (Form LP-1) filed on \_\_[date]\_\_, with the California Secretary of State.

B. The Partners desire to convert the Partnership into a California limited liability company named \_\_[name of converted entity]\_\_, pursuant to Corporations Code §§15911.02, 15911.03 and 15911.06, which are part of the Limited Partnership Act, and Corporations Code §17540.8, which is part of the Beverly-Killea Limited Liability Company Act.

*[Continue]*

NOW THEREFORE, in consideration of mutual agreements, covenants, and conditions contained in this Agreement, and for other good and valuable consideration, the receipt and adequacy of which are hereby acknowledged, the Partners of the Partnership agree as follows:

A. **Definitions.** Capitalized terms used in this Agreement without other definition shall, unless expressly stated otherwise, have the meanings specified in the Operating Agreement of \_\_[name of converted entity]\_\_,

dated \_\_[date]\_\_, (the "Operating Agreement"), attached to this Agreement as Exhibit A.

**B. Terms and Conditions.** Effective on the filing of Articles of Organization-Conversion (Form LLC-1A) (the "Articles") with the California Secretary of State, the Partnership will be converted into \_\_[name of converted entity]\_\_, a California limited liability company (the "Limited Liability Company"), provided, however, that the Partners of the Partnership, who will be deemed Members in the Limited Liability Company from and after that date, will thereafter be governed by the Operating Agreement.

**C. Principal Office.** The principal office of the Limited Liability Company in California shall be located at \_\_[address]\_\_.

**D. Agent for Service of Process.** The agent for service of process of the Limited Liability Company as set forth in its Articles shall be \_\_[name and address of agent]\_\_.

**E. Conversion of Partnership Interests.** Each Partner's interest in the property, profits, losses, distributions, and capital of the Partnership shall be converted into an equal interest in the property, profits, losses, distributions, and capital of the Limited Liability Company.

**F. Governing Documents.** The provisions of the Articles and the Operating Agreement, to which the new Members of the Limited Liability Company agree to be bound, are attached to this Agreement as Exhibit B and Exhibit A, respectively.

[Add one of the following alternatives]

[Alternative 1: Approval of partners in general partnership]

**G. Approval of Partners.** \_\_[All/A majority in interest/More than \_\_[percentage number]\_\_]\_\_ percent of the Partners of the Partnership have approved the terms of this Agreement and Plan of Conversion in accordance with the Partnership Agreement and Corporations Code §16903, which is part of the Partnership Act.

[Alternative 2: Approval of partners in limited partnership]

**G. Approval Of Partners.** \_\_[All/A majority in interest/More than \_\_[percentage number]\_\_]\_\_ percent of the General Partners of the Partnership and \_\_[a majority in interest/ \_\_[percentage number]\_\_ percent]\_\_ of the Limited Partners of the Partnership have approved the terms of this Agreement and Plan of Conversion in accordance with the Partnership Agreement and Corporations Code §15911.03, which is part of the Limited Partnership Act.

[Continue]

#### **H. Miscellaneous Provisions.**

**1. Entire Agreement.** This Agreement, including any exhibits and schedules attached to it, constitutes the entire agreement between the Partners with respect to the subject matter of the Agreement, and it shall not be modified or amended in any respect except by a written instrument executed by all the parties. This Agreement replaces and supersedes all prior written and oral agreements by and among the partners. No party to this Agreement shall be bound to the other in any manner by any warranties, representations, or covenants with respect to the subject matter of this Agreement except as specifically set forth in it.

**2. Counterparts.** This Agreement may be executed in one or more counterparts, each of which shall be deemed an original, but all of which together shall constitute one and the same instrument, and shall become effective when there exist copies of this Agreement which, when taken together, bear the authorized signatures of each of the parties to it. Only one such counterpart signed by the party against whom enforceability is sought needs to be produced to evidence the existence of this Agreement.

**3. Governing Law.** This Agreement shall be governed by and construed in accordance with the laws of the State of California. Any action to interpret or enforce this Agreement shall be brought solely in the State of California. To the extent permitted by law, the parties agree that the sole venue for such an action shall be \_\_[county]\_\_, California. The parties each consent to the jurisdiction of California courts.

**4. Successors and Assigns.** This Agreement shall be binding on and inure to the benefit of the parties and their heirs, personal representatives, and permitted successors and assigns.

**5. Additional Documents.** The parties each agree to perform any and all acts and execute and deliver any and all additional documents that are or may become necessary or convenient or may be reasonably required to effectuate and carry out the provisions of this Agreement.

**IN WITNESS WHEREOF**, the Partners of \_\_ [name of converting entity]\_\_ and the new Partners of \_\_ [name of converted entity]\_\_ hereby execute this Agreement and Plan of Conversion.

[Add one of the following alternatives]

[Alternative 1: Signature block for general partnership]

Date: \_ \_ \_ \_ \_

\_\_ [NAME OF PARTNERSHIP]\_\_,  
a \_\_ [state of organization]\_\_ **partnership**

**By:** \_\_ [Signature]\_\_  
**Name:** \_\_ [Typed name]\_\_  
**Its:** \_\_ [Title]\_\_

[Alternative 2: Signature block for limited partnership]

Date: \_ \_ \_ \_ \_

\_\_ [NAME OF PARTNERSHIP]\_\_,  
a \_\_ [state of organization]\_\_ **limited partnership**

**By:** \_\_ [Signature]\_\_  
**Name:** \_\_ [Typed name]\_\_  
**Its: General Partner**

[Continue]

Date: \_ \_ \_ \_ \_

\_\_ [NAME OF LIMITED LIABILITY COMPANY]\_\_,  
a \_\_ [state of organization]\_\_ **limited liability company**

**By:** \_\_ [Signature]\_\_  
**Name:** \_\_ [Typed name]\_\_  
**Its:** \_\_ [Title]\_\_

*Comment:* This plan of conversion may be used by a general partnership converting to an LLC or a limited partnership converting to an LLC. On the contents and approval of a plan of conversion, see §§12.27-12.28.

**Source:** Business Law/Selecting and Forming Business Entities/12 Converting Existing Entity to Limited Liability Company/§12.44 B. Form: Articles of Organization--Conversion (Secretary of State Form LLC-1A)

**§12.44 B. Form: Articles of Organization—Conversion (Secretary of State Form LLC-1A)**





**State of California  
Secretary of State**

LLC-1A

File # \_\_\_\_\_

**Limited Liability Company  
Articles of Organization - Conversion**

**IMPORTANT — Read all instructions before completing this form.**

This Space For Filing Use Only

**Converted Entity Information**

1. NAME OF LIMITED LIABILITY COMPANY (End the name with the words "Limited Liability Company," or the abbreviations "LLC" or "L.L.C." The words "Limited" and "Company" may be abbreviated to "Ltd." and "Co.," respectively.)

2. THE PURPOSE OF THE LIMITED LIABILITY COMPANY IS TO ENGAGE IN ANY LAWFUL ACT OR ACTIVITY FOR WHICH A LIMITED LIABILITY COMPANY MAY BE ORGANIZED UNDER THE BEVERLY-KILLEA LIMITED LIABILITY COMPANY ACT.

3. THE LIMITED LIABILITY COMPANY WILL BE MANAGED BY (Check only one)

ONE MANAGER

MORE THAN ONE MANAGER

ALL LIMITED LIABILITY COMPANY MEMBER(S)

4. MAILING ADDRESS OF THE CHIEF EXECUTIVE OFFICE CITY STATE ZIP CODE

5. NAME OF AGENT FOR SERVICE OF PROCESS (Item 5: Enter the name of the agent for service of process. The agent may be an individual residing in California or a corporation that has filed a certificate pursuant to California Corporations Code section 1505. Item 6: If the agent is an individual, enter the agent's business or residential address in California. Item 7: If the converting entity is a California limited partnership, enter the mailing address of the individual or corporate agent. Check the box and omit the mailing address if the agent's mailing address is the same as the address in Item 6.)

6. IF AN INDIVIDUAL, ADDRESS OF AGENT FOR SERVICE OF PROCESS IN CA CITY STATE ZIP CODE  
**CA**

7. MAILING ADDRESS OF AGENT FOR SERVICE OF PROCESS CITY STATE ZIP CODE

THE MAILING ADDRESS OF THE AGENT FOR SERVICE OF PROCESS IS THE SAME AS THE AGENT'S BUSINESS OR RESIDENTIAL ADDRESS IN ITEM 6.

**Converting Entity Information**

8. NAME OF CONVERTING ENTITY

9. FORM OF ENTITY

10. JURISDICTION

11. CA SECRETARY OF STATE FILE NUMBER, IF ANY

12. THE PRINCIPAL TERMS OF THE PLAN OF CONVERSION WERE APPROVED BY A VOTE OF THE NUMBER OF INTERESTS OR SHARES OF EACH CLASS THAT EQUALED OR EXCEEDED THE VOTE REQUIRED. IF A VOTE WAS REQUIRED, PROVIDE THE FOLLOWING FOR EACH CLASS:

STATE THE CLASS AND NUMBER OF OUTSTANDING INTERESTS ENTITLED TO VOTE AND THE PERCENTAGE VOTE REQUIRED OF EACH CLASS

**Additional Information**

13. ADDITIONAL INFORMATION SET FORTH ON THE ATTACHED PAGES, IF ANY, IS INCORPORATED HEREIN BY THIS REFERENCE AND MADE A PART OF THIS CERTIFICATE.

14. I CERTIFY UNDER PENALTY OF PERJURY UNDER THE LAWS OF THE STATE OF CALIFORNIA THAT THE FOREGOING IS TRUE AND CORRECT OF MY OWN KNOWLEDGE. I DECLARE I AM THE PERSON WHO EXECUTED THIS INSTRUMENT, WHICH EXECUTION IS MY ACT AND DEED.

\_\_\_\_\_  
DATE

\_\_\_\_\_  
SIGNATURE OF AUTHORIZED PERSON

\_\_\_\_\_  
TYPE OR PRINT NAME AND TITLE OF AUTHORIZED PERSON

\_\_\_\_\_  
SIGNATURE OF AUTHORIZED PERSON

\_\_\_\_\_  
TYPE OR PRINT NAME AND TITLE OF AUTHORIZED PERSON

## Instructions for Completing the Articles of Organization - Conversion (Form LLC-1A)

**Where to File:** For easier completion, this form is available on the Secretary of State's website at [www.sos.ca.gov/business/be/forms.htm](http://www.sos.ca.gov/business/be/forms.htm) and can be viewed, filled in and printed from your computer. The completed form along with the applicable fees can be mailed to Secretary of State, Document Filing Support Unit, 1500 11th Street, 3rd Floor, Sacramento, CA 95814 or delivered in person (drop off) to the Sacramento office. If you are not completing this form online, please type or legibly print in black or blue ink. This form is filed only in the Sacramento office.

**Legal Authority:** Statutory provisions for conversion purposes are found in the California Corporations Code commencing with sections 1150, 15911.01, 16901 and 17540.1. All statutory references are to the California Corporations Code, unless otherwise stated. **Note:** If the converting entity is a domestic (California) limited partnership, signing Form LLC-1A constitutes an affirmation under penalty of perjury that the facts stated in the document are true. (Section 15902.08(b).)

- Form LLC-1A may be used for the following conversions: Any California or foreign corporation, foreign limited liability company, California or foreign limited partnership, California or foreign general partnership, or foreign other business entity converting into a California limited liability company.
- The conversion may be effected ONLY if: (1) the state laws of the converting entity and converted entity expressly permit the formation of that converted entity pursuant to a conversion; and (2) the conversion complies with all other applicable California and foreign laws.

**Professional Services:** Pursuant to Section 17375, a California limited liability company may not render professional services, as defined in Sections 13401(a) and 13401.3. Professional services are defined as any type of professional services that may be lawfully rendered only pursuant to a license, certification, or registration authorized by the Business and Professions Code, the Chiropractic Act, the Osteopathic Act or the Yacht and Ship Brokers Act. If your business is required to be licensed, certified or registered, it is recommended that you contact the appropriate licensing authority before filing with the Secretary of State's office in order to determine whether your services are considered professional. For licensing requirements in the state of California, please refer to the CalGold website at [www.calgold.ca.gov](http://www.calgold.ca.gov) or the California Department of Consumer Affairs website at [www.dca.ca.gov](http://www.dca.ca.gov).)

**Fees:** If a California corporation is the converting entity, the filing fee is \$150.00. For all other conversions, the filing fee is \$70.00. A \$15.00 special handling fee is applicable for processing documents delivered in person (drop off) to the Sacramento office. The special handling fee is in addition to the filing fee, should be included in a separate check, and will be retained whether the document is filed or rejected. The preclearance and/or expedited filing of a document *within a guaranteed time frame* can be requested for an additional fee in lieu of the special handling fee. Please refer to the Secretary of State's website at [www.sos.ca.gov/business/be/service-options.htm](http://www.sos.ca.gov/business/be/service-options.htm) for detailed information regarding preclearance and expedited filing services. The special handling fee or preclearance and expedited filings services are not applicable to documents submitted by mail. Check(s) should be made payable to the Secretary of State.

**Copies:** The Secretary of State will certify up to two copies of the filed document(s) without charge, provided that the complete copies with any required attachments are submitted to the Secretary of State with the document(s) to be filed. Any additional copies submitted will be certified with payment of \$8.00 per copy.

**Minimum Tax Requirement:** Filing this document shall obligate most limited liability companies to pay an annual minimum tax of \$800.00 to the Franchise Tax Board pursuant to California Revenue and Taxation Code section 17941.

### Complete the Limited Liability Company Articles of Organization – Conversion (Form LLC-1A) as follows:

- Item 1.** Enter the name of the limited liability company. The name must end with the words "Limited Liability Company," or the abbreviations "LLC" or "L.L.C." The words "Limited" and "Company" may be abbreviated to "Ltd." and "Co.," respectively. The name of the limited liability company may not contain the words "bank," "trust," "trustee," "incorporated," "inc.," "corporation," or "corp.," and must not contain the words "insurer" or "insurance company" or any other words suggesting that it is in the business of issuing policies of insurance and assuming insurance risks. (Sections 17051 and 17052.)
- Item 2.** This statement is required by statute and should not be altered. Provisions limiting or restricting the business of the limited liability company may be included as an attachment. (Section 17051.)
- Item 3.** Check the appropriate provision indicating whether the limited liability company is to be managed by one manager, more than one manager, or all the limited liability company member(s). (Section 17051.)
- Item 4.** If the converting entity is a California limited partnership, enter the mailing address, including the zip code, of the chief executive office of the limited liability company. (Section 15911.06.) Please do not abbreviate the name of the city.

- Item 5.** Enter the name of the agent for service of process in California. (Section 17061.) An agent is an individual, whether or not affiliated with the limited liability company, who resides in California or a corporation designated to accept service of process if the limited liability company is sued. The agent should agree to accept service of process on behalf of the limited liability company prior to designation. If a corporation is designated as agent, that corporation must have previously filed with the California Secretary of State, a certificate pursuant to California Corporations Code section 1505. Note: **A limited liability company cannot act as its own agent** and no domestic or foreign corporation may file pursuant to Section 1505 unless the corporation is currently authorized to engage in business in California and is in good standing on the records of the California Secretary of State.
- Item 6.** If the designated agent for service of process is an individual, enter the agent's business or residential address in California. Please do not enter "in care of" (c/o) or abbreviate the name of the city. (Section 17061.) Do not complete Item 6 if the agent is a corporation.
- Item 7.** If the converting entity is a California limited partnership, enter the mailing address, including the zip code, of the designated agent for service of process. **Note:** The mailing address is required whether the designated agent is an individual or a corporation. (Section 15911.06.) **If the designated agent is an individual**, check the box and omit the mailing address if the agent's mailing address is the same as the business or residential address in Item 6.
- Item 8.** Enter the exact name of the converting entity.
- Item 9.** Enter the form of the converting entity (i.e., limited partnership, corporation, etc.)
- Item 10.** Enter the jurisdiction (state or country) in which the converting entity was formed or organized.
- Item 11.** Enter the file number issued to the converting entity by the California Secretary of State, if any.
- Item 12.** This statement is required by statute and should not be altered. If a vote was required pursuant to the applicable law, specify the class and the number of outstanding interests of each class entitled to vote on the conversion and the percentage vote required for each class. Attach additional pages, if necessary.
- Item 13.** Attach any other information to be included in the Articles of Organization of the converted entity, provided that the information is not inconsistent with law. Also, attach additional conversion information required by the laws of the state of the converting entity, if any.
- Item 14.** Form LLC-1A must be signed as required by the applicable statutes, as follows:
- **If the converting entity is a California corporation:** Form LLC-1A must be signed and acknowledged by the chairman of the board, the president or any vice president AND the secretary, the chief financial officer, the treasurer or any assistant secretary or assistant treasurer. (Section 1155(b).)
  - **If the converting entity is a California limited partnership:** Form LLC-1A must be signed and acknowledged by all general partners, unless a lesser number is provided in the Certificate of Limited Partnership. (Section 15911.06(b).)
  - **If the converting entity is a California general partnership:** Form LLC-1A must be signed under penalty of perjury by at least two partners. (Section 16105(c).)
  - **If the converting entity is a foreign other business entity,** Form LLC-1A must be signed according to the laws of the foreign jurisdiction.

If additional signature space is necessary, the signatures may be made on an attachment to Form LLC-1A.

Any attachments to Form LLC-1A are incorporated by reference and made part of Form LLC-1A. All attachments should be 8 1/2" x 11", one-sided and legible.

Note: A Statement of Information (Form LLC-12) is required to be filed with the Secretary of State **within 90 days of filing Form LLC-1A and biennially thereafter** during the applicable filing period. The applicable filing period is the calendar month during which Form LLC-1A was filed and the immediately preceding five calendar months. (California Corporations Code section 17060.) Form LLC-12 is available on the Secretary of State's website at [www.sos.ca.gov/business/be/statements.htm](http://www.sos.ca.gov/business/be/statements.htm) and can be viewed, filled in and printed from your computer.



## LIMITED LIABILITY COMPANIES

### California Tax Information

Registration of a limited liability company (LLC) with the California Secretary of State (SOS) will obligate an LLC that is not taxed as a corporation to pay to the Franchise Tax Board (FTB) an annual minimum tax of \$800.00 and a fee based on the annual total income of the entity. The tax and fee are required to be paid for the taxable year of registration and each taxable year, or part thereof, until a Certificate of Cancellation is filed with the SOS. (California Revenue and Taxation Code sections 17941 and 17942.) An LLC is not subject to the taxes and fees imposed by Revenue and Taxation Code sections 17941 and 17942 if the LLC did no business in California during the taxable year and the taxable year was 15 days or less. (California Revenue and Taxation Code section 17946.)

An LLC that is taxed as a corporation generally determines its California income under the Corporation Tax Law commencing with California Revenue and Taxation Code section 23001.

**PLEASE NOTE:** A domestic nonprofit LLC is a taxable entity and subject to the tax requirements stated above unless the LLC has applied for tax-exempt status and the FTB determines the LLC qualifies for tax-exempt status. Therefore, until such a determination is made, a nonprofit LLC must file a return and pay the associated tax (and, if applicable, the fee) every year until the LLC is formally cancelled. If the LLC intends to seek tax exempt status:

- At the time of filing its Articles of Organization with the SOS, the LLC must include, in an attachment to that document, additional statements as required by the law under which the LLC is seeking exemption. Please refer to the FTB's Exemption Application Booklet (FTB 3500 Booklet) for information regarding the required statements and for suggested language.
- After filing its Articles of Organization with the SOS, the LLC may apply for tax-exempt status by mailing an Exemption Application (Form FTB 3500), along with an endorsed copy of the Articles of Organization and all other required supporting documentation, to the FTB, P.O. Box 942857, Sacramento, California 94257-4041.
- The FTB 3500 Booklet and Form FTB 3500 can be accessed from the FTB's website at [www.ftb.ca.gov](http://www.ftb.ca.gov) or can be requested by calling the FTB at 1-800-338-0505. For further information regarding franchise tax exemption, refer to the FTB's website or call the FTB at (916) 845-4171.

For further information regarding franchise tax requirements, please contact the FTB at:

From within the United States (toll free) .....	(800) 852-5711
From outside the United States (not toll free) .....	(916) 845-6500
Automated Service - From within the United States (toll free) .....	(800) 338-0505
Automated Service - From outside the United States (not toll free).....	(916) 845-6600

### Professional Services Information

A domestic or foreign LLC may not render professional services. (Corp. Code § 17375.) "Professional services" are defined in California Corporations Code sections 13401(a) and 13401.3 as:

Any type of professional services that may be lawfully rendered only pursuant to a license, certification, or registration authorized by the Business and Professions Code, the Chiropractic Act, the Osteopathic Act or the Yacht and Ship Brokers Act.

If your business is required to be licensed, registered or certified, it is recommended that you contact the appropriate licensing authority before filing with the SOS's office in order to determine whether your services are considered professional.

partnership, or foreign entity, and the converted entity will be a California LLC. See chart in §12.42. The form is available on the Secretary of State's website and may be completed online and printed out. See <http://www.sos.ca.gov/business/llc/forms/llcconv.pdf>.

For information on the applicable fees and preclearance and expedited filing, see §12.32.

If a domestic LLC, limited partnership, or registered domestic general partnership converts to a foreign LLC (or other business entity), the conversion proceedings will be in accordance with the laws of the place of organization of the foreign entity and the conversion will become effective in accordance with that law. Corp C §§15911.05(b), 16905(b), 17540.5(b). Such a converting entity must file Form CONV-1A, rather than this form, accompanied by the applicable fee, with the Secretary of State. See §12.32.

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**Source:** Business Law/Selecting and Forming Business Entities/Directory

Directory

**Websites, addresses, and phone numbers referred to in the text.**

If we have omitted useful websites or if website changes have occurred since publication, please send that information by e-mail to [general\\_law@ceb.ucla.edu](mailto:general_law@ceb.ucla.edu).

§2.101

A form of Sample Articles of Incorporation for California Stock Corporation is available at [http://www.sos.ca.gov/business/corp/pdf/articles/corp\\_artsgen.pdf](http://www.sos.ca.gov/business/corp/pdf/articles/corp_artsgen.pdf).

The form Statement of Information (Domestic Stock Corporation) (Form SI 200 C) is available at [http://www.sos.ca.gov/business/bpd\\_forms.htm](http://www.sos.ca.gov/business/bpd_forms.htm).

§2.104

Forms for professional corporations for attorneys may be found at [http://calbar.ca.gov/calbar/pdfs/law\\_corp\\_issue\\_reg\\_corp.pdf](http://calbar.ca.gov/calbar/pdfs/law_corp_issue_reg_corp.pdf).

§2.105

The form Statement of Partnership Authority (Secretary of State Form GP-1) is available at [http://www.sos.ca.gov/business/bpd\\_forms.htm](http://www.sos.ca.gov/business/bpd_forms.htm).

§2.106

The form Certificate of Limited Partnership (Secretary of State Form LP-1) is available at [http://www.sos.ca.gov/business/bpd\\_forms.htm](http://www.sos.ca.gov/business/bpd_forms.htm).

§2.107

The form Registered Limited Liability Partnership Registration (Secretary of State Form LLP-1) may be found at <http://www.sos.ca.gov/business/llp/forms/llp-1.pdf>.

The form Alternative Security Provision (Secretary of State Form LLP-3) is available at <http://www.sos.ca.gov/business/llp/forms/llp-3.pdf>.

Forms to register an LLP with the State Bar of California are available on the State Bar website at <http://www.calbar.org/2cer/llp/llpapply.htm>.

The State Bar form Application for Issuance of Certificate of Registration as a Limited Liability Partnership is available at <http://www.calbar.org/2cer/llp/llpapply.htm>.

§2.108

The form Articles of Organization (Secretary of State Form LLC-1) is available at [http://www.sos.ca.gov/business/bpd\\_forms.htm#llc](http://www.sos.ca.gov/business/bpd_forms.htm#llc).

The form Statement of Information (Secretary of State Form LLC-12) is available at [http://www.sos.ca.gov/business/bpd\\_forms.htm](http://www.sos.ca.gov/business/bpd_forms.htm).

§§2.200, 2.207

General tax information for businesses, including information about when and how to apply for a Federal Employer Tax Identification Number, is available on the IRS Business Topics website at <http://www.irs.gov/businesses/index.html>.

The form IRS Form SS-4, Application for Employer Identification Number is available on the IRS website at <http://www.irs.gov/pub/irs-pdf/fss4.pdf>.

Instructions for Form SS-4, information on methods for filing it, and addresses and phone numbers for filing it are available in the instructions for the form at <http://www.irs.gov/pub/irs-pdf/iss4.pdf>.

Form SS-4 is also available by telephone at 800-829-3676.

Form SS-4 may be filed by any of the following methods:

**Mail.** Complete and mail the form to the appropriate IRS office. If the principal place of business, office, or agency—or legal residence of an individual—is in California; or if a business has no principal place of business, office, or agency in any state, mail

the form to:

Internal Revenue Service Center

Attn: EIN Operation

Philadelphia, PA 19255

**Telephone.** Complete the form, then call the IRS at 800-829-4933 to obtain the number over the telephone.

**Fax.** Complete and fax form to the IRS, using the IRS Fax-TIN number. If the principal place of business, office, or agency, or legal residence of an individual is in California, the Fax-TIN is: 859-669-5760. If the business has no principal place of business, office, or agency in any state, the Fax-TIN is: 215-516-1040.

**Online application.** An application for a FEIN is available at <http://www.irs.gov/businesses/small/article/0,,id=102767,00.html>.

### §§2.201, 2.208

Information about employer registration with the California Employment Development Department is available at [http://www.edd.ca.gov/Payroll\\_Taxes](http://www.edd.ca.gov/Payroll_Taxes).

The EDD Form DE 1 for the current tax year is available at [http://www.edd.ca.gov/Payroll\\_Taxes/Forms\\_and\\_Publications.htm](http://www.edd.ca.gov/Payroll_Taxes/Forms_and_Publications.htm).

EDD Form DE 1 may be filed by any of the following methods:

**Mail.** Complete and mail the Form DE 1 to:

Account Services Group (ASG) MIC 28

P.O. Box 826880

Sacramento, CA 94280-0001

**Fax.** Complete and fax the Form DE 1 to the EDD at 916-654-9211.

**Telephone.** Call for telephone registration at 916-654-8706.

The two California EDD publications, California Employer's Guide (EDD Publication DE 44) and Sample Forms Guide (EDD Publication DE 45), are available for the current tax year at [http://www.edd.ca.gov/Payroll\\_Taxes/Forms\\_and\\_Publications.htm#Publications](http://www.edd.ca.gov/Payroll_Taxes/Forms_and_Publications.htm#Publications).

### §2.202

The mailing address for the California State Board of Equalization (BOE) is:

Sacramento District Office

3321 Power Inn Road, Suite 210

Sacramento, CA 95826-3889

For questions about seller's permit applications, call 916-277-6688.

Other contact information for the BOE is as follows:

Information: 800-400-7115

TDD Services: 800-735-2929 (TDD Phones); 800-735-2922 (Voice Phones)

Tax Practitioners Hotline: 800-401-3661

Website: <http://www.boe.ca.gov>.

### §2.203

Information on applicable licenses and permits particular to a business, including city and local permits, is available on the California Business Portal, sponsored by the California Economic Development Partnership, at <http://www.calbusiness.ca.gov>.

The Small Business Assistance Center of the California Tax Service Center:  
[http://www.taxes.ca.gov/Small\\_Business\\_Assistance\\_Center/index.shtml](http://www.taxes.ca.gov/Small_Business_Assistance_Center/index.shtml).

CalGOLD, sponsored by the California Environmental Protection Agency, provides links and contact information for agencies that administer and issue business permits, licenses, and registration requirements, and is available at <http://www.calgold.ca.gov>.

#### §§3.4, 3.20

The United States Patent and Trademark Office maintains a trademark searches website at <http://www.uspto.gov/main/trademarks.htm>.

#### §§3.5, 3.15

The California Secretary of State website for name searches for corporations, LPs, and LLCs is at <http://kepler.sos.ca.gov/list.html>.

The California State Association of Counties maintains a list of counties, which may be used for county-by-county fictitious business name searches, and is available at <http://www.csac.counties.org>.

The number to call at the office of the California Secretary of State to set up a prepaid business name reservation account is 916-653-1233.

#### §3.32

The addresses of the Secretary of State's Sacramento office and regional offices are listed online (with maps) at <http://www.sos.ca.gov/business/regional.htm>. They are also listed in this Directory under §8.18, below.

#### §7.23

The State Bar website where forms are available for registering LLPs is <http://www.calbar.ca.gov>.

LLP forms are also available at:

State Bar Office of Certification

180 Howard Street

San Francisco, CA 94105-1639

415-538-2122

#### §7.24

Contact information for the California Board of Accountancy is as follows:

2000 Evergreen Street, Suite 250

Sacramento, CA 95815-3832

916-263-3680

Fax: 916-263-3675

Website: <http://www.dca.ca.gov/cba>

#### §7.25

Contact information of the California Architects Board is as follows:

2420 Del Paso Rd., Suite 105

Sacramento, CA 95834

916-574-2220

Fax: 916-575-7283

Email: [cab@dca.ca.gov](mailto:cab@dca.ca.gov)

<http://www.cab.ca.gov>

#### §8.11

Information is available on corporate names from the Secretary of State's office at

Division of Corporation Filing and Services

1500 Eleventh Street, Third Floor

Sacramento, CA 95814

Recorded information from the Secretary of State's Name Availability Unit is available at 916-657-5448.

The website of the Secretary of State's office for information on checking and reserving a corporate name is [http://www.sos.ca.gov/business/corp/corp\\_naav.htm](http://www.sos.ca.gov/business/corp/corp_naav.htm).

Addresses of the Secretary of State's regional offices, for processing over-the-counter name reservation requests, and of the Sacramento office, for handling all other requests, are available at <http://www.sos.ca.gov/business/regional.htm>.

#### §§8.14, 8.17

The Secretary of State's office that provides assistance and advice regarding possible problems in articles of incorporation that might render them unacceptable for filing may be contacted at:

Secretary of State

Legal Review Unit

1500 11th Street, Third Floor

Sacramento, CA 95814

916-657-5448

Filing tips for articles of incorporation are available at <http://www.sos.ca.gov/business/be/filing-tips-corp.htm>.

#### §§8.18, 8.19

The website of the Secretary of State's Business Portal, containing information on forms, filing, fees, and addresses, is <http://www.sos.ca.gov/business/business.htm>.

Information on the Secretary of State's preclearance service is available at <http://www.sos.ca.gov/business/precexp.htm#preclear>.

Articles of incorporation may be filed at these offices of the Secretary of State:

#### **Sacramento Office**

Business Programs Division

1500 11th St.

Sacramento, CA 95814

916-657-5448

#### **Los Angeles Office**

300 South Spring Street, Room 12513

Los Angeles, CA 90013

213-897-3062

**NOTE:** Articles of incorporation containing a statement of conversion must be filed in the Sacramento office. See <http://www.sos.ca.gov/business/regional.htm>.

#### §8.21

The website for the California Franchise Tax Board is <http://www.ftb.ca.gov>. It includes forms, information and assistance, services for tax professionals, and online services.

#### §8.122

The form Notice of Transaction Pursuant to [Corporations Code §25102\(f\)](#), and instructions for filing the form, electronically or by paper, are available at the Department of Corporations website at <http://www.corp.ca.gov/forms/default.asp>.

### §10.76

The form for Application for Issuance of Certificate of Registration as a Law Corporation (State Bar of California) is available at [http://calbar.ca.gov/state/calbar/calbar\\_generic.jsp?cid=10164&id=1314](http://calbar.ca.gov/state/calbar/calbar_generic.jsp?cid=10164&id=1314).

### §10.77

Fictitious name search lists for the Medical Board of California are available at [http://www.mbc.ca.gov/licensee/fictitious\\_name.html](http://www.mbc.ca.gov/licensee/fictitious_name.html).

### §11.7

Information about the Franchise Tax Board's procedure for refunding previously paid LLC fees is available at: <http://www.ftb.ca.gov/professionals/taxnews/article/LLCfee.html>.

### §11.11

The form Notice of Transaction Pursuant to Corporations Code §25102(f), and instructions for filing the form, electronically or by paper, are available at the Department of Corporations website at <http://www.corp.ca.gov/forms/default.asp>.

### §11.29

The form Limited Liability Company Articles of Organization (Secretary of State Form LLC-1) is available at <http://www.sos.ca.gov/business/llc/forms/llc-1.pdf>.

### §12.32

Information about the Secretary of State's preclearance review and expedited filing procedures may be found at <http://www.sos.ca.gov/business/precexp.htm#preclear>.

The form Limited Liability Company Articles of Organization—Conversion (Secretary of State Form LLC-1A) may be found at <http://www.sos.ca.gov/business/llc/forms/llcconv.pdf>.

The form Certificate of Limited Partnership—Conversion (Secretary of State Form LP-1A) may be found at <http://www.sos.ca.gov/business/lp/forms/lpconv.pdf>.

The form General Partnership—Statement of Partnership Authority-Conversion (Secretary of State Form GP-1A) may be found at <http://www.sos.ca.gov/business/gp/forms/gpconv.pdf>.

The form Certificate of Conversion (Secretary of State Form CONV-1A) is available at <http://www.sos.ca.gov/business/corp/pdf/obeconv.pdf>.

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**Source:** Business Law/Selecting and Forming Business Entities/Internet Resources for California Businesses

Internet Resources for California Businesses

A. Government Sites—Federal

Americans with Disabilities Act	<a href="http://www.ada.gov">http://www.ada.gov</a> Information and technical assistance on the ADA by the U.S. Department of Justice.
Board of Governors of the Federal Reserve System	<a href="http://www.federalreserve.gov/">http://www.federalreserve.gov/</a> Home page with informational links about the "Fed," monetary policy, banking regulation, economic data, and other topics.
Bureau of Industry and Security (BIS), U.S. Department of Commerce	<a href="http://www.bis.doc.gov/about/index.htm">http://www.bis.doc.gov/about/index.htm</a> Federal agency that administers the U.S. export control and treaty compliance system, including the Export Administration Regulations (EAR).
Business.gov	<a href="http://www.business.gov/">http://www.business.gov/</a> Home page, operated by the U.S. Small Business Administration, with links to legal and regulatory information, and plain-English guides for starting a business, handling finances, managing employees, and other topics.
CIA, The World Factbook	<a href="https://www.cia.gov/library/publications/the-world-factbook/">https://www.cia.gov/library/publications/the-world-factbook/</a> U.S. government profiles of countries and territories around the world.
Equal Employment Opportunity Commission (EEOC)	<a href="http://www.eeoc.gov/">http://www.eeoc.gov/</a> EEOC site with basic introduction to employers' rights and responsibilities under the federal equal employment opportunity laws.
Federal agencies (through Library of Congress site)	<a href="http://www.loc.gov/rr/news/fedgov.html">http://www.loc.gov/rr/news/fedgov.html</a> A Library of Congress resource page with links to most federal agencies.
Federal Citizen Information Center (FCIC)	<a href="http://www.pueblo.gsa.gov/">http://www.pueblo.gsa.gov/</a> Part of the U.S. General Services Administration, the FCIC's Small Business Links offer information for persons planning or owning small businesses, including information on procurement, taxes, woman- and minority-owned businesses, human resources, and financial and legal issues.
Federal Deposit Insurance Corporation (FDIC)	<a href="http://www.fdic.gov/">http://www.fdic.gov/</a> Home page with links to statistical data, pertinent regulations, and FAQs.
Federal Register	<a href="http://www.gpoaccess.gov/fr/index.html">http://www.gpoaccess.gov/fr/index.html</a> Main page, with search functions, for the Federal Register—the official daily publication for federal agency rules, proposed rules, and notices as well as executive orders. Specific Federal Register pages can be retrieved at <a href="http://www.gpoaccess.gov/fr/retrieve.html">http://www.gpoaccess.gov/fr/retrieve.html</a>
Federal Reserve Bank of San Francisco	<a href="http://www.frbsf.org/">http://www.frbsf.org/</a> Home page. The current FRBSF discount rate, used to determine the usury ceiling in California, is posted at <a href="http://www.frbsf.org/banking/data/discount/index.html">http://www.frbsf.org/banking/data/discount/index.html</a>
Federal Trade Commission	<a href="http://www.ftc.gov/ftc/business.shtml">http://www.ftc.gov/ftc/business.shtml</a> Home page for businesses, with links to business publications, advertising guidance, fair packaging and labeling, antitrust law guide, and other topics. Information concerning the Hart-Scott-Rodino premerger notification requirements is at <a href="http://www.ftc.gov/bc/hsr/introguides/introguides.htm">http://www.ftc.gov/bc/hsr/introguides/introguides.htm</a>
USA.gov	<a href="http://www.usa.gov/Business/Business_Gateway.shtml">http://www.usa.gov/Business/Business_Gateway.shtml</a>

	The official web portal of the U.S. government, with links to information on contracting with the U.S. government, export licenses, business financial assistance, and many other topics.
Internal Revenue Service	<a href="http://www.irs.gov/">http://www.irs.gov/</a> Home page; access to downloadable IRS forms and publications.
Occupational Safety and Health Administration (OSHA)	<a href="http://www.osha.gov/">http://www.osha.gov/</a> Home page.
Office of the Comptroller of the Currency (OCC)	<a href="http://www.occ.treas.gov/">http://www.occ.treas.gov/</a> Home page with links to reports and other resources for banking industry professionals, as well as public information about the national banking system.
Office of Federal Contract Compliance Programs (OFCCP)	<a href="http://www.dol.gov/ofccp/index.htm">http://www.dol.gov/ofccp/index.htm</a> Home page with statutory, regulatory, and compliance information regarding nondiscrimination requirements for federal contractors.
Office of the U.S. Trade Representative	<a href="http://www.ustr.gov/index.html">http://www.ustr.gov/index.html</a> Home page.
Securities and Exchange Commission (SEC)	<a href="http://www.sec.gov/">http://www.sec.gov/</a> Home page with links to information for small businesses; online access to proposed and final rules, SEC releases, policy statements, and other commission notices and information; searchable database of all electronic company filings since 1994.
SEC Edgar	<a href="http://www.sec.gov/edgar.shtml">http://www.sec.gov/edgar.shtml</a> SEC Edgar main page, with access to electronic filings and forms.
Small Business Administration	<a href="http://www.sba.gov/">http://www.sba.gov/</a> Home page with extensive links to federal and other resources for small businesses.
Social Security Administration	<a href="http://www.ssa.gov/">http://www.ssa.gov/</a> Home page. SSA forms are available online at <a href="http://www.ssa.gov/online/forms.html">http://www.ssa.gov/online/forms.html</a>
THOMAS	<a href="http://thomas.loc.gov/home/thomas.html">http://thomas.loc.gov/home/thomas.html</a> Website of the Library of Congress providing federal legislative information.
U.S. Citizenship and Immigration Services	<a href="http://www.uscis.gov/portal/site/uscis">http://www.uscis.gov/portal/site/uscis</a> Home page with links to immigration laws and forms.
U.S. Copyright Office	<a href="http://www.copyright.gov/">http://www.copyright.gov/</a> Home page with links to copyright registration and other information. The agency's new Electronic Copyright Office (eCO) is at <a href="http://www.copyright.gov/eco/index.html">http://www.copyright.gov/eco/index.html</a>
U.S. Department of Commerce	<a href="http://www.commerce.gov/">http://www.commerce.gov/</a> Home page.
U.S. Department of Justice, Antitrust Division	<a href="http://www.usdoj.gov/atr/public/guidelines/guidelin.htm">http://www.usdoj.gov/atr/public/guidelines/guidelin.htm</a> Link to Antitrust Division Guidelines and Policy Statements.
U.S. Department of Labor	<a href="http://www.dol.gov/">http://www.dol.gov/</a> Home page with links to statutory and regulatory information, labor statistics, small-business regulatory-compliance assistance, and other information.
U.S. Department of	<a href="http://www.oalj.dol.gov/libdot.htm">http://www.oalj.dol.gov/libdot.htm</a>

Labor, Dictionary of Occupational Titles (DOT)	Dictionary of job titles and standardized job descriptions; useful for job placement, occupational research, career guidance, labor-market information, curriculum development, and long-range job planning. Last updated in 1991, the DOT has now been replaced by O*NET Online, <a href="http://online.onetcenter.org/">http://online.onetcenter.org/</a>
U.S. Department of State	<a href="http://www.state.gov/">http://www.state.gov/</a> Home page with links to international commercial laws and guides.
U.S. Environmental Protection Agency	<a href="http://www.epa.gov/">http://www.epa.gov/</a> Home page.
U.S. Government Printing Office	<a href="http://www.gpo.gov/">http://www.gpo.gov/</a> Home page with links to products and services, including online searchable copies of the United States Code and the Code of Federal Regulations.
U.S. International Trade Commission	<a href="http://www.usitc.gov/">http://www.usitc.gov/</a> Home page with rules, regulations, reports, and other information, including an extensive list of links to international trade resources.
U.S. Patent and Trademark Office	<a href="http://www.uspto.gov/">http://www.uspto.gov/</a> Home page with downloadable forms and information on patent applications and trademark registrations.

#### B. International Sites

Private International Law Database: Trade/Business Transactions Law, U.S. Department of State	<a href="http://www.state.gov/www/global/legal_affairs/transaction_law.html">http://www.state.gov/www/global/legal_affairs/transaction_law.html</a> Access to treaties in force for the United States, other international instruments, and information on current negotiations and projects concerning private international law. Updated through January 1, 2001. For treaty actions since January 1, 2001, see <a href="http://www.state.gov/s/l/treaty/c3428.htm">http://www.state.gov/s/l/treaty/c3428.htm</a>
CURIA	<a href="http://curia.europa.eu/jcms/jcms/j_6/">http://curia.europa.eu/jcms/jcms/j_6/</a> Home page of the courts of the European Communities, with searchable case law and other information.
Electronic Embassy Website	<a href="http://www.embassy.org/">http://www.embassy.org/</a> Information on all foreign embassies in Washington, D.C.
EUR-Lex	<a href="http://eur-lex.europa.eu/en/index.htm">http://eur-lex.europa.eu/en/index.htm</a> Website providing direct free access to European Union law. Among other things, it includes the Official Journal of the European Union, treaties, legislation, case law, and legislative proposals.
European Franchise Federation (EFF)	<a href="http://www.eff-franchise.com/">http://www.eff-franchise.com/</a> Nonprofit international organization that promotes the interests and development of franchising in Europe.
Hague Conference on Private International Law (HCCH)	<a href="http://hcch.e-vision.nl/index_en.php?act=text.display&amp;tid=1">http://hcch.e-vision.nl/index_en.php?act=text.display&amp;tid=1</a> Home page.
International Trademark Association (INTA)	<a href="http://www.inta.org">http://www.inta.org</a> INTA is an international nonprofit membership association dedicated to the support and advancement of trademarks and related intellectual property.
NAICS Association	<a href="http://www.naics.com/index.html">http://www.naics.com/index.html</a> Agency that administers the North American Industry Classification System (NAICS), which replaced the <u>old Standard Industrial Classification (SIC) system in 1997. NAICS codes are used</u> by statistical agencies in the U.S., Canada, and Mexico to classify <u>businesses for the collection, analysis, and</u>

	<u><a href="#">publication of statistical data related to the economy.</a></u>
North American Free Trade Agreement (NAFTA) Secretariat	<u><a href="http://www.nafta-sec-alena.org/en/view.aspx">http://www.nafta-sec-alena.org/en/view.aspx</a></u> Home page with link to text of NAFTA.
Canadian System for Electronic Document Analysis and Retrieval (SEDAR)	<u><a href="http://www.sedar.com/">http://www.sedar.com/</a></u> Home page of the Canadian equivalent to the SEC's EDGAR. Provides access to corporate filings of Canadian companies with Canada's securities regulatory authorities.
United Nations Commission on International Trade Law (UNCITRAL)	<u><a href="http://www.uncitral.org/">http://www.uncitral.org/</a></u> Home page with links to UNICITRAL texts, including conventions, model laws, guides to enactment, legislative guides, legislative recommendations, and model contract rules. In particular, this website includes the text of the U.N. Convention on Contracts for the International Sale of Goods (CISG).
CISG Database at Pace University School of Law, Pace Law Library, Institute of International Commercial Law	<u><a href="http://cisgw3.law.pace.edu/">http://cisgw3.law.pace.edu/</a></u> Site dedicated to U.N. Convention on Contracts for the International Sale of Goods (CISG), with annotated text of CISG, CISG in different languages, cases organized by countries, and related CISG material.
International Institute for the Unification of Private Law (UNIDROIT)	<u><a href="http://www.unidroit.org/dynasite.cfm">http://www.unidroit.org/dynasite.cfm</a></u> Home page.
World Intellectual Property Organization (WIPO)	<u><a href="http://www.wipo.int/portal/index.html.en">http://www.wipo.int/portal/index.html.en</a></u> A specialized agency of the United Nations, dedicated to developing a balanced and accessible international intellectual property system.
World Trade Organization (WTO)	<u><a href="http://www.wto.org/">http://www.wto.org/</a></u> Global international organization dealing with the rules of trade between nations.

C. Government Sites—California

California Department of Corporations (DOC), Franchise Regulation	<u><a href="http://www.corp.ca.gov/SRD/franchise.asp">http://www.corp.ca.gov/SRD/franchise.asp</a></u> Access to information and forms concerning franchise registration.
California Department of Corporations (DOC), Securities Regulation Division	<u><a href="http://www.corp.ca.gov/SRD/default.asp">http://www.corp.ca.gov/SRD/default.asp</a></u> Access to forms, departmental publications, Commissioner's releases, opinions, and notices concerning the California blue sky laws.
Cal-EASI	<u><a href="http://www.corp.ca.gov/CalEASI/caleasi.asp">http://www.corp.ca.gov/CalEASI/caleasi.asp</a></u> California Department of Corporations website providing access to securities and franchise filings.
California Department of Fair Employment and Housing	<u><a href="http://www.dfeh.ca.gov/">http://www.dfeh.ca.gov/</a></u> Home page.
California Department of Insurance, Workers'	<u><a href="http://www.dir.ca.gov/workers'_comp.html">http://www.dir.ca.gov/workers'_comp.html</a></u> Access to information on workers' compensation insurance.

Compensation Information	
California Department of Real Estate (DRE)	<a href="http://www.dre.ca.gov/">http://www.dre.ca.gov/</a> Home page with information for consumers as well as real estate licensees and examinees.
California Division of Occupational Safety and Health (DOSH)	<a href="http://www.dir.ca.gov/dosh">http://www.dir.ca.gov/dosh</a> Access to information concerning the Cal-OSHA program.
California Employment Development Department (EDD)	<a href="http://www.edd.ca.gov">http://www.edd.ca.gov</a> Home page; information concerning job placement and referrals, unemployment insurance, disability insurance, employment and training, the labor market, payroll taxes, and other topics.
California Franchise Tax Board (FTB)	<a href="http://www.ftb.ca.gov/">http://www.ftb.ca.gov/</a> Home page with links to downloadable state tax forms and publications.
California Law Revision Commission	<a href="http://www.clrc.ca.gov/">http://www.clrc.ca.gov/</a> Home page.
Official California Legislative Information	<a href="http://www.leginfo.ca.gov/index.html">http://www.leginfo.ca.gov/index.html</a> Full text of bills, resolutions, and constitutional amendments, as well as their status, history, votes, analyses, and veto messages.
California Legislative Resource	<a href="http://calbar.ca.gov/state/calbar/calbar_generic.jsp?cid=10137&amp;id=10452">http://calbar.ca.gov/state/calbar/calbar_generic.jsp?cid=10137&amp;id=10452</a> Webpage maintained by the State Bar of California with many helpful links regarding California's legislative process, pending bills, legislative calendar, committees, and other topics.
State Bar of California Bill Tracking Service	<a href="http://www.calbar.ca.gov/calbar/legislation/State%20Bar%20Bill%20Tracking-Sections.html">http://www.calbar.ca.gov/calbar/legislation/State%20Bar%20Bill%20Tracking-Sections.html</a> Centralized legislative monitoring and tracking service listing bills of potential interest to members of the State Bar's sections and their committees.
CalGOLD	<a href="http://www.calgold.ca.gov/">http://www.calgold.ca.gov/</a> The CalGOLD website provides links and contact information for California businesses concerning business permits, licenses, and registrations required by federal, regional, state, and local agencies. Information is searchable according to type of business.
California Office of Privacy Protection	<a href="http://www.oispp.ca.gov/consumer_privacy/default.asp">http://www.oispp.ca.gov/consumer_privacy/default.asp</a> State agency dedicated to promoting and protecting the privacy rights of consumers.
California State Agencies	<a href="http://www.ca.gov/">http://www.ca.gov/</a> State of California site with links to California agencies, departments, and commissions.
California State Association of Counties	<a href="http://www.csac.counties.org/">http://www.csac.counties.org/</a> Home page with links to all California counties.
California State Board of Equalization	<a href="http://www.boe.ca.gov/">http://www.boe.ca.gov/</a> Home page with access to information about sales and use taxes, sellers' permits, forms, and publications.
California Secretary of State—California Business Portal:	<a href="http://www.sos.ca.gov/business/">http://www.sos.ca.gov/business/</a> Home page.
Forms and Fees:	<a href="http://www.sos.ca.gov/business/forms.htm">http://www.sos.ca.gov/business/forms.htm</a>

	Directory of forms, sample forms, and fees for different business filings, including UCC forms, some in fill-in format.
<b>Business Filings:</b>	
Business Entities	<a href="http://www.sos.ca.gov/business/be/">http://www.sos.ca.gov/business/be/</a> Business Entities main page with links to services offered for corporations, limited liability companies, limited partnerships, and other business entities; filing tips to meet statutory minimum requirements; name availability; FAQs; and more.
Trademarks and Service Marks	<a href="http://www.sos.ca.gov/business/ts/">http://www.sos.ca.gov/business/ts/</a> Trademarks and service marks main page with links to forms and fees, name availability, FAQs, private service companies, and more.
California Business Search	<a href="http://kepler.sos.ca.gov">http://kepler.sos.ca.gov</a> Fill-in boxes to check records online for corporations, limited partnerships, and limited liability companies.
Starting a Business	<a href="http://www.sos.ca.gov/business/be/starting-a-business.htm">http://www.sos.ca.gov/business/be/starting-a-business.htm</a> A step-by-step guide for starting a business in California.
e-file Statement of Information	<a href="https://businessfilings.sos.ca.gov/">https://businessfilings.sos.ca.gov/</a> Fill-in boxes to file a Statement of Information for a corporation online.
Notary Public	<a href="http://www.sos.ca.gov/business/notary/">http://www.sos.ca.gov/business/notary/</a> Notary public main page, with links to topics such as obtaining a notary public commission, handbook, authentications, apostille or certification, forms, and fees.
Uniform Commercial Code	<a href="http://www.sos.ca.gov/business/ucc/">http://www.sos.ca.gov/business/ucc/</a> UCC main page with links to UCC Connect (the Secretary of State's online service for UCC inquiries, filings, requests for copies and debtor search certificates, and more), financing statement forms and filing fees, administrative rules, FAQs, and other resources.
International Business Relations Program	<a href="http://www.sos.ca.gov/business/ibrp/">http://www.sos.ca.gov/business/ibrp/</a> Main page with links to chambers of commerce, foreign consulates, trade associations, and other agencies, and to other resources to assist foreign business entities with various California filing procedures.
Business Program Division, Legislation	<a href="http://www.sos.ca.gov/business/bpd_newleg.htm">http://www.sos.ca.gov/business/bpd_newleg.htm</a> Summaries and links to new state laws affecting businesses.
Victims of Corporate Fraud Compensation Fund	<a href="http://www.sos.ca.gov/vcfcf/">http://www.sos.ca.gov/vcfcf/</a> Main page with information, including application requirements, instructions, and forms, concerning the fraud compensation fund administered by the Secretary of State's office.

#### D. Private Agency Sites

ABA Section of Business Law	<a href="http://www.abanet.org/buslaw/home.html">http://www.abanet.org/buslaw/home.html</a> Home page with links to publications and other resources for business lawyers.
Active Capital	<a href="http://activecapital.org/">http://activecapital.org/</a> Site dedicated to helping individual accredited investors, SBICs, and institutional venture capitalists find small, growing companies through a secure Internet database, and providing ongoing training and research for entrepreneurs and small investors.
AllBusiness	<a href="http://www.allbusiness.com">http://www.allbusiness.com</a> Small business portal, with links to forms, directories, and resources on many

	topics.
American Arbitration Association	<a href="http://www.adr.org/">http://www.adr.org/</a> Home page with links to rules and procedures.
American Intellectual Property Law Association (AIPLA)	<a href="http://www.aipla.org">http://www.aipla.org</a> Home page with links to practice areas, professional development, educational materials, meetings, and events.
Annual Reports.com	<a href="http://www.annualreports.com/">http://www.annualreports.com/</a> Free service offering links to annual reports of public companies.
BenefitsLink	<a href="http://www.benefitslink.com">http://www.benefitslink.com</a> Compliance information and tools for employee benefit plan sponsors, service providers, and participants.
Better Business Bureau	<a href="http://www.bbb.org/">http://www.bbb.org/</a> National home page. There are separate regional Better Business Bureaus covering different geographical areas of California, each with its own website.
The Biz-Tech Network by Brint Institute, LLC	<a href="http://www.brint.com/">http://www.brint.com/</a> Portal with a meta-index of business, management, and information technology topics; it also provides search capabilities and full text articles on related issues.
Business.com	<a href="http://www.business.com/">http://www.business.com/</a> Business search engine and directory intended to help users find companies, products, services, and other business-related information; some features are fee-based.
Business Law Section of the State Bar of California	<a href="http://www.calbar.ca.gov/state/calbar/calbar_sections_generic.jsp?sCategoryPath=/Home/Attorney%20Resources/Sections/Business%20Law">http://www.calbar.ca.gov/state/calbar/calbar_sections_generic.jsp?sCategoryPath=/Home/Attorney%20Resources/Sections/Business%20Law</a> Home page with links to standing committees, programs, and publications.
Business Week Online	<a href="http://www.businessweek.com/">http://www.businessweek.com/</a> Articles, links, and opportunity to subscribe to free newsletter.
CNBC	<a href="http://www.cnbc.com/">http://www.cnbc.com/</a> Home page of business and financial news cable network.
CNN Money	<a href="http://money.cnn.com/?cnn=yes">http://money.cnn.com/?cnn=yes</a> General business news website offered by CNN and <i>Fortune</i> and <i>Money</i> magazines.
Corporate Finance Sourcebook	<a href="http://www.financesourcebook.com/">http://www.financesourcebook.com/</a> Link for ordering popular guidebook published by National Register Publishing. The guidebook features over 1500 top investment sources and 1700 service firms for business entrepreneurs.
Corporate Information	<a href="http://www.corporateinformation.com/">http://www.corporateinformation.com/</a> Subscription-based website offering research reports on public, private, domestic, and foreign corporations.
The Corporate Library	<a href="http://www.thecorporatelibrary.com/">http://www.thecorporatelibrary.com/</a> The Corporate Library is an independent research firm providing corporate governance data, analysis, and risk assessment tools.
Creative Commons	<a href="http://creativecommons.org">http://creativecommons.org</a> A nonprofit organization founded by Prof. Lawrence Lessig of Stanford University that provides special copyright license forms and other free tools to enable authors, scientists, artists, and educators to share intellectual property.

Dun & Bradstreet	<a href="http://www.dnb.com/us/">http://www.dnb.com/us/</a> Home page of Dun & Bradstreet. Subscribers can request reports and run online queries in proprietary databases.
Edgar Online, Inc.	<a href="http://www.edgar-online.com/">http://www.edgar-online.com/</a> Edgar Online, Inc. is a private company, not affiliated with the SEC, specializing in the extraction, packaging, and distribution of public-company information contained in SEC filings.
Entrepreneur.com	<a href="http://www.entrepreneur.com/mag">http://www.entrepreneur.com/mag</a> Free access to <i>Entrepreneur</i> magazine articles back to 1998.
Financial Accounting Standards Board (FASB)	<a href="http://www.fasb.org/">http://www.fasb.org/</a> Access to FASB Statements of Financial Accounting Standards and other resources.
Findlaw Business Center	<a href="http://smallbusiness.findlaw.com/">http://smallbusiness.findlaw.com/</a> Portal with links to articles and guides on starting a business, taxes and accounting, small business legal concerns, and more. Part of West Group.
Garage Technology Ventures	<a href="http://www.garage.com/">http://www.garage.com/</a> Venture capital fund for emerging technology companies.
GNU	<a href="http://www.gnu.org/">http://www.gnu.org/</a> Organization promulgating the development and use of free software and the use of open-source software licenses.
Google Business News	<a href="http://news.google.com/nwshp?tab=wn&amp;ned=us&amp;topic=b">http://news.google.com/nwshp?tab=wn&amp;ned=us&amp;topic=b</a> Business news headlines with links to full stories from news organizations around the world.
Google Small Business Directory	<a href="http://directory.google.com/Top/Business/Small_Business/">http://directory.google.com/Top/Business/Small_Business/</a> A directory of small business resources.
Hieros Gamos Small Business Center	<a href="http://www.hg.org/sbcenter.html">http://www.hg.org/sbcenter.html</a> Portal with links to topics such as starting a business, choosing a legal structure, and financing.
Hoover's Online	<a href="http://www.hoovers.com/">http://www.hoovers.com/</a> Subscription-based site with industry snapshots, company profiles, earnings, and other information.
Intellectual Property Law Section of the State Bar of California	<a href="http://www.calbar.ca.gov/state/calbar/calbar_sections_generic.jsp?cid=10707">http://www.calbar.ca.gov/state/calbar/calbar_sections_generic.jsp?cid=10707</a> Home page with links to standing committees, programs, and publications.
International Franchise Association (IFA)	<a href="http://www.franchise.org/">http://www.franchise.org/</a> Trade association promoting responsible franchise development worldwide.
Internet Corporation for Assigned Names and Numbers (ICANN)	<a href="http://www.icann.org/">http://www.icann.org/</a> Private agency responsible for global coordination of the Internet's system of unique identifiers, including domain names (such as .com, .org, and country codes such as .fr), as well as addresses used in a variety of Internet protocols.
IP Mall	<a href="http://ipmall.info/">http://ipmall.info/</a> Website sponsored by Franklin Pierce Law Center, with links to intellectual property resources around the world (including patents, copyrights, trademarks, trade secrets, licensing, and technology transfers).
JAMS	<a href="http://www.jamsadr.com">http://www.jamsadr.com</a>

	Home page with information about JAMS mediation and arbitration services and a search engine to assist in locating qualified mediators and arbitrators. The website also offers sample dispute resolution clauses for commercial contracts.
Jefren Publishing Co.	<a href="http://www.jefren.com">http://www.jefren.com</a> Subscription service offering proxy statement forms and strategies.
MarketResearch.com	<a href="http://www.marketresearch.com/">http://www.marketresearch.com/</a> Free database of market research reports representing all market and industry sectors.
NASDAQ	<a href="http://www.nasdaq.com/">http://www.nasdaq.com/</a> Comprehensive current information on market performance and investments.
National Association of Attorneys General	<a href="http://www.naag.org/">http://www.naag.org/</a> Association of the attorneys general of all 50 states, with contact information and links to enforcement initiatives.
National Association of Seed and Venture Funds	<a href="http://www.nasvf.org/">http://www.nasvf.org/</a> Network of private, public, and nonprofit organizations investing and facilitating investment in entrepreneurs.
National Business Association	<a href="http://www.nationalbusiness.org/">http://www.nationalbusiness.org/</a> Nonprofit association's site for the self-employed and small business community.
National Venture Capital Association (NVCA)	<a href="http://www.nvca.org/">http://www.nvca.org/</a> Home page with links to members and other resources.
New York Stock Exchange (now NYSE Euronext)	<a href="http://www.nyse.com/">http://www.nyse.com/</a> Comprehensive, current information on market performance and investments.
PayChex	<a href="http://www.paychex.com/index.aspx">http://www.paychex.com/index.aspx</a> Company offering payroll processing, human resources administration and compliance, and employee benefit administration services for small and mid-sized businesses.
PayPal Merchant Services	<a href="https://merchant.paypal.com/cgi-bin/marketingweb?cmd=render-content&amp;content_ID=merchant/home">https://merchant.paypal.com/cgi-bin/marketingweb?cmd=render-content&amp;content_ID=merchant/home</a> Commercial service enabling businesses to accept credit card and other payments securely on websites, by e-mail, or over the telephone.
The Public Register Online	<a href="http://www.annualreportservice.com/">http://www.annualreportservice.com/</a> Free access to annual reports of over 2200 companies. Site also has links to the SEC's Edgar database for filings.
Reuters	<a href="http://www.reuters.com/finance">http://www.reuters.com/finance</a> Business and finance news database with reports on business transactions, markets, small businesses, industries, the economy, and other topics.
Safeselling.org	<a href="http://www.safeselling.org/">http://www.safeselling.org/</a> ABA-sponsored resource for business people launching e-commerce enterprises and for businesses venturing into online sales.
The Small Business Portal	<a href="http://www.thesmallsbusinessportal.com/">http://www.thesmallsbusinessportal.com/</a> Links to topics such as starting a business, franchise advice, financing, and home-based businesses.
Standard & Poor's	<a href="http://www.standardandpoors.com/">http://www.standardandpoors.com/</a> Home page with search engine for public company credit ratings and other

	features.
Tripod by Lycos	<a href="http://www.tripod.lycos.com/smallbiz/index.html">http://www.tripod.lycos.com/smallbiz/index.html</a> Portal with tips on starting an online business, yellow pages, and some free and some fee-based services.
U.S. GAAP Information	<a href="http://cpaclass.com/gaap/">http://cpaclass.com/gaap/</a> Comprehensive source of information on generally accepted accounting principles in the U.S.
Wall Street Journal Online Edition	<a href="http://online.wsj.com/home-page">http://online.wsj.com/home-page</a> General business and financial news.
Washburn University School of Law Small Business Portal	<a href="http://www.washlaw.edu/subject/small.business.html">http://www.washlaw.edu/subject/small.business.html</a> Portal with links to a forms library and business and economic data.
Yahoo! Finance	<a href="http://biz.yahoo.com/i/">http://biz.yahoo.com/i/</a> Free company profiles and stock charts for over 9000 public companies.
Yahoo! Small Business	<a href="http://smallbusiness.yahoo.com/index.html?">http://smallbusiness.yahoo.com/index.html?</a> Portal with links to topics such as creating a website, promoting a business, and selling online.

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